A roadmap to adequate retirement incomes for all

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About Phoenix Insights

Phoenix Insights is a think tank set up to transform the way society responds to the possibilities of longer lives. Our particular focus is on pensions and employment. We use research to prompt fresh debate and inspire the action needed to make better longer lives a reality for all of us.

Introduction

In recent times, by far the most well-known – totemic, even – expression of a government's commitment to retirement income adequacy has been the policy of the 'triple lock' on the state pension. But achieving decent, financially secure retirements for people in the UK is about a lot more than that. The Government has committed to a broader review that will "consider further steps to improve pension outcomes…including assessing retirement adequacy".[1]

This commitment to looking broadly at outcomes and adequacy for pension savers is to be welcomed. The growth in pensioner incomes and dramatic falls in pensioner poverty over the past two decades are achievements to be celebrated. The proportion of pensioners in relative poverty has fallen from over 40 per cent in the late 1980s to 15 per cent today. Average pensioner incomes are now comparable to those of working age households, having been a quarter lower prior to the 1990s. But pensioner poverty is on the rise again, and the future does not look so bright.

With the decline of more generous defined benefit (DB) workplace pensions, and a state pension that has been protected by the triple lock but is less generous than other OECD countries, the challenge of being financially secure in retirement has increased substantially, leaving current working-age people at risk. Despite the fact that automatic enrolment (AE) has brought millions more workers into regular pension saving since 2012, a substantial proportion of people look set for inadequate incomes in their retirement.

In this paper, we propose a way forward for the Government's retirement income adequacy review to address this challenge and improve the retirement prospects for future generations.

[1] See HM Treasury's press release: Chancellor vows 'big bang on growth' to boost investment and savings

Understanding the problem

There are two principal ways to define and measure retirement income adequacy that tend to be used in the UK. The first is the 'Target Replacement Rate', a relative measure developed by the Pensions Commission in 2004. This assumes that the median earner will require 67 per cent of their pre-retirement income, the lowest-earning quintile 80 per cent, and the highest-earning quintile (those earning over £61,500 on 2021 earnings) just 50 per cent. The second measure now in wide usage is the Pensions and Lifetime Savings Association's (PLSA) Retirement Living Standards, which are absolute measures, developed using public consultation, and which provide three levels of adequacy (minimum, moderate and comfortable) for both single retirees and couples.[2]

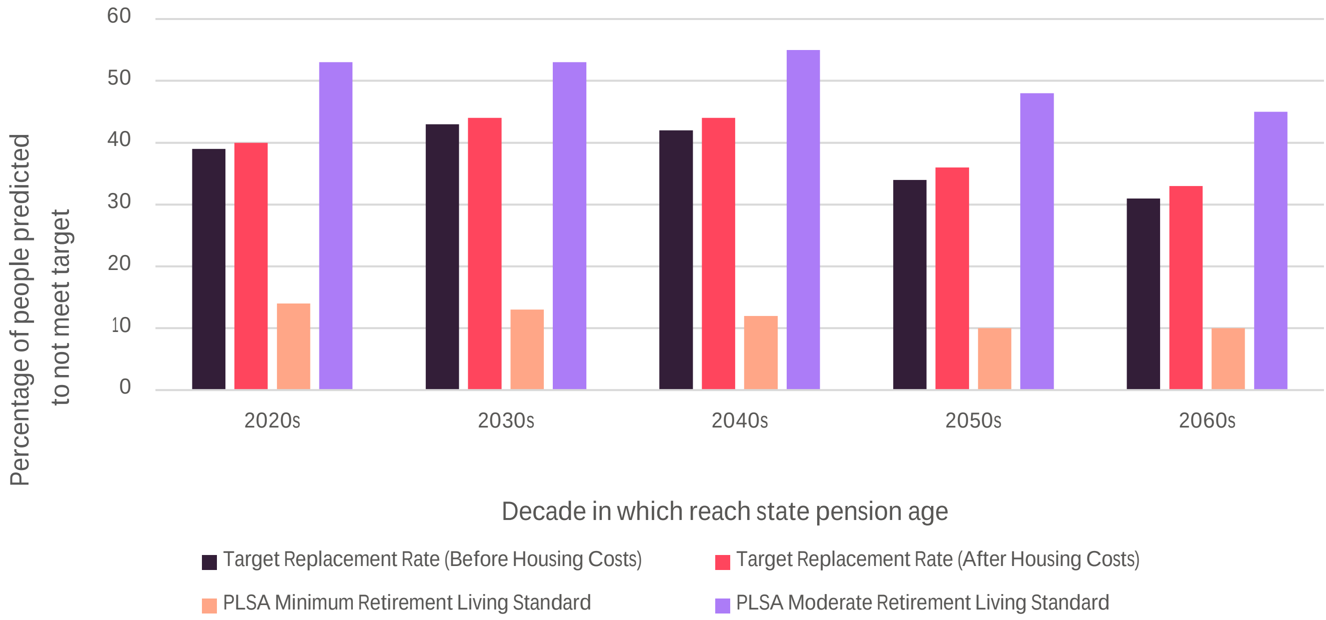
Analysis using either measure reveals significant proportions of people are not on track for decent incomes in retirement. Recent analysis by the Department for Work and Pensions (DWP) estimates that around two in five (38%) working age people in England, Scotland and Wales (12.5 million people) look set to retire on an inadequate income, as measured using the Target Replacement Rate.[3]

As shown by Figure 1 below, which looks at the DWP's predictions for adequacy by decade, the problem looks set to become most acute in the 2030s and 2040s. For people set to reach their state pension age in the 2040s (who would be aged now between 42 and 52 years old), 44 per cent look set to miss their target replacement rate after housing costs. Fully 55 per cent of this group look set to miss out on the PLSA's 'moderate' retirement living standard.

[2] See Pensions and Lifetime Savings Association's website: Retirement Living Standards

[3] Analysis of future pension incomes (Department of Work and Pensions, 2023).

