Spotlight on Pensions
PRESENTS
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Building pensions optimism

It seems that almost every week another survey appears purportedly showing pessimism amongst the working population about their retirement prospects. The most extreme view expressed is that they will never be in a financial position to enable them to retire.

Where someone wishes to continue working and earning and are able to do so that is a good thing. However where the individual either does not wish to continue in paid employment, or is unable to do so, the prospect of inadequate replacement income is worrying. The subtext of these survey responses is that respondents believe they will fall into the latter group, fuelling pessimism about their retirement prospects.

In many cases such pessimism is unwarranted. It may however to some extent reflect poor understanding of the workings of the pensions system, with individuals unable to fathom how they will be able to build a sufficient fund to live off. The existence of automatic enrolment and the plethora of details that accompany membership seem not to have entirely worked through to the collective consciousness. Pessimism may also be fuelled by herd mentality, where friends and colleagues express such views and the individual does not have sufficient understanding to be able to counter them.

The opposite extremis view held, that unrealistically small pots will finance a comfortable lifestyle in retirement and from an early age, is another manifestation of poor understanding.

State pension inadequacy

Attempts to counter the pessimism are not helped by the ungenerous level of the state pension – and in the context of the recent surge in inflation and its likely duration the decision to suspend the triple lock for the April 2022 increase looks increasingly questionable. That, and continuing increases in the state pension age give the impression that any state contribution to retirement income is unreliable.

Some progress

This has long been a recognised problem and a considerable amount of good work has been done to improve the position. There are some encouraging signs that the number of people who are engaging with their pension provision is increasing, albeit not at the rate needed. New initiatives continue to be developed. These range from new regulations requiring schemes to provide increasing amounts of information and guidance towards centrally-provided assistance such as Pension Wise, through to initiatives to boost individuals' understanding, such as clearer-worded statements, videos and the PLSA's living standards illustrations.

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Genuine problem?

But does saver pessimism really matter? Should we be concerned that, despite all our efforts, we are seemingly making only limited headway against the tide? Is it not sufficient just to keep pressing on with what we are doing, and rely upon factors such as automatic enrolment to continue to improve matters over time, whether or not it is currently recognised by members?

There are reasons why we should be concerned. Although initiatives like automatic enrolment are making a strong contribution to future retirement security, they are clearly not sufficient on their own. The system still requires considerable input from savers to fulfil its full potential. Decisions are required about such things as contributions and investment during accumulation, and timings and management of retirement. If individuals don't have faith in the system's ability to provide a secure retirement income, then they won't make the effort to engage. Dipping into the engagement process only on isolated occasions when nudged, pressured or forced by third parties leaves them open to taking poor decisions, and even to fraud. They need help with raising knowledge-led engagement on a continuous basis throughout a lifetime, as part of a planned wider financial strategy. Without it, the success of automatic enrolment and other key developments will be undermined and pessimism will persist.

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Any simple solutions?

So, what more can be done? Is there a strategy, as yet untried, that has the potential to turn things around? Probably not. In extremis the state could decide to provide a universal pension at a sufficient level to give every citizen a comfortable retirement without the need for private supplement. However, the many implications of such a strategy would not sit well with a modern western democracy (although that is not to say that there isn't room for improvement to the current level of state pension, as mentioned earlier). The solution will continue to require a mixture of tools, applied as required in individual cases.

Contribution from scheme design

Looking back several decades, when final salary defined benefit schemes were commonplace (although, despite a common misconception, by no means universal) members benefitted from a package of support measures intrinsically provided through the system by employers and trustees. There were some problems with mismanagement and fraud, but largely the system delivered on its promises and so members' confidence was accordingly high. In most cases members could (and did) simply ignore pensions matters and still expect to receive a reasonable pension.

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The widespread switch to defined contribution models largely removed those support mechanisms. There are positive benefits from the DC system, including greater freedom of choice. However, positives quickly turn negative if the individual is unable or unwilling to make appropriate decisions.

