Written evidence from B&CE (PSL0041)

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

Prior work in this area, notably the PLSA's 2017 study "Retirement Income Adequacy, Generation by Generation"[1] shows that the main determinant of whether an individual is likely to have an adequate retirement income[2] is whether they have a substantial Defined Benefit (DB) entitlement.

Those dependent on Defined Contribution (DC) pensions are not likely to achieve an adequate replacement rate for two reasons. First, they may not have been saving into a pension prior to the implementation of automatic enrolment. Second, the Pension Commission's modelling shows that roughly double the statutory minimum contributions[3] would be required to achieve the replacement rates the Commission used in their reports.

However, new research, carried out by Ignition House, and attached as an addendum to this evidence paper, shows that despite only making minimum contribution, DC savers tend to think that they are saving enough for retirement.

Six in ten respondents (57%) are paying the minimum employee contributions into their pension, and half state that they are getting the minimum payments from themselves and their employer. Yet only 7% of savers in the Ignition House survey understand that current rates of DC saving will deliver a basic retirement (using the PLSA Retirement Living Standards). The rest foresee a moderate, or even comfortable, lifestyle on the horizon. Worryingly, six in ten (62%) of those who receive minimum contributions (4% employee, 3% employer, and 1% basic rate tax relief) are confident they will have enough retirement income for the standard of living they hope for.

Savers are surprised to find out that what they are paying will not be sufficient; four in ten (38%) members agreed with the statement "the contribution rates have been set by the government which means that the amount I'm saving will be enough for my retirement". And while adequacy is at a household level, worryingly 45% of couples don't know how much their partner has in their pensions.

This picture of minimum contribution levels for vast swathes of the DC membership base would be less concerning if they were paying the minimum into pensions and saving elsewhere. However, two-thirds (64%) of savers in our survey currently have liquid savings of less than £10,000.

As this issue is of utmost relevance to our membership, we have commissioned further work and will submit further evidence to the committee as soon as this work has been completed. This work will use round seven of the Wealth and Assets Survey, which has been delayed, but we expect to be released for analysis imminently. As round seven went into field in April 2018, this will give us a picture of the state of pension entitlements in the UK after the completion of both staging and phasing. This is different to other work on pension adequacy using Wealth and Assets, which uses earlier data and does not fully capture the impact of automatic enrolment.

However, we do not think that the overall picture will change. It is one in which DC dependent savers do not have sufficient savings for an adequate retirement and are not saving enough. However, despite this they are

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[1] https://www.plsa.co.uk/portals/0/Documents/0605-Retirement-income-adequacy-Generation-by-Generation.pdf
[2] Defined in this instance as whether they are likely to hit a replacement rate set by the Pensions Commission
[3] See figure Ex7 on p 19
https://webarchive.nationalarchives.gov.uk/ukgwa/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf

likely to think that they are on track for an adequate retirement income, in part because government has set default contribution levels that many, wrongly assume are sufficient to provide a moderate retirement income.

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

We are cautious about recommending changes to statutory minimum contributions. It is for politicians to make decisions about what the minimum level of contributions should be under automatic enrolment. We do, though, see it as our role to help the decision-making process by providing evidence.

That said, we continue to support the conclusions of the 2017 review of automatic enrolment as they relate to extending coverage and removing the lower earnings threshold. We also support reducing the earnings trigger to £6,240 to bring more women and people from ethnic minorities into the scope of pension saving.

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

Of the available levers that policymakers can pull in pensions policy, engagement is the weakest. Engaging and taking guidance and advice may bring enormous benefits for people who choose to engage, but limited take-up and strong information asymmetries mean that those benefits do not scale, and we do not see them at the population level.

Engagement options, like guidance and advice should be there for people who want to use them. Pension providers should think carefully about the role of guidance and advice in their offer. But the focus should be on making sure that workplace pensions are set up to provide a good outcome, both in relation to adequacy of savings and decumulation choices for the majority who will either not engage at all or who will struggle to engage.

Could retirement income targets help savers plan for retirement?

