Written evidence from Smart Pension (PSL0033)

Executive summary

- We are pleased to respond to the third part of the Committee's inquiry into the pension freedoms five years on. The topics covered in this phase of the review are important and determine whether people have the opportunity to achieve a decent retirement outcome.
- The foundation for our current pension system is automatic enrolment and we need to build on its success to date. We need a system that gives people the opportunity to achieve good outcomes even if they don't actively engage with their pension. That's not to say advice and guidance aren't important, they are. The right engagement, on the right issues, at the right time will lead to better outcomes. However, we need to note that we cannot rely on engagement alone to ensure people have adequate retirement outcomes.
- In terms of the key themes in our submission we'd like to highlight:
    - The Government should implement the conclusions of the 2017 review into automatic enrolment. Lowering the age threshold to 18 and absolishing band earnings so contributions are made from the first pound of earnings are a sensible and proportionate extension of the system.
    - While we would like to see default contributions increase in the longer term we need to be alive to the fragile economic environment with households and employers under increased pressure due to the fallout of the pandemic. We think the Government should prepare and build a consensus around any increase so we are ready to phase in the change when economic circumstances are more favourable.
    - We support the use of retirement income targets as developed by the PLSA. Targets like these bring pensions to life and make it much more real for people, rather than talking about amorphous concepts like contribution percentages.

- To deal with underpensioned groups such as the gig economy and self-employed, the government first and foremost needs to make sure employment status is clearly defined so groups that should be subject for automatic enrolment are covered. Furthermore, while the current testing of initiatives to look at increasing self-employed participation are welcome, we don't think these will seriously move the dial in terms of getting more of the self-employed into pensions. What is needed is a solution that mimics the effects and incentives in automatic enrolment and that is delivered through the tax system. That, in our opinion, is the only way we will make a real difference to the retirement outcomes of the self-employed.
- Regarding underpensioned groups more generally, labour market status and participation is the key determinant of retirement outcomes. While we should look to correct, where we can, anomalies in the pension system, and the pension system should certainly not reinforce disparity, fundamentally these are labour market issues and they need to be tackled to ensure these groups achieve adequate retirement outcomes.
- Finally, we would like to make a macro point about the importance of consensus and stability in the pension system as a key driver of good outcomes. Constant chopping and changing of the rules makes it difficult for individuals to plan and for providers to develop best in class products. Unnecessary cost in the system ultimately leads to poorer outcomes as it is members that ultimately pay.

