Summary
- The opening up of at-retirement choices for those aged 55 and over has moved pension savers from a simple annuity pick, to a complex selection of retirement funding options.
- It has been recommended that contribution levels should rise to 15 to 20 per cent of income in order to fund retirement.
- Scheme trustees and providers should take behavioural economics seriously and apply them to the accumulation journey. Nudging is seen as the answer to contributions and auto-escalation. The pension dashboard can act as a signposting conduit.
- It is argued that affordable, personalised, jargon-free information via apps will revolutionise financial thinking.

Decisions, decisions

Following the introduction of the pension freedoms, a lack of understanding regarding retirement saving planning, and pension accumulation in general, has come to the fore. How can savers be saved from picking the wrong options?

Here's a headline you won't see in the London *Evening Standard* any time soon: George Osborne's pension freedoms lead to disastrous retirement saving decisions. No matter. It's a story that will probably be told elsewhere over the coming years.

The hard evidence is already there. By January 2017, £9.2 billon worth of pension savings had been accessed flexibly. And in the 2015/2016 financial year, Osborne's successor Philip Hammond banked £1.5 billion in tax revenue from savers converting their pots to cash – five times the amount HM Treasury initially forecast that it would raise.

"You could argue that this is just because we are in a fledgling state, and these are small pots," Barnett Waddingham partner Damian Stancombe says.

"But the small pot environment is going to extend for the next decade or two due to small DC contributions for the vast majority."

Stancombe believes that opening up at-retirement choices for those aged 55 and over has moved pension savers from a simple annuity pick, to a complex selection of retirement funding options.

"We're now in an environment where complexity leads to paralysis. And paralysis leads to the one thing which everyone understands – cash. 'Forget about the risk of higher rate tax, I put it into my bank account and I live on it.'"

As concerning as this flight to cash is, there is an even bigger problem brewing at the accumulation stage, according to BlackRock's head of UK DC Claire Finn.

Citing a recent BlackRock survey, she reveals that Brits want an average annual household retirement income of £23,000. The problem however, is that many of them are under the impression that £200,000 will be enough to fund it. In reality, they would need something like £700,000 in their pots to secure such an income.

This disconnect is made worse by people's lack of appreciation of adequate contribution levels. The minimum total level under auto-enrolment will rise to 8 per cent of salary from 2019. Finn warns that members will start to view that as the recommended contribution if it hovers at that figure for too long.

"It needs to be between 15 to 20 per cent of income in order to fund the type of retirement that you would have got with a DB scheme," says Finn.

Impact

The consequences of inadequate contributions and poor at-retirement decisions are far reaching.

Intelligent Pensions marketing director Andrew Pennie says that many individuals will end up running out of money too quickly, while others will find themselves victims of increasingly sophisticated scammers.

"And could people go back to pursue legal action against the trustees and employers? You can never rule it out."

The cohort most vulnerable to these negative effects, Momentum UK managing director Samantha Seaton explains, is the one that sits in pensions no-man's-land. Due to retire in the next 10 to 15 years, they have no DB benefits and have not had the benefit of being auto-enrolled into a plan early on in their working lives.

"They are going to have the worst retirement provision that we're going to see for a long time," predicts Seaton.

"My fear is that they're going to use their small DC pots to pay off the mortgage, for example, thinking that it's not worth using for anything else. And then they're going to have nothing to retire on apart from the state pension."

A widespread extension of such a scenario, says Stancombe, will lead to problems for employers as well.

Is it any wonder?

Despite all the talk in recent years of engaging with members and pushing financial education, savers clearly remain detached from their pension schemes.

Xafinity head of proposition development Paul Darlow says that part of the problem still lies with basic communication.

"Most of the information provided by schemes is nigh on impossible to understand," he says.

"It tends to be lengthy, complicated and full of jargon and doesn't tell people what they really need to know. It all seems to be about covering the backs of the providers to make sure that it's legally watertight and does everything that the regulator says they should do."

Without decent communication, no amount of scheme improvement is going to benefit the majority of savers, says Stancombe. He advocates building some safe harbouring around communications to help schemes take off the regulatory shackles. "We've got to go basic and be abrupt in style. People are not stupid. They make very complex decisions around their lives every day of the year. They buy houses, go on holidays and buy car insurance, but the language is far more tangible," he says.

Nudging and signposting

As well as addressing members in a

manner that they can relate to, scheme trustees and providers should also take behavioural economics seriously and apply them to the accumulation journey, according to Seaton.

She believes that nudging is the answer to low contributions. Over several years educating and modelling pension contribution levels to try and encourage higher pension saving, she says that she has had little success. “However, the States have had a lot of success by nudging up contributions.”

Introducing auto-escalation as a standard feature should be a priority she says.

“It comes out before you have it in your bank account so you never miss it – because you’ve never had it.”

If nudging is not everyone’s preferred option, then providers and employers can also still use behavioural economics, albeit in a different way, to encourage higher contributions.

Standard Life head of pensions strategy Jamie Jenkins is a big fan of prompting savers at certain stages in their lives. This is based on the well founded theory that once a pension pot starts to exceed someone’s annual salary, then people begin to take more of an interest in it. Prompts to review investments and contributions can be delivered at 30, 40, and then, crucially, he says, at 50.

“By that time you won’t know exactly what you’re going to do in retirement, however, you can think about when you want to retire so that the lifestyle default fund can de-risk you towards a certain age. That’s a good time to recalibrate your plans around your targets,” says Jenkins.

With the pensions dashboard on the horizon, prompting could work for all savers, rather than those lucky enough to have a sophisticated scheme run by a paternalistic employer.

Jenkins says that the dashboard can act as a signposting conduit. So for example, someone can be prompted at age 40 to view the pension schemes they have had with their previous and current employers, calculate how much they could get – along with the state pension – and realise that they have a financial investment that they should dedicate more time to.

Filling in the gaps post-RDR

Ever since the Retail Distribution Review did away with commission payments which cross-subsidised smaller clients for IFAs, advice has been out of reach for many retirees. Unfortunately, this has developed just as the need for advice, following the scrapping of compulsory annuitisation, has grown.

Robo-advice however, says Mark Grimes, product director at EValue, could well step in to help out.

“Affordable, personalised, jargon-free information via apps will revolutionise the way we all think about our finances,” he says.

“Robo-advice will help consumers to gain more confidence in their decision making and will empower them to make decisions to secure their financial future. It will also revolutionise the advice market, speed up the traditional advice process, and enable advisers to service more clients efficiently.”

For those who aren’t comfortable with relying on an online adviser, LV= head of policy Phil Brown says that there may be a simpler way to get them some guidance.

“We need to shovel members towards guidance bodies,” he says. “If you look at Pension Wise’s satisfaction stats, they are amazing, the envy of most schemes.

“They’re doing a great service, the issue is that they’re not getting enough people in front of them.

“The default option should be – if you’re not getting financial advice, you should be getting guidance. And that should be government-backed and impartial.”

Written by Marek Handzel, a freelance journalist