Figure 1: The proportion of working age people projected to have an inadequate retirement income by different measures of adequacy and by decade of reaching state pension age



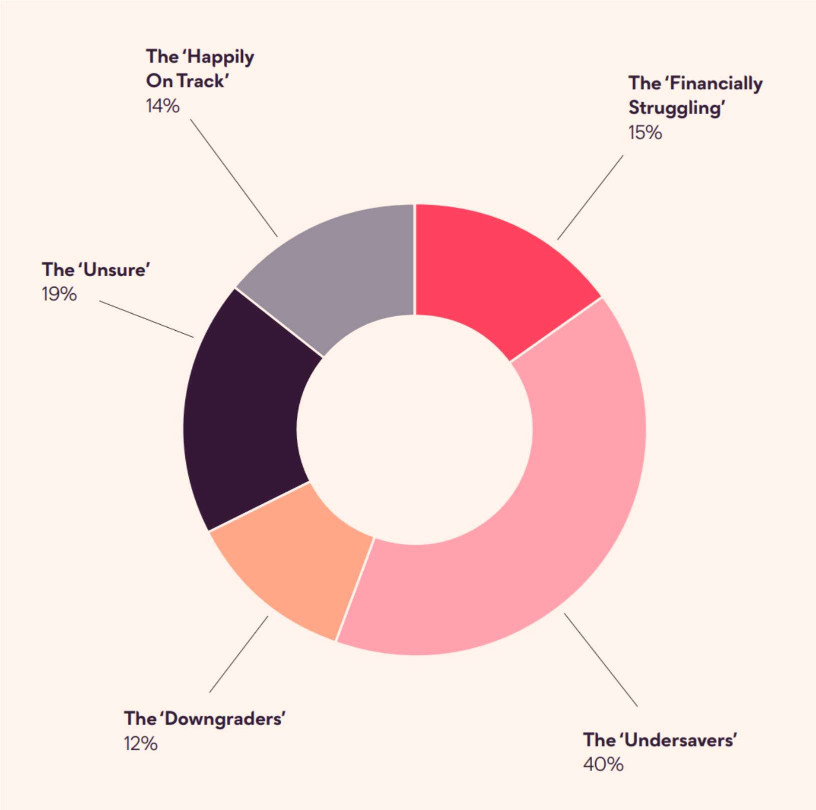
Source: Phoenix Insights' presentation of Department of Work and Pensions Analysis of Future Pension Incomes

The DWP model predicts that the situation will improve somewhat for younger cohorts, a great many of whom will have benefited for most of their working lives from automatic enrolment into workplace pensions, although inevitably the accuracy of future projections (based as they are on assumptions about income growth, interest rates, housing affordability and so on) will be lower for younger generations.

In a research project we carried out in partnership with Frontier Economics, we surveyed UK pension savers aged 25 and over to ask them directly for information about their income and savings patterns, their expected retirement date and their expected retirement income.[4] We found only one in seven DC pension savers were on track for a retirement income that would mean a sustained and adequate standard of living (the 'happily on track' segment in Figure 2 below).

[4] Great Expectations: Are people's retirement income expectations adequate and achievable? (Phoenix Insights, 2022).

Figure 2: Segmentation of the retirement income prospects of DC pension savers over 25



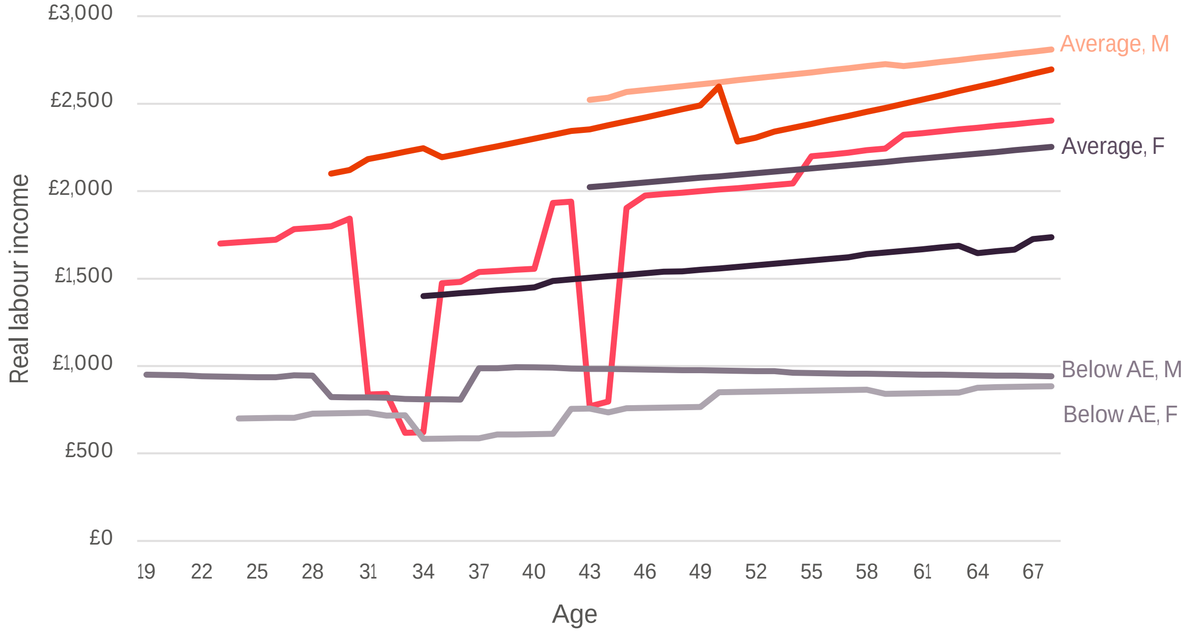
Source: Survey analysis presented in Great Expectations (Phoenix Insights 2022)

We found 15 per cent of DC savers expect an income less than that the PLSA's minimum amount in retirement, a group we have termed 'Financially Struggling'. 40 per cent think they will get at least a minimum income, but in our modelling are not in fact on track to achieve what they expect – we called this group the 'Undersavers'. And 12 per cent of people, the 'Downgraders', are on track to achieve the minimum income standard, but this would mean a material decline in their post-retirement standard of living.