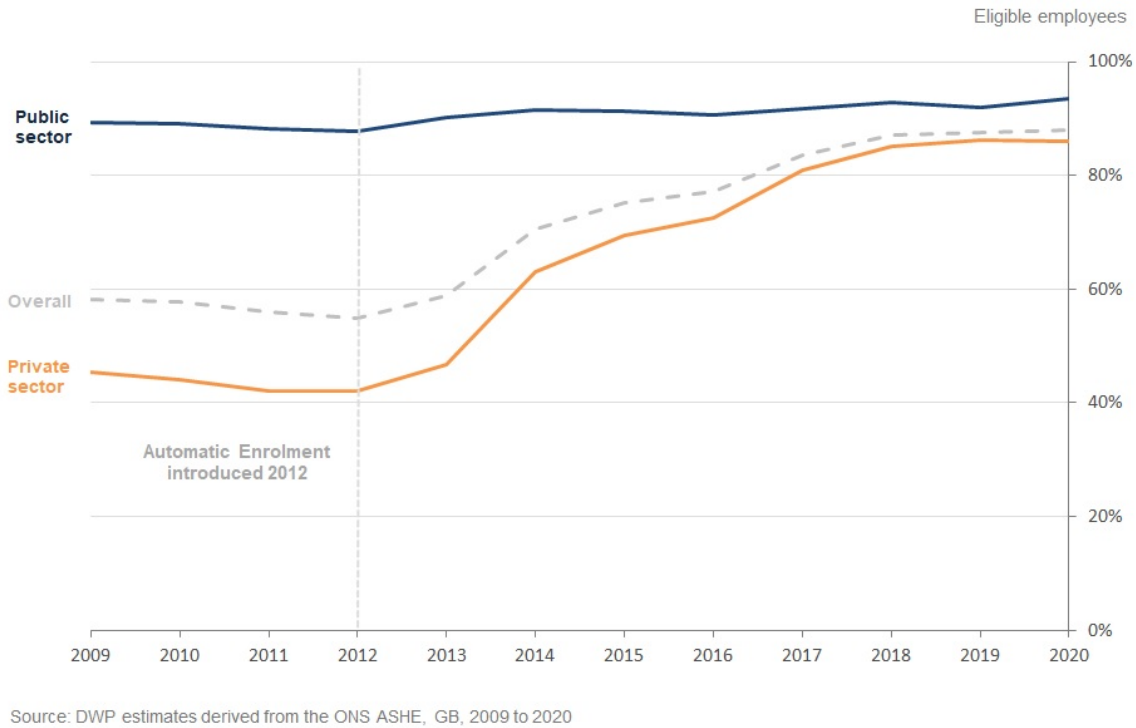
Questions

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

1.1. DWP analysis[1] suggests that 88% of eligible employees (19.4 million) were participating in a workplace pension in 2020, with total annual savings for eligible savers increasing to £105.9 billion in 2020. This is driven by continued high levels of public sector defined benefit pension provision, and the impact of the introduction of automatic enrolment in 2012, which, as a percentage, more than doubled participation in private sector workplace pensions

[1] DWP: Workplace pension participation and savings trends of eligible employees - 2009-2020, September 2021

between 2012 and 2020 and has seen c.11m people automatically enrolled since its introduction.



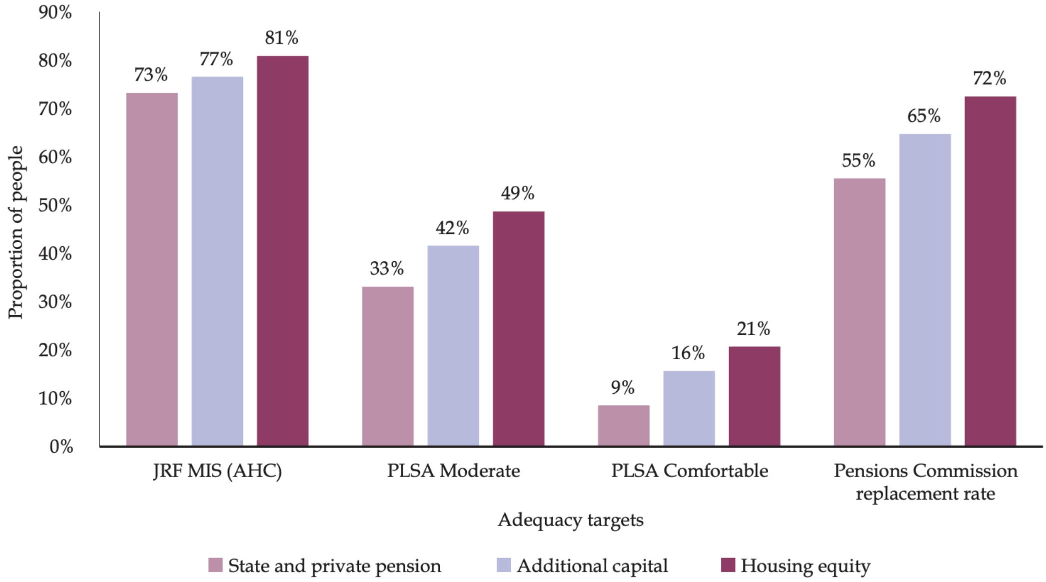
1.2. But while this macro picture is generally moving in the right direction, it does mask a number of issues concerning general adequacy and adequacy of certain groups in particular (note we discuss certain groups in answer to question 9).

1.3. In terms of a comprehensive picture of pensions savings and adequacy, we would direct the Committee to the excellent Pensions Policy Institute (PPI) work that has been done in this area, including its June 2021 paper[2] on 'What is an Adequate Retirement Income'. According to this report, a quarter of people approaching retirement are unlikely to receive a basic minimum income, with approaching half failing to meet a personally acceptable level of income in retirement. Furthermore, the report notes that fewer than one in 10 can expect to live a comfortable life in retirement.

[2] PPI: What is an Adequate Retirement Income, June 2021

Using State and private pension income, nearly three in four people aged 50 to 65 could reach the Minimum Income Standard and around one in ten could reach the PLSA's "Comfortable" Living Standard

Proportion of UK population aged 50 to 65 in 2016/18 who are on track to reach retirement adequacy targets using different sources of income, GB



Source: PPI, What is an adequate retirement income, June 2021

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

2.1. Automatic enrolment is the bedrock of the UK's pensions policy. It's been an undoubted success with over 10 million people newly saving or saving more into a pension. It has massively increased participation and, alongside the new state pension, is, and should continue to be, the fundamental foundation for the UK's pensions policy.

