Policy Position Paper

Private pensions

UK

November 2018

All current and future pensioners should have sufficient income from state and private sources to live comfortably and participate in society.

"It's a very serious matter. If I muck up at 60, I muck up for the rest of my life, I've got to get this absolutely correct and that's the problem, it's a minefield."
'New choices, big decisions', State Street / People's Pension

The private pensions landscape has changed considerably in recent years. The introduction of automatic enrolment has meant many more people are now saving into a pension through their employer, and the end of compulsory annuitisation – known as pensions 'freedom and choice' – has given people a wider range of options for what happens .

These changes have raised new challenges for consumers as well as a number of concerns for Age UK.

Automatic enrolment

All employees meeting the eligibility criteria – being aged between 21 and State Pension age and earning at least £10,000 a year – are now automatically enrolled into their employer's pension scheme. This means that their employer

Key statistics

9.5 million

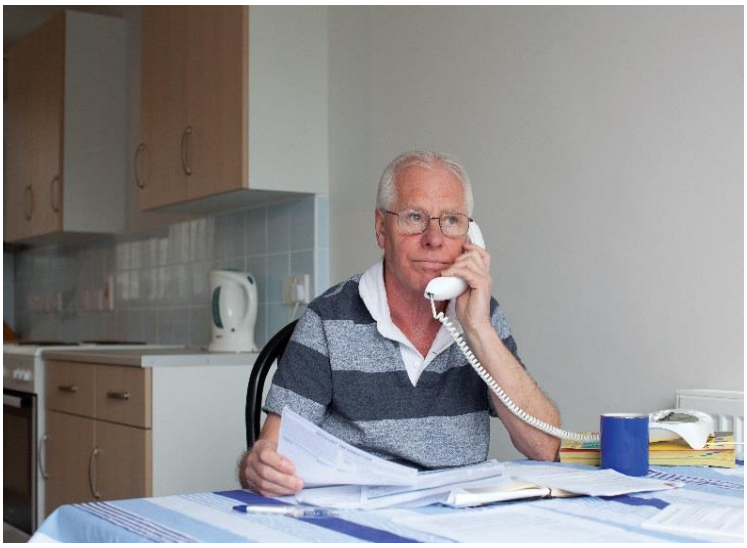
people newly saving into a private pension since auto enrolment began in 2012 (ONS)

94%

of non-advised income drawdown customers (i.e. those who withdraw their money flexibly on an ad-hoc basis) stay with their existing provider

44

- the number of different charges that can be levied on income drawdown customers.



puts them into the scheme, but the individual can opt-out if they do not wish to save. At present (April 2018 – April 2019) people save a total of 5 per cent of their relevant earnings (known as 'band earnings'),[i] made up of 2.4 per cent from their salary, 0.6 per cent in Government tax relief, and 2 per cent from their employer. This will rise to a total of 8 per cent (4, 1 and 3 per cent contributions respectively) from April 2019.

Auto-enrolment is widely supported by all stakeholders, crucially including employees[ii] and small employers[iii], with over 80 per cent of both believing it to be worthwhile.

In 2017, the Government conducted a review into auto-enrolment, and as a result recommended some changes that should be made in future. For example, the age limit for starting saving should be lowered to 18; pension contributions should apply from the first pound of earnings; the self-employed and 'gig economy' workers should be encouraged to save more; and the Government will do further work to assess whether the current contribution rates are sufficient to deliver an adequate income in retirement. The date for changes was suggested as being the 'mid 2020s', and no immediate action is being considered.

Pensions 'freedom and choice'

For people accessing their private pension savings, pensions 'freedom and choice' was introduced in April 2015, a change with significant and widespread implications. Previously, most people with defined contribution (DC) pensions would have had to buy an annuity – from April 2015 this has no longer been the case, with people having more flexibility over how and when they use their funds.

In principle, this means that people can access their pension savings in a way that suits them. While Age UK has welcomed the increased flexibility this offers[iv], it brings with it greater complexity.[v] Many people are disengaged with their pension saving – only half of DC pension savers understood what an annuity is, for example,[vi] and this lack of knowledge can make choosing the right product difficult.

"I didn't seek any advice… because I thought I can do it. I'm not stupid or thick, but when I see that word annuity - I don't know what it means. I can't get my head around it."
FCA/Ignition House, Retirement Outcomes Review interim report

The ‘freedom and choice’ reforms expose people to a range of risks, for example:

- high and/or inappropriate charges;
- underestimating life expectancy;
- withdrawing money too quickly;
- understanding how income tax is applied to pension withdrawals;
- susceptibility to making bad investment choices;
- or even scams.

All these need to be taken into account by individuals as they plan their retirement income – the complexity of the system makes this no easy task.