The reasons behind which people find themselves in which segment will of course be complex. Undoubtedly to some extent they will reflect their experiences of financial security and employment over the course of their lives. We have been working with Nest Insight to develop a much more detailed adequacy model based on 30 different life course and household personas[5]. While the full findings are not yet published, Figure 3 below shoes how lower earners often face difficult trade-offs between pension saving for the future and sufficient disposable income today, and also experience irregular income patterns that do not match a simple steadily growing income trajectory so often used in pension adequacy models.

[5] How much is enough? A contextual view of retirement savings (Nest Insight, to be published in 2024)

Figure 3: **Real labour income of seven lower to median earner personas in Nest Insight's upcoming adequacy model**



This figure compares the predicted labour incomes of seven saver personas selected to highlight the disparities in working-life finances. It shows their income from work, in real terms, from their current ages through to age 68. All these personas are at or below median earnings and are eligible for auto enrolment.

Source: Nest Insight modelling using Understanding Society waves 1–13

What is clear from this analysis is that policies designed around median or average earners might not always deliver fair outcomes for all savers.

The lack of flexibility in our work and pensions system to accommodate different career and savings path is arguably a significant contributor to the striking gender gap in pensions saving. The Organisation for Economic Co-operation and Development (OECD) estimates that the gender pension gap in the UK in 2020 was between 34.2% and 40.5% which is over twice the gender pay gap.[6] In analysis we conducted in partnership with the Institute of Employment Studies, we found that women are in fact more likely to contribute to a workplace pension if the impact of different average earnings between genders is removed. Thus, gender differences in earnings are the primary factors that hinder women's pension participation.[7] Women are substantially more likely than men to earn below the £10,000 threshold for automatic enrolment – 35 per cent compared with 11 per cent. Women also tend to be more likely to have stayed outside of the labour market for longer due to social norms to take up care responsibilities, and as the

[6] Towards Improved Retirement Savings Outcomes for Women (OECD, 2021)

[7] Caught in a gap – the role of employers in enabling women to build better pensions (Phoenix Insights, 2022).

Pension Policy Institute (PPI) analysis suggests the decline in earning ability after childbirth seldom recovers[8]. Some women might be actively choosing to rely partly on their partner's retirement income, but this could make them more vulnerable to financial insecurity during events like bereavement and divorce, as well as at higher risk of financial abuse. This is a structural inequality that needs to be tackled together with employment policies.

Looking more closely at one particular group, pension adequacy for self-employed workers looks especially concerning. Analysis by the Institute of Fiscal Studies (IFS) has shown that the proportion of self-employed workers contributing to a private pension has been steadily declining since the 1990s. In 1998, 48 per cent of the self-employed contributed to a private pension, and by 2018 this had declined to just 16 per cent.[9] It is possible of course that this group are choosing to save for their retirement in other ways, but the proportion of the self-employed saving in savings accounts, individual savings accounts (ISAs) and shares has also been declining over the past two decades, so these forms of saving don't appear to be acting a substitute for pension saving.

Finally, no brief overview of future retirement income adequacy would be complete without considering housing costs. The DWP 'after housing costs' benchmark incorporate some assumptions around greater housing costs for certain groups such as renters, but it is hard to predict how the composition of private renters, social renters, owners with mortgages and outright owners will change for future generations of retirees. PPI analysis of Family Resources Survey (FRS) data suggests that, if housing tenure trends among households aged 45-64 today were carried through to later life and all other factors remain unchanged, the total number of pensioner households could rise from 8 million to almost 10 million, of whom around 3.6 million would be renting, either socially or privately, up by 1.9 million from around 1.7 million today[10]. This would constitute a trebling of the share of older households in privately rented homes over the next twenty years (from one in twenty to one in six) and has major implications for retirement income adequacy benchmarks today which do not take housing into account.

All future modelling is based on assumptions and is therefore uncertain. But all the data suggest that the problem of future retirement income inadequacy is real and likely to be significant. As Generation X and the older Millennials approach retirement and begin to retire in large numbers on mainly or only DC pensions and with lower rates of home-ownership than previous generations, higher rates of self-employment, and employment trajectories that often include periods not working, it looks likely that many face a nasty shock that their retirement prospects will not be what they hoped for or expected.

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[8] Technical Report. Every little helps: Should low earners be encouraged to save? (Pensions Policy Institute 2023)

[9] Retirement saving of the self-employed (Crawford and Karjalainen, Institute of Fiscal Studies, 2020)

[10] Renting in Retirement - The Fault Line Below the UK Pension System (Pensions Policy Institute, 2023)

Principles for approaching the Government's review

At the time of writing, the Government has yet to set out details of its approach to its adequacy review. We believe it would be valuable if it approached it with the following principles in mind:

Political, industry, employer and public consensus

The impact of pensions policy decisions is felt far into the future. It is also a policy area where a range of actors have responsibility – present and future governments, individuals as both savers and taxpayers, employers, and the long-term savings industry. The review will have the greatest chance of achieving lasting and positive change if it successfully includes all these voices and makes explicit how it is managing the competing interests, responsibilities and trade-offs between these different groups, achieving consensus wherever possible. A structure for the review that seeks to depoliticise the decisions and seeks actively to engage the public – similar to the approach taken by the Pensions Commission in the early 2000s, could be an effective way to achieve this. Phoenix Insights conducted a major public deliberative exercise into the future of the state pension in particular in 2022-3 in collaboration with the Policy Institute at King's College London, and the final report from this work can provide the review with rich recent insight into how the public are thinking and feeling about our pensions system.[11] The IFS also plan to conduct some public engagement activity in the coming months as part of their ongoing Pensions Review.