2.2. The 2017 review into automatic enrolment[3] made a number of recommendations to remove some of the wrinkles from the system and to expand coverage. The two main recommendations included removing band earnings so contributions count from the first pound of savings and reducing the age where people become eligible to be automatically enrolled to 18. The Government has committed to introducing these measures by the 'mid 2020s'. We support both of these measures and urge the Government to come forward with proposals to implement these recommendations as soon as possible to give the pensions industry, employers and individuals time to plan.

2.3. In a defined contribution context, along with investment returns, the key driver for most people's retirement outcomes is the amount of contributions made by employers and individuals. When considering its proposals, the Pensions Commision thought that automatic enrolment and the state pension should get a worker to approximately a 45% replacement rate of average earnings. The Commission thought that there was a need for voluntary saving to

[3] DWP, Automatic enrolment review 2017: maintaining the momentum, December 2017

reach the recommended replacement rate for an average earner of 60%. So there is a gap that needs to be filled. Furthermore, there is a risk that just because people have been automatically enrolled that they think they are saving enough, which might not be the case. The obvious way to fill that gap is to increase minimum auto enrolment contributions to approximately 12% and we would argue that should be the long term objective for the automatic enrolment system. However, while we support an increase we need to think very carefully about timing given wider pressures on households and employers as we look to exit the pandemic. Looking to increase contributions as the country battles a cost of living crisis, with households and employers struggling, could do more harm than good. We also acknowledge that 8% contributions may be enough for some individuals and that some people might not need to save more. However, we need to do the work and build the consensus now around what is next for automatic enrolment, post the implementation of the 2017 review. We also encourage the Government to look at the merits of initiatives like auto escalation as a way of increasing pension saving.

2.4. In terms of priorities we would strongly advocate that the Government focuses first and foremost on implementing the 2017 automatic enrolment review conclusions. In parallel it should also undertake the preparatory analysis and work necessary to build a consensus around the level of default contributions so changes can be implemented at speed when the time is right.

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

3.1. As previously noted, automatic enrolment is the bedrock of our pensions policy. It harnesses individuals' behavioural biases to improve individual and societal outcomes. Our starting point when thinking about advice and guidance should be that we need a system that works for all individuals whether they are active participants or serial defaulters. We cannot rely solely on engagement and active personal decision-making to drive good outcomes. Equally we should ensure that our system supports individuals who can and want to take personal responsibility and engage.

3.2. For the majority of the population we need a system that means pension saving is on 'autopilot'. Schemes and providers need to ensure that member journeys and pathways deliver good outcomes for individuals no matter what their levels of engagement. It is important to note that this might not lead to the best possible outcomes, but such an approach charts a path to a retirement income even if people don't engage.

3.3. Harnessing inertia and strong defaults does come with risks and needs to be overseen by strong governance to protect members. Trustees and governance committees need to continue to step up to the plate to ensure schemes and providers are delivering value and have propositions and investment strategies that help people achieve good outcomes. This governance also needs to encourage (or at least create the opportunity for) people to engage and interact with their pension to improve outcomes. This can be quite low key. Using simple nudges and communications to get people to update contact details, nominate death beneficiaries and activate their online accounts are good starting points for engagement as they create a connection between the scheme/provider and the individual.

3.4. On top of strong defaults and harnessing inertia schemes, providers and third parties should make it easy for people to engage and assist people with their saving and retirement choices. Advice/guidance needs to cover holistic financial education including money management and budgeting. 57% of adults with low financial capability feel nervous or overwhelmed speaking to financial services providers or find it hard to find suitable financial products or services[4]. If the basics are not covered/taught during the accumulation phase it is difficult to cover more advanced topics like the importance of saving for retirement. If people have a poor relationship with money during their working life these habits will follow through to retirement with the potential to have an adverse effect on their standard of living.

3.5. Simple tools and calculators can, for example, help people consider options and work out how much they could and should be saving for their retirement. Independent services like MAPS, TPAS and Pension Wise can also complement what schemes and providers do by providing simple and impartial information to help people make choices.

3.6. Advice will only ever be suitable for a small proportion of the population and there are well-documented reasons for both the demand and supply constraints about regulated financial advice. We certainly should not be basing policy on people having to seek and receive advice to get good outcomes, although we should ensure that the system works for people who want and need to get advice.

