Summary
• There are growing pressures on domestic economies as cost-of-living crisis escalates, but it is too soon for real data on pension impact.
• Different life stages create different challenges for savers, and therefore different solutions are needed from the pension sector.
• Communicating the importance of continued contributions is necessary but must be sensitive to economic pressures.

Cost-of-living crisis: The pensions view

Consumers are having to make tough decisions as rising inflation and economic hardship bite. Andy Knaggs finds out how the pensions sector will be impacted and how it can respond

The true impact of the current cost-of-living crisis on retirement savings is still to become apparent. Government and industry statistics reflect only a recent picture, not a current one, and with the continuing inflationary pressures still spiralling upwards, the depth and breadth of the current crisis is yet to be revealed.

In January this year, the PLSA carried out research referencing the cost-of-living crisis, which found that almost

half of those surveyed who were not retired said they could not afford to save at that point because of the rising costs of everyday life. Meanwhile, 32 per cent said that they could afford to contribute more to their pensions to boost retirement income.

That was in January though. Six months further on, the crisis has dug deeper, exacerbated by events such as the Russian invasion of Ukraine. Slightly more recent research from March 2022 was conducted by Cushon. It indicated that people were more focused on cutting down everyday expenses, but that one in five would consider stopping saving altogether to help them cope with the cost-of-living crisis.

Even without fresh data, however, it is entirely reasonable to expect that the tightening of domestic budgets will have some impact on how people view saving for the long term. Interactive Investor head of pensions and savings, Rebecca O'Connor, sums it up thus: "In this current climate, the last thing that most people will be thinking is: 'I've got some spare cash, time to up my pension contributions.' If people do have any spare money, they are more likely to be thinking: 'I'm going to hold on to that because I might need it very soon, like in winter, when energy bills go up again significantly'. This focus on the here and now and on short term, emergency saving, if any saving can be done at all, presents the industry with a monumental challenge."

At the sharp end of this, wealth management company Netwealth reports that it has seen a 160 per cent increase in the number of people approaching it for longer-term or 'annual' advice this year. "Short term needs may have to be prioritised but if so, their consequences need to be well understood," says Netwealth CEO, Charlotte Ransom.

Cutting discretionary costs

So, the full impact of the current crisis cannot yet be known, and much will depend on its duration and severity. Consumers have likely been going through a process of assessing where savings can and need to be made within discretionary spending – switching supermarkets, reducing spending on things like entertainment and social life, putting off home improvements. Pension savings are only one outgoing amongst many that might be reduced or stopped.

It must be understood of course that pension savers are not a homogenous mass. They are at different life stages, and they have different priorities and different financial means. In considering the impact of the cost-of-living crisis on people's ability to save and how the pensions industry can respond, it might therefore be useful to view the issue from those different life stages: Those who are far away from retirement; those approaching or at retirement age; and those who are already retired.

Difficult period for AE

A particular concern has been that the cost-of-living crisis will have an adverse impact on rates of automatic enrolment, as financial pressures lead people to opt out. So far though, this is not showing up in the data, according to PLSA director of policy and advocacy, Nigel Peaple. The caveat here is that the data itself is a few months old, perhaps before the crisis really gripped. "My feeling is that it's bound to have an impact at the margins, in terms of extra opt-outs," he adds.

Others expect a difficult period for AE. Quilter pension expert, Ian Browne, says: "The cost-of-living crisis may seriously test automatic-enrolment. Recent figures show that it has largely stayed flat for some time. However, AE relies on people's inertia and significant financial pressures on someone's finances today may make people take action and reduce or stop pension funding altogether. We won't see how badly AE has suffered until the next set of government data comes out."

Aegon head of pensions, Kate Smith, agrees that while pension saving and AE held up well during the Covid-19 pandemic, "sustained high inflation could be the biggest challenge yet,

and put the brake on progress in this area".

Peaple is additionally concerned that the financial woes being experienced will affect the government's policy commitments in respect of pension contributions, saying: "The government has said it is committed to removing low earning thresholds on AE, but I could see it being pushed back further into the decade because of this, which will have an indirect impact on savings levels."

Other solutions

Cushon CEO and founder, Ben Pollard, highlights other ways that the problem could be approached, citing pension redirect and salary sacrifice. He said: "Pension redirect allows employees to redirect some of their pension contributions, over and above auto-enrolment minimums, into accessible savings so that they start building up a financial buffer as well as a pension pot. It's the perfect balancing tool that speaks to the financial issues that employees are facing today. We really need to start thinking about workplace savings and not just pensions – it's about a holistic savings approach."

He continues: "Salary sacrifice is an old tool in the bag but still very few employers offer this, despite the fact it can make a difference of £200 a year for an employee earning £30,000 a year – and when people are struggling, this can be significant. We've calculated that collectively UK pension members are losing out on £1.9 billion worth of savings a year by not doing salary sacrifice. It's low-hanging fruit."