Clarity on objective

It will be important for the review to be clear about its diagnosis of the problem and its objectives in solving it. For example, how the review chooses to define adequacy (in relative or absolute terms, through existing or new benchmarks), and whether it sets a goal for minimum or other levels of adequacy for the population will be critical. How it seeks to balance adequacy against other important factors for an effective system such as affordability and fairness, is also important.

Broad but defined scope

Retirement income adequacy is driven by a complex range of interacting factors. We would encourage the review to take a broad scope, incorporating proper consideration of issues such as the challenges many face in continuing to stay in work up to the state pension age, and the implications of housing costs, as well as the state and private pensions systems themselves. Given how DC pension savers now have the responsibility for deciding how to secure and

[11] The Future of the State pension (The Policy Institute at King's College London, 2023).

manage their retirement income, the review should also look at retirement income decisions and decumulation, not just at pensions and savings accumulation.

Investment return and the value for money of pension schemes will also impact on whether people's savings provide sufficient retirement income. Productive pension investment can also boost the UK economy.[12] We expect the first part of the pensions review and the upcoming pensions schemes bill will explore these in detail, rather than the second adequacy phase of the review that is the focus of this paper.

Taking prompt action where possible, and committing to specific further consideration where necessary

There are some decisions that the Government needs to take urgently, because they are required to do so by legislation. A review of the state pension age is due in this parliament, which will need to include making a decision on whether to accept previous recommendations to speed up the legislated increase to age 68, and, with the age due to rise to 67 between 2026 and 2028, the Government will also need to decide what support if any it will put in place for people below 67 who are adversely affected by the age increase. It also has opportunities to act swiftly in other areas, such as in automatic enrolment where legislation was passed in 2023 to enable automatic enrolment to be expanded, but has not yet been implemented. We encourage the Government to ensure that the review facilitates prompt action where possible, and where issues may need further and deeper consideration or evaluation, leads to commitments from Government for that further work to be done.

[12] Phoenix Group has recently worked with think tanks and peers on understanding how to make the UK more attractive to pensions capital and how policies can be adapted to provide more incentives. These include an international comparison of pension fund asset allocation, system changes needed to boost the UK market, and what policy data are needed to inform the debate.

Policy recommendations and roadmap

Without attempting to be fully comprehensive, in this section we set out some of the key policy areas we believe the review needs to include, and our recommendations within them. We also offer a roadmap for how the review and subsequent policy interventions could be implemented.

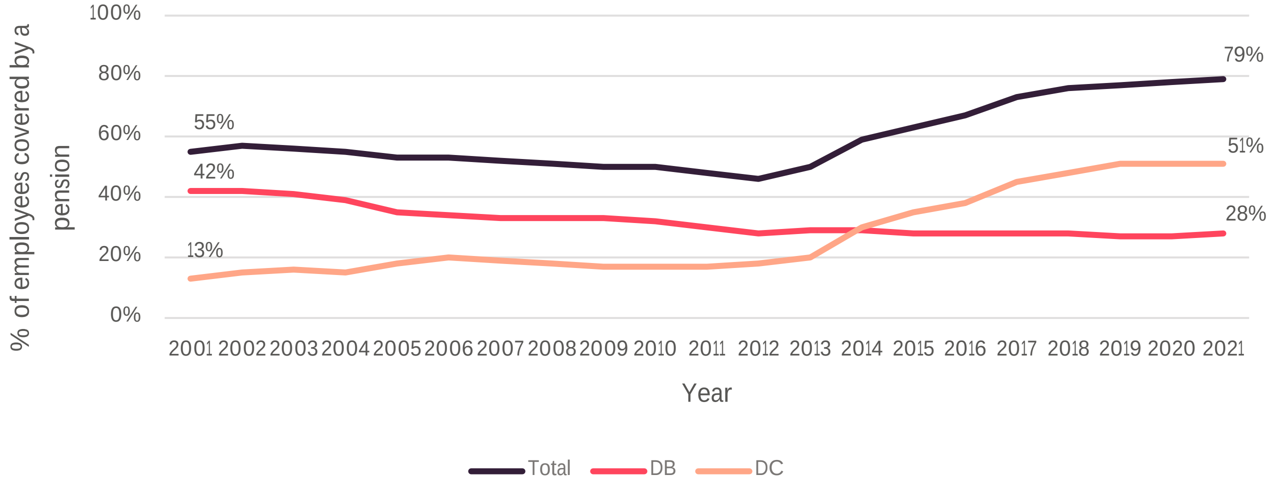
We look in particular at:

- Furthering automatic enrolment
- A more flexible and engaging saving system
- Better support for decumulation decisions
- Employment up to the state pension age
- Align plans for workplace and state pensions

Furthering automatic enrolment

Increasing default contributions into workplace pensions is undoubtedly the single biggest lever the government could pull to increase the amount of private pension savings. Rolled out between 2012 and 2019, automatic enrolment is one of the most successful policy measures in creating saving habits by default. By enrolling people into a workplace pension scheme unless they explicitly opt-out, 79 per cent of employees now contribute to a workplace pension. This is a huge increase from only 47 per cent prior to 2012, as shown in Figure 4 below.

Figure 4: Pension provision between 2001 – 2021



Source: PPI analysis for Phoenix Insights, to be published in 2024

Although more people are now covered by a pension, it still does not always mean they have enough for retirement. Since 2019, the default AE contribution rate has remained unchanged at 8 per cent for people aged 22 and over, earning above £10,000. This is made up of 5 per cent from the employee and 3 per cent from the employer. The decision to choose an 8 per cent contribution rate was influenced by the assumption that people might choose to opt out of pension saving if they felt the rate was too high, and that automatic enrolment would create more engagement from people in their pensions, and so encourage those that could afford to do so to choose to increase their contribution rate. Indeed, the Commission and later implementers of the policy in government at the time fully recognised that 8 per cent was likely too low a level of saving for most people. The Commission estimated that a contribution from private pension saving of 15 per cent would be what the average worker would need to save for a decent retirement.[13] However, policymakers wanted to ensure that the default level could be justified ethically as benefiting everyone (ie that very few low income workers would be oversaving relative to their working age income) and were hoping that most people would be prompted to choose higher contributions if and when they could afford to do so.