3.7. Without wanting to go off at a tangent, any answer to a question about advice and guidance would not be complete with mention of the regulatorary perimeter between advice and guidance. Despite numerous reviews, this is still a total mess and causes confusion for providers and consumers. As a trust-based scheme we want to help members to do the right thing, but concerns regarding the regulatory perimeter can act as a constraint on what we can or cannot do to support members. If we are truly going to focus on the consumer/scheme members then this needs resolving as the current system we have really doesn't increase access to help and support or fully protect members.

3.8. In its recent report on "Protecting Pension Savers - five years on from the pension freedoms: accessing pension savings"[5] the Committee, while welcoming the overarching intent of the Pensions Advice Allowance, questioned its impact and implementation. It recommended a review. We very much support the need for review, but would also like any review to cover what the Pension Advice Allowance can be used for.

3.9. We note that the advice market works effectively for those that can afford it and have more complex financial affairs. But there is a huge guidance gap and initiatives like the Pension Advice Allowance should be specifically tailored and targeted to meet these needs. So, we would question why the allowance has to be used for regulated advice. People need support, coaching and guidance and we would like to see any review seriously consider what the allowance could be used for, starting where that help and support is best and where the gaps in help and support are.

Q4. Could retirement income targets help savers plan for retirement?

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[4] Financial Lives 2020 survey: the impact of coronavirus | FCA

[5] Protecting pension savers—five years on from the Pension Freedoms: Accessing pension savings, Fifth Report of Session 2021–22, January 2022

4.1. Yes. We think retirement income targets can help savers plan for their retirement and, in particular, we support the work of the Joseph Rowntree Foundation on their minimum income target and the PLSA's Retirement Living Standards. Research from the PLSA[6] showed that 77% of savers don't know how much they'll need in retirement and only 16% of savers can give a figure.

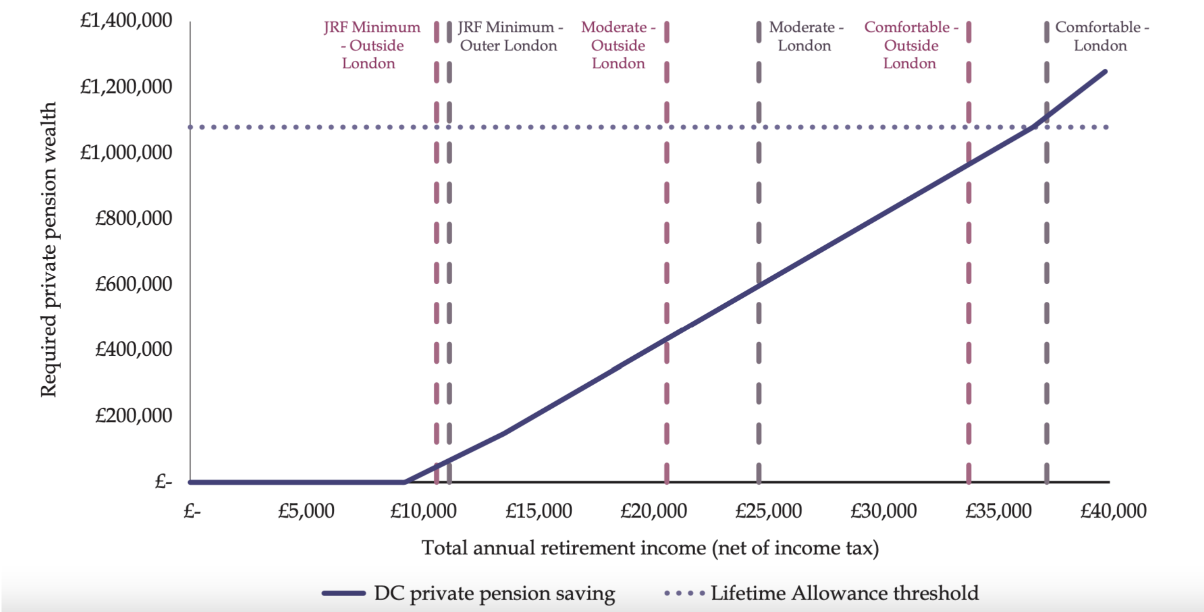
4.2. Income (or, more accurately, expenditure) targets bring the concept of pension saving to life and moves discussion away from amorphous concepts like, for example, contribution rates to something more tangible and real, for example, whether you are able to afford to go on a holiday. PLSA research[7] showed that 74% of savers believe that Retirement Living Standards would make it easier to plan for retirement.

