Summary
- The IFS is conducting a crucial review of UK pension savings.
- It is hoped the review will provide realistic changes the government can implement.
- Savings inadequacy must be a key component of the review, say industry commentators.
- A strategic approach with less regulatory change is needed for long-term success.

The tortoise and the hare

Can slow-moving DC reform finally catch up with financial reality and futureproof pension saving? Marek Handzel finds out

The UK's 21st century pension system has been under constant refinement for the past decade or so. From auto-enrolment to pension freedoms, continual efforts have been made to improve the accumulation and decumulation stages of retirement savings as the defined contribution (DC) model has emerged as the UK's main retirement savings vehicle.

Nevertheless, the measures taken so far have not been enough, as proven by the Institute for Fiscal Studies' (IFS) announcement in April that it was to conduct the latest in a long line of pensions reviews, in partnership with the Abrdn Financial Fairness Trust, after its research raised concerns around the "substantial risks" facing future generations of pensioners.

The review, due to conclude in the summer of 2025, will be centred around three key questions. Firstly, it will ask if workers are saving appropriately for retirement. Secondly, it will examine how the state supports people from late working life into and through retirement. Thirdly, it will consider if people require more assistance to use their wealth appropriately through retirement and, if so, then in what manner.

The study, however, faces two major foes: Time and industry fragmentation.

"The core questions asked by the review are vital to providing the population with the right support for retirement," says WTW DC consulting director, Stuart Arnold. "The challenge will be ensuring that this review has an impact on policymakers. The review is due to take 2.5 years and so the outcome will not be shared until nearly a decade after the DWP's review into auto-enrolment — this could be too late for many."

My Pension Expert's policy director, Lily Megson, hopes the review will provide some "realistic and sustainable" changes that the government can implement, "as opposed to what we've seen in previous years, which are just sticking plasters".

The Investing and Saving Alliance (TISA) head of retirement, Renny Biggins, stresses that the proposals that emerge from the review must garner the backing of the whole industry. "This can be hard to achieve if decision-makers are hearing disconnected proposals from different sections of industry," he says. "But even with proposals fully supported by industry, successful progress is dependent on parliamentary time, which has understandably been very tight in recent times.

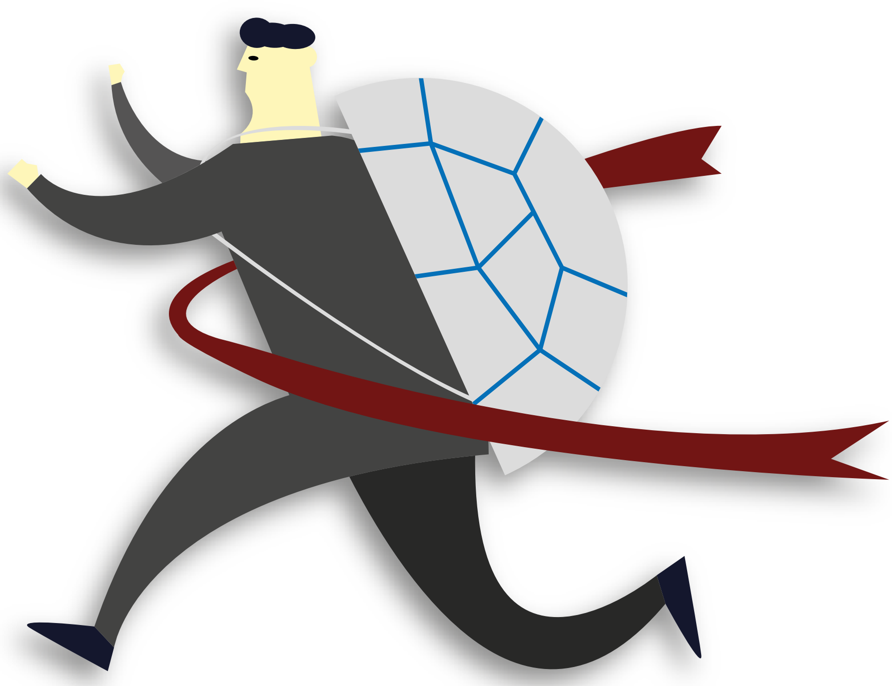
"Nonetheless, ongoing discussions with relevant bodies and individuals can help this stay on the radar for when a gap in the legislative schedule becomes available."

Saving in a financial fog

According to several commentators, the review's first port of call has to be the widespread inadequacy of current saving levels.

Generally speaking, contributions are not high enough. According to the Office for National Statistics (ONS), the median pension pot for the cohort aged between 35 and 44 is £30,600. And as PPI head of policy research, Daniela Silcock, stated in June when writing for *Pensions Age*, the typical woman's private pension income in 2022 was 64 per cent that of the already too-low average amount. Ethnic minority retirement incomes, meanwhile, sat at 62 per cent of the UK average, with little sign of improvement in the future, based on current contribution rates.

"The mechanisms in place to help people maintain their savings habits need reviewing," says Standard Life managing director for workplace, Gail Izat. "Over the past couple of decades, we've seen a shift from the responsibility for retirement saving move from employers and the state to the individual, and the pensions system needs to adjust to support this. The scale of under-saving is stark and there's a real risk future generations will fall way short of their anticipated standard of living in retirement. There's also the question of pensions for the self-employed, who aren't eligible for auto-enrolment at all, and a huge gender pension gap to deal with."