In reality, though, rates of workplace pension saving appear relatively static and the hoped-for nudge to opt to save more than the minimum appears not to have materialised. Analysis of pension behaviour over time from the IFS has shown that the share of earnings saved tends not to vary over time, and is generally unresponsive to changes in pay or changes in people's lives such as paying off a mortgage.[14]

Consensus is increasing that automatic enrolment needs to evolve to better address retirement income inadequacy. The 2017 review of AE recommended changes to the qualifying criteria, including lowering the age threshold to 18 and removing lower earnings limit (LEL), aiming to help more people to start saving early and benefit from employer contributions.[15] In 2023, Parliament passed the Pensions (Extension of Automatic Enrolment) Act 2023 to give the Secretary of State the power to make these changes, but it has yet to be implemented.[16]

On increasing contributions, there is consensus across the pension industry that the AE contribution level should increase to at least 12 per cent. [17] [18] Some other bodies including the TUC have even been calling for an incremental increase to 15 per cent.[19] Modelling from WPI Economics[20] estimates that increasing automatic enrolment

[13] A New Pension Settlement for the Twenty-First Century. Second Report of the Pensions Commission (2005)

[14] When and why do employees change their pension saving? (Cribb and O'Brien, Institute of Fiscal Studies, 2023).

[15] Automatic enrolment review 2017: Maintaining the momentum (DWP, 2017)

[16] See Pensions (Extension of Automatic enrolment) Act 2023

[17] See PLSA welcomes further calls for Automatic enrolment reform

[18] Automatic enrolment: What will the next decade bring? (Association of British Insurers, 2022)

[19] See TUC press release in 2023: Plans to expand pensions automatic enrolment are a welcome first step

[20] Falling behind the curve: The costs of delaying an increase in auto-enrolment contributions (WPI economics, 2024)

contributions to 12% could lead to a typical 18-year-old today having an extra £96k in their pension pot at retirement. But the window to act is narrow – delaying the increase by 10 years will reduce the benefit of increasing contribution by £22k. For 45-year-olds today, a group that is at high risk of undersaving, over half of the benefits of increasing contribution will disappear after a 10-year delay.

In making a decision on increasing the minimum contribution rate, and planning a roll-out for implementation, the review will need to consider the cost to employers and individuals, and their capacity to bear that cost. There will also need to be a decision on how the additional contribution will be shared between employers and employees more generally, and how the contribution rate could rise gradually, for example in one per cent increments over time. WPI Economics recently developed a framework alongside a wide range of stakeholders from across different sectors, which sets out a series of tests to determine the economic and financial conditions suitable for contributions to start increasing, set out in Figure 5 below.[21]

Figure 5: A framework of economic tests for the rollout of AE default minimum contribution increases

Decision	Economic tests
Start/go ('starting the journey', whether contributions should begin to rise from 8% to 12%.)	• That these changes are determined as valuable to address pension saving adequacy, and AE opt-out rates are not above a certain threshold (e.g. 20%). • Real Household Disposable Income per person (RHDIpp) has risen in one of the last two quarters. • Vacancies are between no more than 2% and 3% of total employment
Pause ('handbrake', whether increases in contributions should be temporarily paused due to extreme wider conditions.)	• RHDIpp has fallen every quarter for a year. • Vacancies are above 3.5% or below 1.5% of total employment
Wider Considerations (a set of metrics that wouldn't prevent/slow rate increases, but that government should address with wider policy measures)	• High overall employment costs, including those driven by e.g. Employer's NICs. • Rising household debt among low income households • Increased risk of over saving by those on lower incomes

Source: WPI Economics

Key policy recommendations:

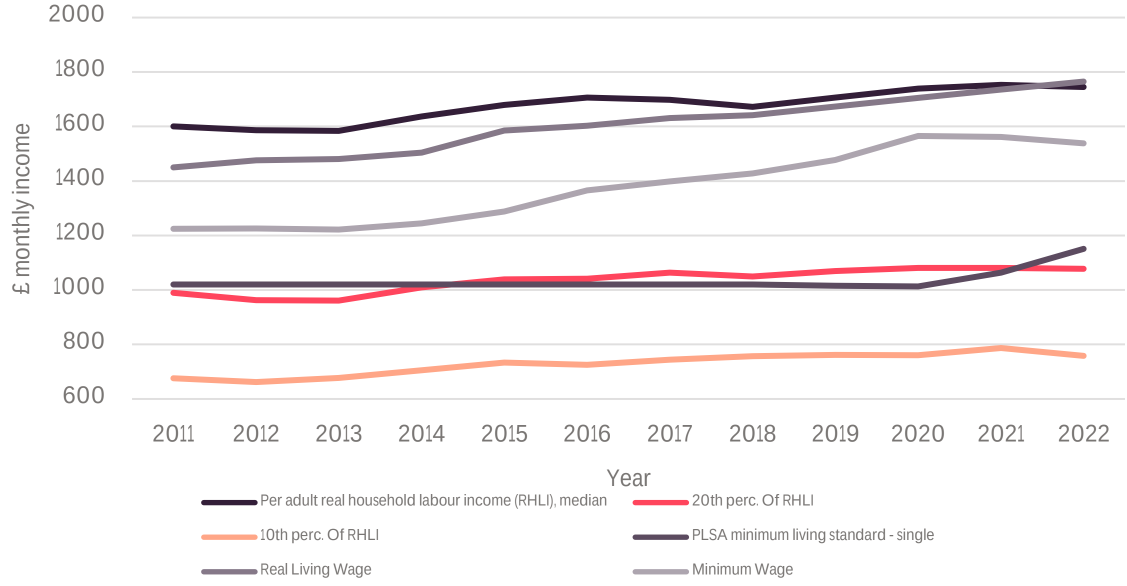
- Incrementally increase AE contributions based on an agreed set of economic metrics
- Reconsider how to expand the qualifying criteria in conjunction with any decision to increase contribution rate