4.3. Our view is that the PLSA has done a great job in developing and promulgating their living standards and it should be applauded for its efforts in this area.

4.4. Even though our overarching view is positive, the use of targets needs to be carefully interwoven with how pension schemes and providers communicate and guide their members/savers. With any target there is a risk that people see it as unachievable and this could potentially put them off saving. To meet the PLSA's 'comfortable' living requires a pot of around £1 million (see chart below), which is significantly more than the vast majority of savers have in their pension. So messaging needs to be carefully considered and testing so the use of targets doesn't put people off.

The PLSA Moderate and Comfortable Targets require private pension funds of £440,000 – £1,100,000 for a single person household

The relationship between annual retirement income and the private pension wealth required, in addition to State Pension, to achieve the level of retirement income for an individual in a single household (2021 earnings terms)



Source: PPI, What is an adequate retirement income, June 2021

[6] PLSA retirement Living Standards website, PLSA
[7] Op Cit.

4.5. Also, we need to make sure targets are used effectively and integrated into wider messaging, and tools/calculators, so people can use them to plan and adjust to their own circumstances. We are already aware that some providers are using the PLSA standards in this way, and that could potentially be expanded and used by, for example, Pension Wise and the Money and Pensions Service. A good example, in our opinion, of a comparison tool is provided by Uni Super[8] (an Australian Superannuation scheme). It has a tool that allows people to compare where they are against people like themselves, in terms of age, gender and pot size to help see whether they are on track (or not). Interventions like this and the use of simple tools and calculators that can bring pension decision-making to life need to be at the forefront of thinking if we are to help people understand and engage with their pension, without overwhelming them with technical jargon.

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

5.1. Our answers to questions 3, 4, 7, 8 and 9 are all relevant here regarding discrete things that the Government could do to help improve outcomes for savers, including by expanding coverage.

5.2. However, there is a bigger, more structural, point that we want to highlight in response to this question.

5.3. Pension saving, by definition, is for the longer term. Individuals make contributions, often across many decades and look to use the assets built up to finance their retirement. The long term nature of pension saving comes with a number of challenges that initiatives like automatic enrolment are designed to counterbalance. However, constant changing of the system, tinkering with the rules, and changes in policy direction often make it difficult for individuals to make decisions that stand the test of time over the longer term. Furthermore, we would argue that instability in the long term savings environment adds to mistrust and damages confidence in pension saving, and makes it harder for providers to innovate and provide best in class products for savers.

5.4. The cornerstone of our current pension system stems from work of the Pensions Commission between 2002-2005. This paved the way for many of the features we now see in our pension system today. It contained tomes of analysis and built consensus across the political spectrum, the industry and different interest groups. While we don't think that a standing pensions commission, as some have argued, to take the politics out of pensions is a good idea (after all issues of tax, regulation and government spending need a proper democratic foundation), we do think that Government policy should be built on consensus and against a set of longer term objectives against which success can be measured. We would go as far as advocating having an office of pension responsibility (modelled on the office of budgetary responsibility) that would ensure that the Government set out and maintained a long term strategy, and importantly would explain and assess the inherent trade offs that are a consequence of any government policy or regulatory decision.

5.5. We note here that the independent Pensions Policy Institute has recently launched a pension framework[9] that is designed to assess the UK pension system against the criteria of adequacy,

[8] UniSuper website
[9] Pensions Policy Institute. The UK Pensions Framework. December 2021

sustainability and fairness. In our view this is a powerful contribution to developing a longer term framework for UK pensions policy.

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

6.1. We have seen a lot of innovation and improvements to pension products over the last ten years. Much of this has been driven by automatic enrolment and Government/regulatory initiatives to improve standards and value for money. This is all welcome and we have a very different landscape to one when automatic enrolment was introduced.

6.2. Areas that should be in focus for development include:

6.2.1. **Investment innovation.** This is a current hot topic. Investment returns need to do a lot of heavy lifting to help defined contribution pension savers achieve a decent retirement income and we need more sophisticated products to meet these needs and help tackle some of the serious challenges facing society (for example, climate change). However, the current pensions market is driven by price over quality and it is difficult for providers and schemes to spend more in developing better investment strategies, including looking at more expensive longer term illiquid investments. So we need to shift the debate and discussion to value rather than just price. While we wouldn't want to see increased charges just for the sake of it, more active investment strategies do cost more and we won't get the innovation we need in this space unless we focus the debate on value.