As Arnold points out, back in 2017, the DWP's own auto-enrolment review identified insufficient savings as a major threat to retirement saving outcomes, but little has changed since then.

In order to avert a major pension savings gap, Arnold advocates a swift implementation of an extension to auto-enrolment, as laid out in a Private Member's Bill by Conservative MP Jonathan Gullis. This would see the abolishment of the lower earnings limit for contributions and reduce the age of auto-enrolment from 22 to 18. Izat also supports the Bill and would also like to see minimum contributions rise to 12 per cent further down the line.

"This might seem modest, but could add up to a much bigger pot as the years go by," says Izat. "Small tweaks could really help people grow their pension savings."

Arnold also argues that further consideration should be given to a structure whereby auto-enrolment contributions change as a worker progresses through their career – linked either to age, service, income or a combination of all three.

This tendency to recommend further behavioural economics-based nudging techniques is predicated on the continued lack of interest many people still display towards their pension pots. "The main crux of the problem does need to seem to be engagement," says Megson. "My Pension Expert's own research has found that 62 per cent of Britons in full-time employment don't actually know how much they have saved into their pension."

This situation could pose some massive problems later down the line, she warns, including under-saving, inappropriate investments, and even completely losing tracking of pensions built up under different employers. Currently, says Megson, the UK has some £90 billion of unclaimed pension pots languishing in the system.

This is why, she says, the government must stick to the new deadline for the pension dashboards. "It could transform the way people interact with their pension," claims Megson.

"More support and appropriate, easy to access vehicles need to be put in place to help savers"

The need for advice

Raising contribution rates, however, is only the first step, says Arnold.

"I wish pensions were as simple as 'save as much as you can' but, unfortunately, it is far more complex," he says. "The Organisation for Economic Co-operation and Development (OECD)'s research suggests that only 67 per cent of adults are being assessed as financially literate in the UK. Without improving this, it's difficult to get individuals to understand how much they can save and, importantly, take action."

Regardless of how much people pay into their DC pot, there is also a question of how those savings are used at retirement that are appropriate for their own personal circumstances. Unfortunately, says Arnold, default funds are partly to blame for this situation, as they have meant that people are not used to having to make decisions around their pension until this is thrust on them at the point of retirement. Without advice or even using Pension Wise, therefore, individuals are making sub-optimal decisions. The implications of such behaviour is clear, says Arnold, who cites data from the FCA that routinely shows that over 85 per cent of people buying an annuity at retirement choose to buy a non-increasing annuity, which provides no inflation protection over their retirement.

"Pension savers are presented with a range of options and uncertainties at the point of turning their hard-saved money into a retirement income and they are often ill-equipped to make these decisions," says Arnold. "More support and appropriate, easy to access vehicles need to be put in place to help savers."

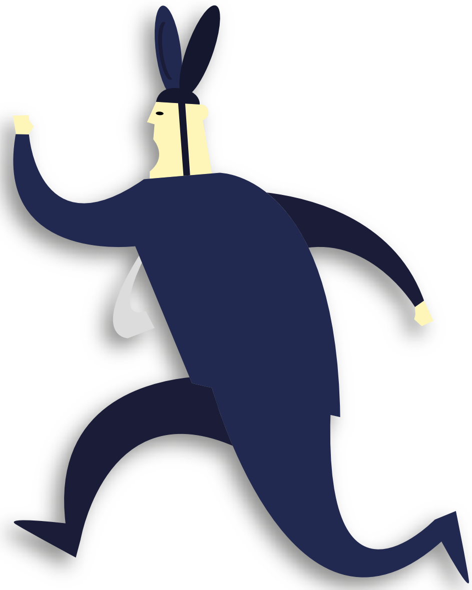
To this end, he supports the DWP's suggestion that all DC schemes will be required to help members access the full range of options post-retirement, even if these are not offered in a scheme.

These proposals, along with the extension of auto-enrolment, are more short- to medium-term actions. Longer term, the need for greater financial education and providing access to support are vital for the long-term success of pension savings. "Financial education, guidance and high-quality advice are needed to empower savers to make the right decisions," argues Arnold.

In Megson's opinion, the government should be focusing on granting access to affordable advice as opposed to just guidance. In her view, guidance is too limited by its very nature as it is unable to arm a saver with a tailored route to retirement.

A more strategic approach

Whatever course the IFS review recommends and subsequent government pursues, speed and firm widespread action are of the essence, stresses Biggins.



He says the UK's pension landscape is in a prolonged period of almost constant regulatory change, which is piecemeal and reactive. The challenge policymakers have with incremental change, however, is that there are no areas of pensions which can be completely isolated and focused on. "There is always a knock-on impact with another area and sometimes we see open consultations addressing connected areas," he says. "It makes it difficult to respond to one consultation without understanding what the outcome of another will be, for example the interaction between the stronger nudge and scams guidance."

Constant incremental change only serves to confuse consumers, says Biggins, and often adds to the negative perception individuals have towards pension saving.

"In an ideal world," he says, "we would like to see a more strategic approach taken to regulatory change, that considers the main drivers and creates a framework that has cross-party agreement, delivers consistency, equality, and value for money for all savers."

Written by Marek Handzel, a freelance journalist