Furthermore, the industry has failed to develop good value drawdown products aimed at lower and mid-sized savers, meaning choice is still limited and many people – 94 per cent of non-advised drawdown customers – are failing to shop around for a better deal.[vii]

Between 2016 and 2018 the Financial Conduct Authority conducted a major review of the pension freedoms. It found that many people were withdrawing part of their pension (usually the 25 per cent tax-free lump sum) as soon as possible – in their mid/late 50s – and moving the remainder of their pension savings into an income drawdown account with little intention to use it in the foreseeable future.[viii] The FCA identified that many people ended up having their money invested in cash, which is unlikely to be the best strategy to meet their needs, while being subject to potentially high charges. It recommended the creation of ‘investment pathways’ that would link the longer-term aspirations of disengaged savers to an appropriate strategy decided by the pensions company, while allowing those who wanted more control to opt out.

“It’s hard when you don’t know all the whys and wherefores…It’s that crystal ball moment, but you don’t know what’s going to happen, do you? At least I’m better drawing it now than leaving it and snuffing it.”
Age UK, For Love and Money

Others, such as the National Employment Savings Trust (NEST), have suggested that similar default pathways for products should also be established, to help people get better long-term outcomes.

The Government has set up a free service, Pension Wise, to provide people aged 50+ with guidance relating to their pension options. Following its first year of operation, many consumers have found Pension Wise to be delivering a good service.[ix] While this is positive, it is still only reaching about 20 per cent of 55-70 year olds at retirement, and there is no monitoring of outcomes (rather than just satisfaction) following a session.

Policy Position Paper

Private pensions United Kingdom
September 2018

Public Policy Proposals

- The ‘freedom and choice’ reforms must deliver reasonable outcomes, in both the short- and long-term, for all pension savers, especially those who are disengaged or have smaller savings.
- As part of this, the FCA should develop and roll out its proposed ‘investment pathways’ as soon as possible.
- The FCA, industry and Government should build on the proposed investment pathways to develop ‘retirement income pathways’ to help consumers get the most out of the flexibilities. This should include guiding people through suggested products and ensure that people are avoiding unnecessary charged and poor investment choices.
- The annual management charge cap applied to default investment funds, currently set at 0.75 per cent, should be lowered to 0.5 per cent in order to improve value for money.
- Everyone accessing their defined contribution pension should be defaulted into the Pension Wise service in a timely manner, with the ability to opt-out should they not wish to receive guidance on their pension options.
- The Government and the Financial Conduct Authority should work together to ensure that all retirement income products are good value and meet appropriate quality standards.
- The Department for Work and Pensions needs to stimulate innovation in the retirement income product marketplace by allowing NEST, the Government-backed pension saving scheme, to develop and sell its own income drawdown products.
- Data monitoring of the reforms should be improved by the FCA, alongside a regular and substantive review of how the pension flexibilities are affecting individuals. This should include the impact they are having on different age groups.
- We continue to support auto-enrolment. The measures proposed in the DWP’s Auto-Enrolment Review should be taken forward as soon as possible, especially the proposals to help the self-employed save into a pension. The Government should legislate for increased contributions in the next Pensions Bill.
- Everybody automatically enrolled needs to be confident they are paying into a pension scheme that is good quality and value for money. In order to improve governance in contract-based schemes, the role of Independent Governance Committees should be extended to cover what happens once people are accessing and using their savings, and by having stronger powers to require the pension scheme to take action.
- The system of pension tax relief should be reformed to provide better and fairer financial incentives to those on low and modest incomes. This may require a reduction in the tax relief available for those on higher incomes.

- People earning less than the income tax personal allowance and being paid through a 'net-pay' payroll system are losing out on the government contribution to their pension saving. The Government must take immediate action to amend pension tax relief to ensure that all savers are being treated fairly.
- Pension sharing among divorcing couples must be increased, for example by inserting a 'nudge' in the divorce process to encourage people to consider dividing their pensions.
- The Government should resist calls to introduce a market for re-selling existing annuities, which brings serious risks to many consumers, especially those who are more vulnerable.

Want to find out more?

Age UK has agreed policy positions on a wide range of public policy issues. Our policies cover money matters, health and wellbeing, care and support, housing and communities. There are also some crosscutting themes, such as age equality and human rights, age-friendly government and information and advice

Further information

You can read our policy positions here;
www.ageuk.org.uk/ our-impact/ policy-research/policypositions/
Individuals can contact us for information or advice here;
www.ageuk.org.uk/informationadvice/
or call us on **0800 169 8787**

Further information

---

[i] 'Band earnings' means someone's salary between the lower earnings limit of £6,032 and the auto enrolment upper threshold of £46,350
[ii] British Social Attitudes Survey 2016
[iii] Department for Work and Pensions (2018), Automatic Enrolment: Quantitative Research with Small and Micro Employers, Research Report 960
[iv] 87% of respondents said it was important to have flexibility, PPI Briefing Note 72 (2014)
[v] PPI (2015), 'Supporting DC members with defaults and choices up to, into, and through retirement'
[vi] International Longevity Centre UK (2015), 'Making the system fit for purpose'
[vii] FCA (2018), Retirement Outcomes Review final report
[viii] FCA (2017), Retirement Outcomes Review interim report
[ix] DWP/Ipsos Mori (2017), Pension Wise service evaluation: customer experiences and outcomes