6.2.2. Technology platform. It is fair to say that the pensions industry is behind the curve when it comes to investing in technology. This is due to the cost and risk of changing systems and that administration platforms have been merged, often using manual processes and sticky plaster to make them work. Using a more modern platform, based on the latest technology, would provide a firmer platform against which the industry could improve administration and build more innovative products. One of the reasons that the pensions dashboard is so hard to deliver is the mismatch of legacy systems that are currently used by the majority of pension schemes and providers in the UK.

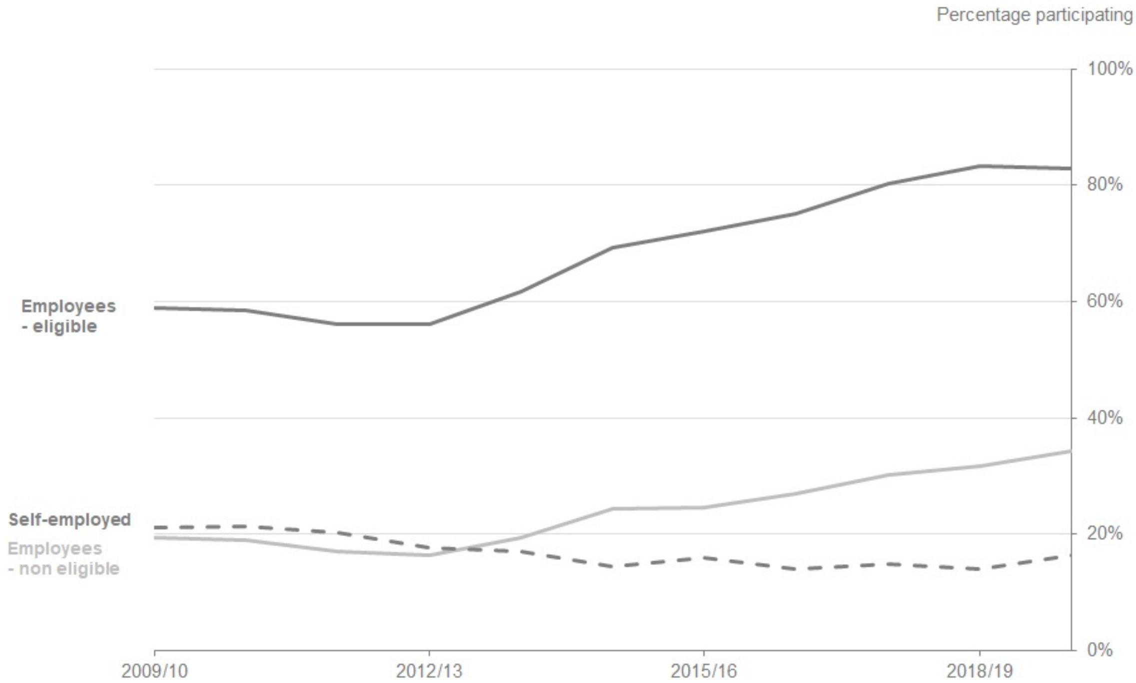
6.2.3. Product innovation. Putting the user at the heart of the product through testing and refining solutions should be at the heart of provider and scheme development. Investing in user experience, providing information in bite-sized understandable chucks, and providing simple tools and calculators can help people plan for their future and engage with their pension. The pensions dashboard will be a game-changer and will reconnect people with their pensions. It should also act as a springboard for the industry to have conversations with savers about their pensions.

Q7. What should the Government be doing to support self-employed people to save for retirement?

Context

7.1. This is a huge question and one that successive Governments have grappled with over the years.

7.2. Compared with the success of automatic enrolment in increasing participation in pensions since 2012, the opposite has been true for the self-employed. This can be seen from the DWP analysis of pension participation in the chart below. The self-employed group has seen an overall long-term decline in participation from 21% in 2009 to 2010 to 16% in 2019 to 2020[10].



Source: Modelled analysis derived from the FRS, UK, 2009 /10 to 2019/20

7.3. This picture is backed up by research from the IFS[11] which found that in 1998, 48% of the self-employed contributed to a private pension, but this had declined to just 16% in 2018. Importantly, the IFS research notes that this has coincided with significant growth in the numbers self-employed from 3.4 million (12.9% of the workforce) in 1998 to 4.8 million (15.1% of the workforce) in 2017.