[21] Raising the bar: A framework for increasing auto-enrolment contributions (WPI Economics, 2023)

A more flexible and engaging saving system

The review will also have to consider how lower earners' take-home income will reduce with AE increases and expansion of coverage. Analysis by the PPI suggested that removing the earning trigger and LEL will increase retirement income for most of the low earning population, while worsening the circumstances of approximately 300,000 people during working life[22]. With the age threshold being removed at the same time, it might bring in students who also work, or those who are still at the beginning of their career whose income could be better spent on other short term financial needs such as repaying student loan or saving for a mortgage. The review will therefore have to balance on the one hand the need for most savers to be saving more when they can, and on the other hand the risk of oversaving for certain groups on low incomes or temporary difficult circumstances. Figure 6 presents analysis from our recent work in collaboration with Nest Insight, and shows how for the 10 per cent lowest income working households, their working-age income is significantly below the level of the PLSA minimum retirement living standard, suggesting that saving even at the current minimum rate of contribution could constitute oversaving if it delivers a higher rather than lower income in retirement as compared to working life.[23]

Figure 6: Working-age income as compared to various adequacy benchmarks



Note: The sample include individuals between ages 23 and 66. The benchmarks income measures of statutory minimum wage for over 23's and the Real Living Wage by the Living Wage Foundation are computed based on 35-hour working week. The PLSA standards and the Real Living Wage vary for London versus the rest of the UK. All income measures are adjusted at 2023 prices using annual household expenditure deflator.

Source: Nest Insight analysis of Understanding Society: Waves 1-13

[22] Technical Report. Every little helps: Should low earners be encouraged to save? (Pensions Policy Institute 2023)

[23] How much is enough? A contextual view of retirement savings (Nest Insight, to be published in 2024)

One route through this could be to allow more flexibility in the AE system to account for periods of financial hardship. If contribution rate is going to increase, there might need to be an option for lower earners to 'opt down' back to 8% to avoid pushing up the opt-out rate. Our research with Nest Insight shows that they could still reach the PLSA minimum standard by saving at that rate. Income might also not always stay on a low level, and it will make more financial sense for these groups to resume a higher saving rate when it is more affordable.

There might also be benefit to reviewing the opt-out mechanism. At the moment, opting out from AE happens in an all-or-nothing manner, where not contributing to a workplace pension means losing out on employer contributions as well. While opting out can increase employee's disposable income to get through financial struggles, it is arguably unfair for them to be additionally penalised by their employers stopping contributing at the same time. We recommend therefore that the review should consider requiring employers to contribute their minimum contributions during opt-out.

Another aspect to consider is the re-enrolment process. If employers were encouraged to re-enrol employees annually, this would benefit workers who have taken breaks from their pension saving – something more common among women. Employers should use re-enrolment as an opportunity to re-engage workers if they have taken career breaks or have opted out because of a lack of affordability. It also presents a window for employers to understand the reasons why people may choose not to opt back into the scheme and allow them to act accordingly. [24]

Innovative saving products like side car saving accounts should also be considered to allow people to have rainy day savings when saving for a pension and not feel forced to choose between long-term and short-term saving. These products can work in various models, including allowing savings to be made into an account, with any excess built up over time being rolled over into their pensions. Through years of trials, these products have demonstrated good potential to let low earners start saving more and even into pensions. [25]

Having more flexibility will benefit all savers regardless of income level, but people need to be equipped to make appropriate adjustments. While AE is clearly a powerful and effective policy intervention in creating saving habit, it remains important to also seek to engage people consciously and actively in their pension saving. Our research with Nest Insight shows that there is a strong case for median and above-median earners to increase pension contributions above the default, but most people would oversave or undersave at some point if they stick with the defaults. However, most people are not equipped to make decisions on pensions. Our recent analysis of the British Social

[24] Caught in a gap – the role of employers in enabling women to build better pensions (Phoenix Insights, 2022).

[25] Workplace sidecar saving in action (Nest Insight, 2023)

Attitudes survey in collaboration with NatCen found that 58 per cent of the UK population have low confidence in knowledge of pensions, and 65% said they knew little or nothing about workplace pensions.[26]

It is therefore not surprising that there are estimated to be £26.6 billion in lost pension pots[27], where the providers have no contact with the pension pots' owners. This is usually due to customers changing address without informing their pension providers, or wrong contact details being provided in the first place. These savers might miss out from important communications like annual statements, as well as the opportunity to change fund options or consolidation, which could potentially provide better return. If the situation continues into people's retirement, they even could miss out from entitled payments.

We believe that pensions dashboards should be launched as soon as possible to allow people to have sight of all their pensions in one place, in order to boost public awareness of their potential pension entitlement. Once dashboards are available, they need to be regularly and extensively promoted to ensure people understand how they could be used securely and where they can receive further support if needed.

In the past few years there are also more proposals and debate around whether multiple small pension pots could be consolidated and move with the members during employment in more automated ways and in line with how they are created. The idea is that having fewer pots will make it easier for people to look after their pensions, similar to Australia's experience. To execute that vision, the Government and industry have both proposed various solutions with shorthand names including pot follows member, multiple default consolidators, member exchange and pot for life[28]. We are aware that the Government is planning to further explore these options through the Pension Schemes Bill. While there will likely be considerable long-term benefits in having a more consolidated market and simplified pension system, we expect the implementation of these systematic changes could take a long time and initiatives like Pensions Dashboards or AE reforms should be prioritised in the short term.