Another potential response comes from Pensions Policy Institute head of policy research, Daniela Silcock, who says that employers paying a full 8 per cent contribution to pensions for employees with earnings below £12,000 would help. "We look at how different policies might impact, and the benefits of this one are fairly self-evident, but people are politically quite scared to push it. It is being talked about, but at the moment we are struggling to get the recommendations from the 2017 auto-enrolment review put through."

Meanwhile, Ransom suggests that savers should scrutinise investment and wealth management fees to improve finances, saying that the firm regularly sees prospective clients who are paying a percentage or two more in fees than they should be: "Every 1 per cent that can be saved in annual fees is worth 14 per cent of your starting capital over 10 years."

Decision time

For those approaching or at retirement age, the high rate of inflation requires them to make, or perhaps re-make, some big decisions, according to Smith.

"People in this situation may be asking themselves whether rising prices mean their expected retirement income will still be enough to do what they planned or even to just 'get by'. This may lead to them revisiting their decision, and deciding to work longer, perhaps on a transitional basis, so they receive an income for longer."

Smith continues that those who are over 55 might consider it wiser to hold off from starting to access their pension savings, while those at retirement age who delay the big day could gain a significant boost to their retirement income by doing so, due to the triple boost from continued investment returns on their pension pot, further pension contributions from themselves and their employer, and fewer years to spread the fund over once retired.

Fit for purpose

Those who have already retired and are drawing their pensions will have welcomed the government announcement that state pensions will once again benefit from the 'triple lock' rise mechanism first introduced in 2010. This could mean a double-digit pension increase, depending on the September inflation figure. However, Silcock argues

that the annual uprating of the state pension is "not fit for purpose in a time of cost-of-living crisis", adding: "You would need to increase pensions on a quarterly basis, because the gap is getting bigger and bigger, and pensioners cannot easily go out and get more work to fill that gap."

Retirees are facing the predicament of watching the value of their pension pots draining away as inflation continues its remorseless march upwards, although some will be protected by inflation-linked DB schemes.

"It's a horrible time to be suddenly reliant for income on a pot of money that is dwindling in value all the time, not only because of the effect of inflation, but also because of stock market downs," says O'Connor.

"I think the stress of managing money in drawdown will also have increased for people. Retirees who were managing drawdown okay when the markets were averaging a steady 5-7 per cent may now be finding it far more difficult to know where to invest and how to take their income to preserve their pot. The burden of drawdown management right now is immense."

There is a danger that investment decisions made because of the cost-of-living crisis could impact far into the future. Ransom comments: "As pots are drawn down, the knock-on consequence is that there may be less room for manoeuvre in the future. This could also potentially dramatically change people's financial futures if a large additional and unexpected percentage is taken during these more difficult times."

Clear communication

There is perhaps a delicate balancing act for the pensions sector to achieve as this cost-of-living crisis develops. On the one hand, it needs to communicate clearly what the benefits of retirement savings are and why the public should keep saving through a difficult period. On the other hand, given the inertia factor that so often characterises people's relationship to their pension provision, would too overt an emphasis on maintaining pension contributions have the opposite effect?

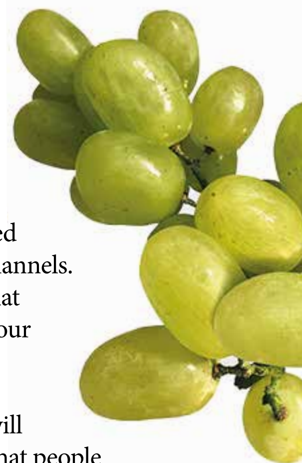
O'Connor sees there is a danger that reminding people of their pension payments could "potentially accidentally encourage people to cut that part of their cloth". She observes that continuing contributions into workplace pensions with matched employer contributions and tax relief might "logically and sensibly be the best chance to get inflation-beating returns". Nevertheless, some will arrive at the nuclear option of cancelling pension payments.

"The key for the industry will be getting those people who make this choice back on track once their immediate challenges have passed," she says.

Multi-channel campaign

There will be a communication campaign coming from the PLSA in the autumn, according to Peaple, and it will publish its latest inflation update in October, providing new data on the prices of goods and services that feed into its Retirement Living Standards initiative, used extensively in tools such as pensions calculators.

The autumn campaign pre-dates the cost-of-living crisis in its conception, Peaple explains, and will deal more broadly with engaging the public on the basics of pension saving. Communication experts have been enlisted to help simplify the subject matter, and the campaign will be rolled out across multiple channels.



"We are hoping that through pushing out our messages to improve the understanding of pensions saving, we will reinforce the feeling that people have that it's important for them to do it; that people understand that something like auto-enrolment is a good thing for them to do," he says.

In the current financial climate, he believes it is necessary for the industry to "ensure that people think not just about the short term, but the long term too"; that they don't give up pension contributions unless they really need to, and also, as O'Connor says, to emphasise the benefits of employer contribution and tax relief.

Ultimately, individuals will make their own decisions about the short- and long-term management of their finances. The pensions sector must recognise the pressures of the moment and respond with subtlety and agility, for no-one knows how long the current crisis will continue.

Written by Andy Knaggs, a freelance journalist