7.4. The IFS research also found that the proportion of the self-employed saving in other forms, such as savings accounts, individual savings accounts (ISAs) and shares, has also been declining over the past two decades, with the IFS conclusion that other forms of saving are acting as a substitute for the self-employed (chart below).

[10] DWP analysis, Opt cit.
[11] Retirement saving for the self employed, IFS, October 2020

Pensions and the self-employed

7.5. Focusing on saving in pensions, there are, broadly speaking, two issues that need to be addressed to build pension saving for the self-employed: demand side and supply side. We also need to remember that the self-employed are not a homogenous group and a one size fits all approach is unlikely to be appropriate.

7.6. Taking the supply side first, there traditionally hasn't been the products for people to save into at a reasonable price. This has changed significantly over the past decade and there is now a good range of low cost, good value personal pension products on the market. Also, NEST is available to the self-employed so there is no market failure. The key question from a supply side perspective then is whether or not pensions are the right savings product for the self-employed given their specific circumstance? The answer to that is they could be, but arguably more flexibility is needed in, for example, managing contributions since self-employed income is less predictable and more lumpy than employed income. Also, the self-employed are less likely to want to (or have the resources to) lock their money away for an extended period of time given they may need shorter term funding to finance their business.

7.7. Importantly, as was the case with the introduction of automatic enrolment, we would expect more supply side solutions to emerge if the Government took action to deal with the demand side market failure which is still prevalent and a key barrier to getting the self-employed to use pensions as a retirement vehicle.

7.8. To deal with the demand side we need to find a way of mimicking the incentive structures in automatic enrolment to default people into pension savings (the auto part) and a financial consequence of opting out (the employer contribution).

7.9. This could be achieved through using the national insurance system, for example, by raising self-employed national insurance contributions by 3 percentage points (not an uncontroversial idea) and having these routed into an automatic enrolment pension scheme provided through a carousel mechanism that allocates individuals to a registered provider (they would, of course, be free to choose their own). This assumes the individual is willing to make an additional 4 per cent contribution (the member contribution). If, however, a person opted not to make the 4 per cent contribution and opt out, they would lose the additional 3 per cent, and associated tax relief, to the state (this mirrors the effect of losing the employer contribution when opting out of an employer scheme).

7.10. Through ideas like this (and there are other variants), we can normalise/default pension saving for the self-employed, but it does require significant Government intervention and the building of consensus. Without that, initiatives like looking at language and messaging, at best will only make a small dent in the problem. Ideas like these have been suggested before, for example, in an Article for Pensions Expert[12] by Darren Philp, now Smart Pension's Director of Policy.

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

8.1. This is predominantly a labour market issue and our view is that there needs to be a firm line drawn between the self-employed and those in employment and then defined as a worker for the purposes of automatic enrolment.

8.2. The pension products on the market as a result of the introduction of automatic enrolment have the flexibility to cater for gig economy workers. Gig economy workers exhibit many of the features of the target group for automatic enrolment, for example, low income, flexible hours, transient workforce. Similar characteristics that are seen in traditionally underpensioned sectors such as retail, hospitality and catering. Effective use of payroll and/or middleware solutions means that eligibility assessment and allocation of contributions can be done relatively straightforwardly and at scale.

8.3. The main problem, as noted above, is the blurry line between when an individual is classed as a worker for the purposes of automatic enrolment. We have seen some examples of this being challenged in the courts, most notably the Uber case which has seen automatic enrolment extended to Uber drivers, but our understanding is that these examples are very case-specific and can turn on small variations in working terms and contracts. If, as a matter of policy, we want to get gig economy workers into pension saving then we need to more clearly define the boundary between the self-employed and gig economy to ensure that these individuals are covered.

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

9.1. Our pension system is fundamentally and inextricably linked to the labour market status and trajectory of individuals, with the gender pensions gap being driven by the gender pay gap and

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[12] Bringing the self employed in from the cold, Darren Philp, Pensions Expert, May 2017

adult care responsibilities (resulting in women being out of the labour market and not earning/accruing a pension and/or working part-time or in lower paid jobs).