[26] Planning for retirement: the pensions knowledge gap and attitudes to working longer (Phoenix Insights, 2023)

[27] Lost Pensions 2022: What's the scale and impact? (PPI, 2022)

[28] Small Pots Cross Industry Co-ordination Group: Spring 2022 report (ABI and PLSA, 2022)

Consolidation of the DC market will also drive value for money (VFM) for customers. As people could be stuck in poor performing schemes that their employer chose, and most will not be moving away from their default funds, improving general VFM will be key to driving up pension outcomes. We expect the first part of the pension review to explore these in detail.

Key policy recommendations:

- Protect lower earners by improving the flexibility of AE, including requiring employers to continue their contribution during opt-out and exploring introducing sidecar products to allow employees to have emergency access to some contribution
- Launch Pensions Dashboards at the earliest opportunity and invest, alongside industry, in their promotion

Better support for decumulation decisions

Since the introduction of 'pension freedoms' in 2015, DC pension pot holders are no longer required to buy an annuity and retirement, and are able to take a proportion of their pension pots out at the current age of 55 tax-free. Our pension system is in a sense now based on two completely contrasting models for how the public are expected to interact with their pensions. AE seeks to protect people from missing out on pension saving by defaulting them into pensions, requiring little or no decision or involvement from them, but at retirement, our system suddenly expects and requires people to take major active decisions in how their pensions are translated into retirement income. Choosing different combinations of the options (buying annuities, drawdown and cashing out) can have a big impact on a person's retirement outcomes, with individuals bearing both their own investment risk and their 'longevity risk' (the risk of not managing your income so that supports you adequately across your whole life). This fundamental problem – how, in a defined contribution pension environment, to make sure people don't outlive their money – has been dubbed by Nobel Prize winning economist William Sharpe "the nastiest, hardest problem in finance".

There is a strong case therefore that good decision-making support and products are needed to help people make the best choices. The Financial Conduct Authority's (FCA) data suggested that only 8 per cent of UK adults (4.1m) have received regulated financial advice. While free, impartial guidance is available through Pension Wise, usage of the guidance service is low. Among those who have accessed a DC pension in the recent years, only 18 per cent have taken Pension Wise appointments[29]. Evidence has shown that people from lower earning households are especially likely making these decisions without consulting any free information, guidance service or financial advice[30].

We therefore need to ensure that advice and guidance services are accessible and affordable. One route could be through pension providers, but many firms are unable to support their customers beyond basic guidance during day-to-day interactions. This is due to existing regulations preventing them from giving tailored personalised recommendations unless it is formal financial advice. The FCA and HM Treasury have recognised this problem and recently consulted on reforming the advice and guidance boundary and introducing a potential new form of service called targeted support. The regulator and Government have not yet published their response to the consultation, but it is clear that more evidence is needed to understand the scale of the impact of decision making without advice or guidance and the difference new forms of support could make to people. At Phoenix Insights, we will be conducting further research through public deliberation to understand the public's experience and views on potential support solutions, including targeted support.

[29] Financial Lives 2022: Key findings from the FCA's Financial Lives May 2022 survey (FCA, 2023)

[30] Pension Freedoms: a qualitative research study of individuals' decumulation journeys (DWP, 2020)

Beyond improving access to information, support and guidance about retirement income choices, we believe there should also be a safety net of defaulting into a 'least worst' decumulation option. The previous government consulted on requiring trustees to offer decumulation default products in certain trust-based schemes, and the proposal is now expected to be featured in the next Pension Schemes Bill.[31] The government concluded that 'an individual should expect to receive a level of help and support from their pension scheme when they wish to access their pension savings'.[32] Their intention was to put duties on trustees of occupational schemes to offer retirement income solutions, including default investment options to their members. Based on same rationale, we think it will be sensible to expand the requirement to other types of pensions as scheme members will have the same expectations. Collecting data once the requirement has been implemented will be important to see if the proposed range of defaults and definitions of these products are working in the best interest of most members.

Key policy recommendations:

- Reform the current advice and guidance regime to service a wider audience, including allowing new solutions like targeted support to emerge
- Clearly define the requirement to offer decumulation defaults and expand to contract-based schemes if benefits could be demonstrated