Yes, we think that retirement income targets are likely useful to those who choose to engage with pension saving. Ignition House's recent survey of pension adequacy issues shows that 95% of respondents agreed that the PLSA's Retirement Living Standards are useful to help them plan for retirement. There is overwhelming support among savers for this approach and we think that the Retirement Living Standards should be considered for inclusion on pension dashboards and other retirement planning tools.

There are two problems here. First, many people do not to engage and follow defaults. Second, it is not clear to many people how much saving is required to deliver each of the standards. When asked to say how much money is needed to deliver each of the PLSA's Retirement Living Standards for a single person and a couple, very few were able to have a reasonable guess at the right amounts. In the Ignition House survey, six in ten (59%) were incorrect across the board, and just one person in the survey of 2,069 respondents correctly estimated all six.

For one in three (34%), seeing this information changed their perception of the adequacy of their pension savings. A small proportion became more confident they were on track, but most had a wake-up call that they may need to do more.

As such, we see the living standards as working as a hook for a conversation about adequacy with the minority who choose to engage during the accumulation phase. The standards may draw people into a conversation about what it really takes to achieve a given level of income in retirement, but people must be ready to have that conversation in the first place. It follows that a lot more material is needed to sit behind the standards and translate a target income level into a plan for achieving it.

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

Government is right to challenge the workplace pensions sector to improve. The improvement in scheme quality over the last decade means that further improvements should be incremental rather than leading to a step change in outcomes.

We see it as possible to reduce costs and improve investment performance by encouraging scale. The UK government is already doing this, and Australia is going further by mandating the consolidation of Superannuation funds that fail a value for money test two years running. This is based on considerable empirical literature showing both economies of scale and, to an extent, higher investment returns in larger schemes[4].

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

We understand that there is considerable interest in CDC. We remain neutral on the subject and are waiting to see how the first UK CDC scheme operates in practice before forming a view.

That said, we see a clash between the philosophy sitting behind CDC and the philosophy that underpins much of the current workplace and retail DC market. As we see it, the internal economics of CDC are likely to require a continual flow of contributions, whether they are used both in accumulation and decumulation or decumulation only. This makes them a more natural fit for pensions systems where contribution and asset flows can be predicted with a high degree of confidence.

This is much more the case in schemes serving a particular industry sector than it is for DC master trusts during accumulation where contribution flows are a function of a scheme administrator's ability to distribute the scheme. Something similar is the case at retirement where savers have a free choice. It is hard to see how a scheme could be set up to run sustainably given these constraints. It seems a model much more suited to a pensions system dominated by strong institutions rather than by consumer choice. This is not intended as a criticism of consumer choice, merely to note that choice places constraints on scheme design.

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

We think that there are challenges in respect of the self-employed and retirement saving. In this context, by self-employed, we mean people who are genuinely in business on their own account and not people working in the gig economy who have been rendered self-employed by virtue of clever legal drafting.

The first challenge is the joining mechanism: how people start saving in the first place. Automatic enrolment is based on the insight that people do not voluntarily save for their retirement in sufficient numbers. Policymakers have, sensibly in our view, applied this insight to one part of the labour market. They have yet to apply it to the other. We do not see efforts to drive up retirement saving among self-employed people that rely on weaker nudges and communications as likely to be any more successful than previous attempts to drive up saving among in other parts of the labour market. There is therefore a case for expanding automatic enrolment to self-employed people that merits further study.

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[4] https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2021/2021-11-18-what-can-other-countries-teach-the-uk-about-measuring-value-for-money-in-pension-schemes/

The problem with this is not the mechanics of the policy problem. We are convinced that a form of automatic enrolment through the tax or NI system for self-employed people is viable. This was demonstrated in 2017 during the automatic enrolment review. The problem is the political acceptability of any proposed reform as automatic enrolment has not yet found favour with self-employed people themselves and has, periodically, been caught up with other contentious issues like reform of NI. We see this, therefore as a problem requiring consensus building, the further development of an evidence base and political leadership. As a pension provider we can participate in but not lead the development of that consensus.