9.2. Furthermore, because of the link with the labour market, different outcomes not just arise because of gender, but also:

9.2.1. People from Black, Asian and minority ethnic (BAME) groups

9.2.2. People with disabilities

9.2.3. People with caring responsibilities

9.2.4. People with multiple jobs, particularly those earning less than £10,000 in each single job

9.2.5. The self-employed (see question 8)

9.3. The PPI, in its underpensioned index[13], illustrates the impact of outcomes for certain groups as per the chart below. Key drivers that impact on pension saving, leading to underpensioned, include:

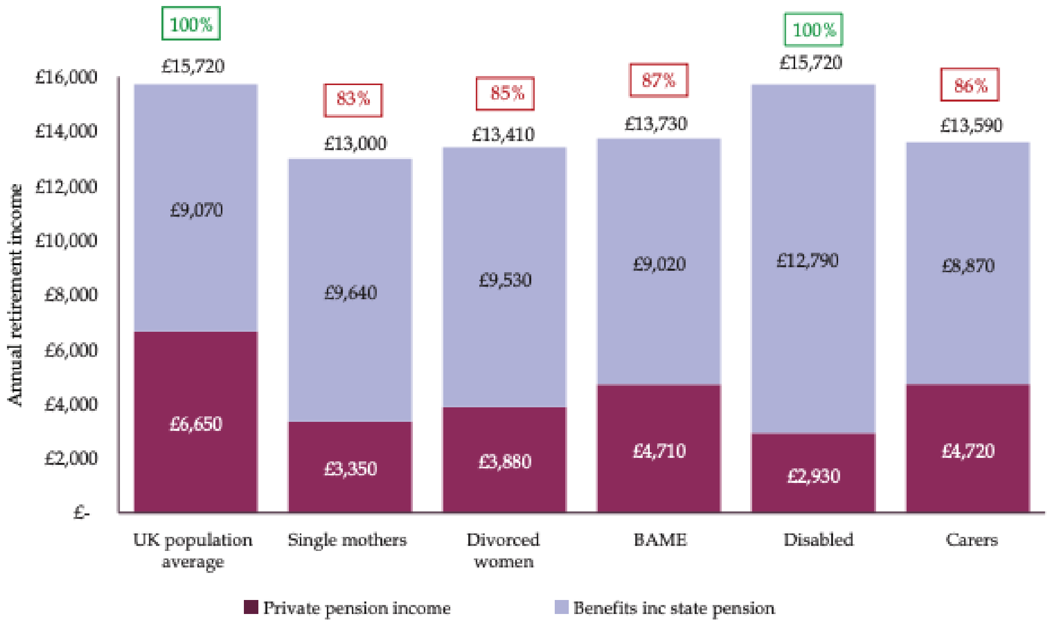
9.3.1. Lower employment rates

9.3.2. Higher levels of part-time work

9.3.3. Lower average incomes

Even when state pension and other benefits are taken into account, on average Underpensioned groups have lower overall incomes

Annual retirement incomes of underpensioned groups compared to the population average, split by state and private, aged 65+, 2018



9.4. The PPI has also recently published a report looking at underpensioned groups and the impact of the pandemic[14]. This reinforces the points about labour market status and impact being the determinant of retirement outcomes for the underpensioned. Strikingly, it notes that *"Underpensioned groups are disproportionately affected by negative changes in the labour*

[13] PPI, The underpensioned index, December 2020

[14] PPI: What impact has the Covid-19 pandemic had on underpensioned groups?, December 2021

market precipitated by economic crises. During the last year and a half, members of underpensioned groups have been more likely to experience unemployment, furlough and reduced income as a result.“

9.5. So, first and foremost we need policy to correct the labour market issues that lead to poorer pay and pension outcomes for under-pensioned groups and have a pension system that supports these groups to save for retirement.

9.6. What that means for pensions is that we need a system that doesn't exclude certain groups of people just because of their patterns of employment. While implementing the conclusions of the 2017 automatic enrolment review will help, we need a system that can, for example, cope better with multiple job holders and people having gaps in their contribution records.

9.7. We also need to think carefully about increases in contribution rates as this could put people off from saving. Looking at initiatives like allowing people to 'opt down' could help people keep contributing something to their pension.

About Smart Pension

The Smart Pension Master Trust, launched in 2015, is overseen by independent professional trustees and is authorised and supervised by The Pensions Regulator. As at 31 December 2021, the master trust had over 900,000 members, over 70,000 participating employers and assets under management of c£2.1bn. The award winning master trust is powered by the innovation of the Smart platform.

Smart Pension is a signatory of the UN Principles of Responsible Investing (PRI), a member of the Occupational Pensions Stewardship Council and has partnered with Make My Money Matter to develop its investment approach and commit to Net Zero emissions well ahead of the 2050 deadline.

February 2022