One bright hope is the development of CDC scheme models, including on a multi-employer basis which the Government has flagged as an objective for the latter part of 2022. Although still requiring a degree of member understanding and engagement, the more predictable outcomes expected under such schemes should reduce the potential downside of poor member engagement. Of course, employers will need to adopt such schemes, and they will not fit every business model. However, there are encouraging signs that a number of employers see potential benefits from CDC and are actively considering adopting it.

Supporting decision-making

A tool mandated through the regulatory route is the "nudge" to pensions guidance. The Government has introduced new legislative requirements for schemes to follow, from June 2022, which should help the cause.

A number of parties, including the Work and Pensions Select Committee, believe that the new provisions do not go far enough, warning that savers need more support when making pension decisions. They have called for a trial of automatic Pension Wise appointments. That may cause some resentment as an unwarranted interference in savers' personal lives. However, with freedom comes responsibility, and if such a step is effective in ensuring that savers are equipped to make sensible decisions (even if they choose not to apply the guidance they have received) that is not an unreasonable "ask" of them – particularly as the state subsidises their savings through the tax system.

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Better information

A further legislation-led development which should prove crucial in this area is the Pensions Dashboard. This undertaking has the potential, if properly devised and implemented, to make a major contribution through providing accurate and relevant information upon which a saver can base their plans.

However, it also has the potential to undermine saver confidence if it does not deliver against expectations (whether or not those expectations are reasonable). Building this system from scratch always looked like a major challenge, and so it has proved. Given legacy issues with scheme data, and difficulties around producing accurate predictions of benefit levels, the current proposed timetable to achieve an all-singing, all-dancing system by 2023 looks ambitious. Even then, the system will not contain details of state pension entitlements – a serious omission from a system designed to provide accurate information upon which to plan a retirement strategy.

If dashboards fail to meet expectations at outset, they will struggle to recover confidence in the future. For these reasons, it may be sensible to launch a more modest dashboard first, simply providing a record of all pension entitlements, moving on later to include a pension prediction tool. It will also be sensible to manage public expectations before launch.

Ongoing development

There are many other new initiatives, with the industry doing its part to innovate where it sees gaps. But if the apparent savings pessimism is to be effectively countered, a consistent effort from multiple sources will be required. We should give due recognition to achievements thus far but continue with efforts to encourage savers to contribute towards providing for their own futures. Success will require savers' confidence in the underlying system, and in its ability to deliver for them individually if they make the effort to engage.

The complexity of the current systems is a barrier. It is possible (and desirable) to remove some of that complexity and we should continue to do so where possible. However, financial matters are inherently complex and so there is a limit to how far simplification can be taken in practice. Any means of simplifying how the system impacts on individual savers, including providing assistance with some of the tougher decisions, will therefore be invaluable.

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The role of Government and regulators is also crucial. The desire to see improvements at scheme level is both understandable and welcome. However, care is needed that new burdens placed upon schemes are thoughtfully prioritised, balancing desirable improvements with the ability of schemes to implement them within set timescales. It is counterproductive to impose highly-publicised new measures on schemes that are not achievable, with the result that expectations will not be met. The resulting discord played out in public further undermines savers' confidence. Unfortunately, the current burden of new obligations being imposed upon schemes threatens just such an outcome and points to the need for a rethink on the implementation timetable.

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Positive messaging

Actual positive outcomes for individual savers will provide the ultimate source of confidence in the system and counter saver pessimism. People need to know that their engagement will deliver benefits. That requires a strong and continuing messaging campaign, backed up with positive statistics about the growing numbers of people benefitting from having saved, and illustrated with real case studies. In this, there is not only a requirement on Government, but also from schemes, providers and employers, to showcase how savings goals can be achieved in practice.

A strong collective voice accentuating the positives, backed by continued practical initiatives will go a long way to countering the negative sentiment that appears currently to undermine saver confidence. Despite the distance already travelled, the road ahead is still long and difficult, but the prize will be worth the effort.

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