We also need to think about the savings vehicle. Self-employed people are more likely to have “lumpy” earnings than people in regular work. Money may arrive in irregular chunks, and this frequently requires self-employed people to save such that they can maintain a given level of spending during fallow periods. Their personal and business finances are more likely to be closely intertwined, with some self-employed people needing to invest capital in equipment or premises in a way that other workers do not.

Liquidity is therefore much more of a concern for self-employed people and the illiquidity of a pension may mean that it is not the right choice for retirement saving. It may be that some form of ISA and pension combination, perhaps along the lines of the NEST sidecar, is the right way forward.

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

One of the recurring themes in our evidence is that inequalities in workplace pension outcomes tend to reflect wider labour market inequalities. This is true for the bulk of the gender and ethnicity pensions gaps and is also true for gig economy workers also.

We think there are two categories of gig economy workers. In the first category sit gig economy workers who are victims of labour market arbitrage. This group consists of individuals who are, rightly, limb b workers but who are not yet treated as such by their employer and workers who sit just outside the definition of a limb b worker but who should be brought within it. We hope that the delayed Employment Bill, announced in the 2019 Queen’s Speech will review the line between a limb b worker and self-employment to bring more gig economy workers within the scope of employment regulations. We do not see this happening without statutory redefinition of the line between a limb b worker and a self-employed person and are cautious about whether cases like Uber B.V v Aslam will establish a wider precedent. This is because the recent group of gig economy cases have each turned on the individual facts of the case, where contracts between companies and those working for them are often significantly different.

We see the second category of gig economy workers as genuinely self-employed. These people could be brought within the scope of automatic enrolment through a separate mechanism for self-employed people.

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

As we noted in our response to the last question, there are some pensions problems where the root of the problem is an underlying labour market problem. In our 2019 research report “The Gender Pensions Gap Tackling the motherhood penalty[5]” we explored the relationship between the gender pay gap and its origins and the gender pension gap.

We started with a statistic from the Prospect showing that the gender pensions income gap (39.5%) was more than double the size of the total gender pay gap (18.5%), with the average female pensioner £7000 p.a. poorer

[5] https://thepeoplespension.co.uk/media-centre/policy-research/the-gender-pensions-gap-tackling-the-motherhood-penalty/#:~:text=Our%20new%20report%2C%20'The%20gender,more%20if%20childcare%20was%20cheaper.

than their male equivalent. This is partly exacerbated by the fact that the pensions gap contains non-workers but still serves to highlight the disparity.

This inequality in the present is the result of the unequal accrual of pension entitlements over decades. It is mainly the product of women’s lower state pension entitlement, the gender pay gap, lower historic access to workplace pensions and increased time out of the labour market to care for children and other family members. The challenge for pensions policy is to ensure that this historic inequality does not persist into the future.

Reforms to state pension entitlement should over the long term largely remove the state pension as a source of future inequality. But other interrelated factors: caring responsibilities, the gender pay gap and lower levels of entitlement to workplace pension saving through automatic enrolment may continue to combine to reduce women’s retirement income in the future. This is despite the considerable progress made by automatic enrolment in increasing women’s access to pension saving. Since 2012 the proportion of eligible women saving into a workplace pension has risen by almost half.

Workplace pensions are tightly tied to lifetime pay as pension contributions are typically a percentage of pay. As such, the pensions gender gap is largely a function of the gender pay gap. This has two angles to it: first the pay gap itself and second, the interaction between women’s lower pay and the earnings trigger for automatic enrolment. Many women are out of scope of workplace pension saving because they earn below £10,000 – the threshold for automatic enrolment to kick in.

Recent studies show that the biggest single reason for the gender pay gap are changes in women’s working patterns as a direct or indirect consequence of motherhood[6]. A gender pay gap exists between men and women before the birth of children, but it is comparatively small. The gap grows once women become mothers and, either voluntarily or involuntarily reduce their work commitment to look after children.

Often, women reduce their hours to look after children and find that their earnings then grow at a much slower rate than that of comparable men. This seems to be due to a complex blend of factors, which seem to centre on the lack of pay and skills progression in part time work. This slower rate of earnings growth, combined with lower pay, will result eventually in lower retirement incomes because of lower pension contributions.

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[6] Ibid