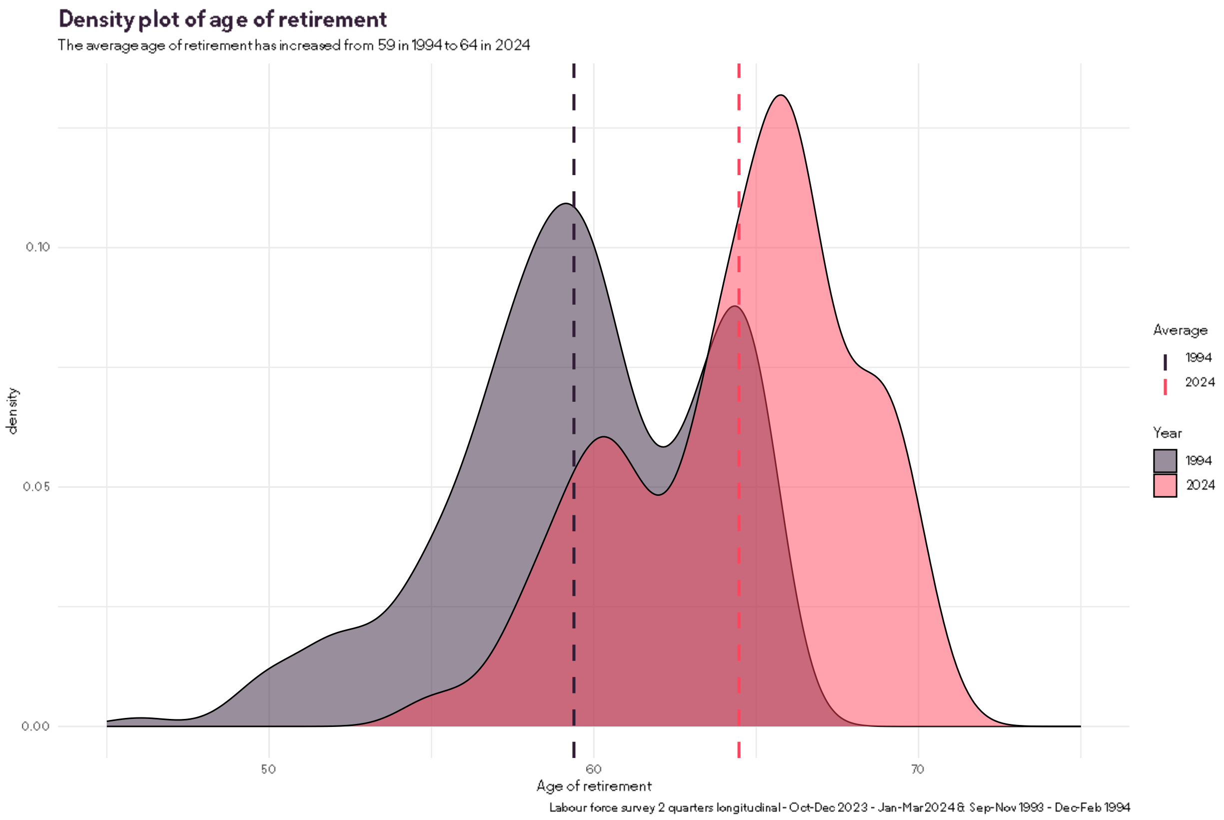
[31] The King's Speech 2024 - Background Briefing Notes

[32] Helping savers understand their pension choices (DWP consultation, 2023)

Employment up to the state pension age

People's ability to save for their pensions during their lives is of course affected by their ability to stay in work in jobs that enable them to save. Figure 7 below shows how retirement ages have changed over the last thirty years, between 1994 and 2024.

Figure 7: Density plot of ages of retirement in the UK, 1994 and 2024



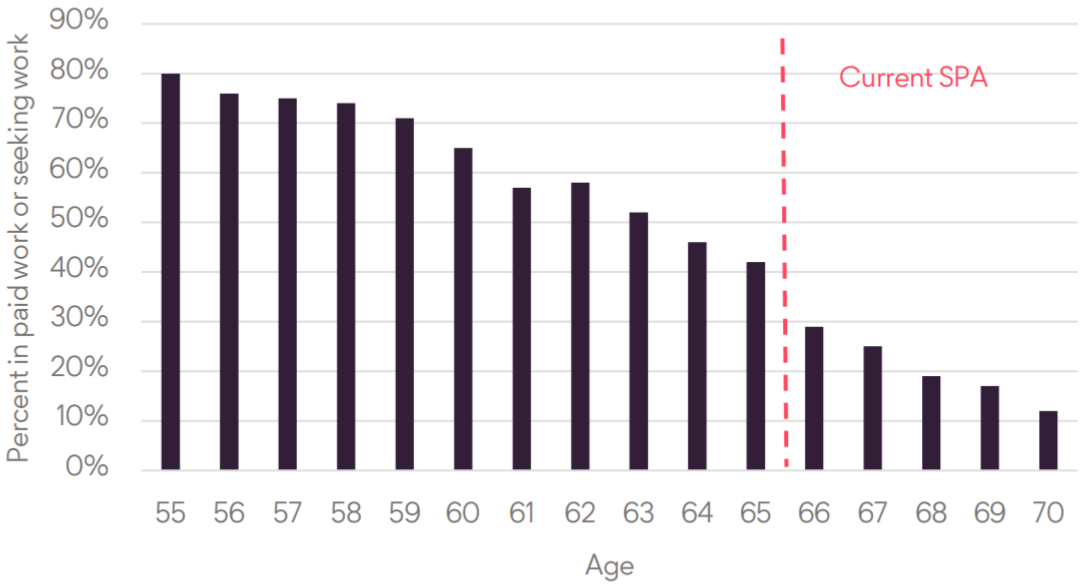
Source: Phoenix Insights analysis of Labour Force Survey data

The state pension age is one driver of this shift towards later average retirement ages. In 1994, the state pension age stood at 60 for women and 65 for men. Many companies at the time were also encouraging early retirement of older workers. By 2024, the state pension has equalised to 66 for men and women, and there is less explicit focus from companies on encouraging early retirement, and default retirement ages where companies were able to require workers to retire at a certain age were made illegal in 2011.

But while retirement ages have been increasing in recent decades, only a minority of workers are still in paid work (including self-employment) or actively seeking work in the year prior to the state pension age, with just over 40 per cent of 65 year-olds in work as shown in Figure 8 below. [33]

[33] Pre-retirement poverty: causes and solutions (Phoenix Insights, 2024)

Figure 8: Employment rate by age, UK



Source: Phoenix Insights analysis of ONS Labour Force Survey data

Re-employment rates of people over the age of 55 who find themselves involuntarily out of work are low. This contributes to a significant and growing problem of pre-retirement poverty which the Fabian Society highlighted in a recent report supported by Phoenix Insights.[34] One quarter of all 60–65-year-olds live in poverty, an increase of 800,000 people since 2012. Over 70 per cent of the people in this age group in poverty are not in work, and 47 per cent live in a household where no-one works.

People who are not working in the decade prior to the state pension age are significantly more like to have started to draw from the private pension. In polling for the Fabian Society research, we found that 55 per cent of 60-65 year-olds and 31 per cent of 55-59 year-olds have already begun to draw from their pension wealth. Of these, 55 per cent are not working, compared to 17 per cent who are still working full-time.

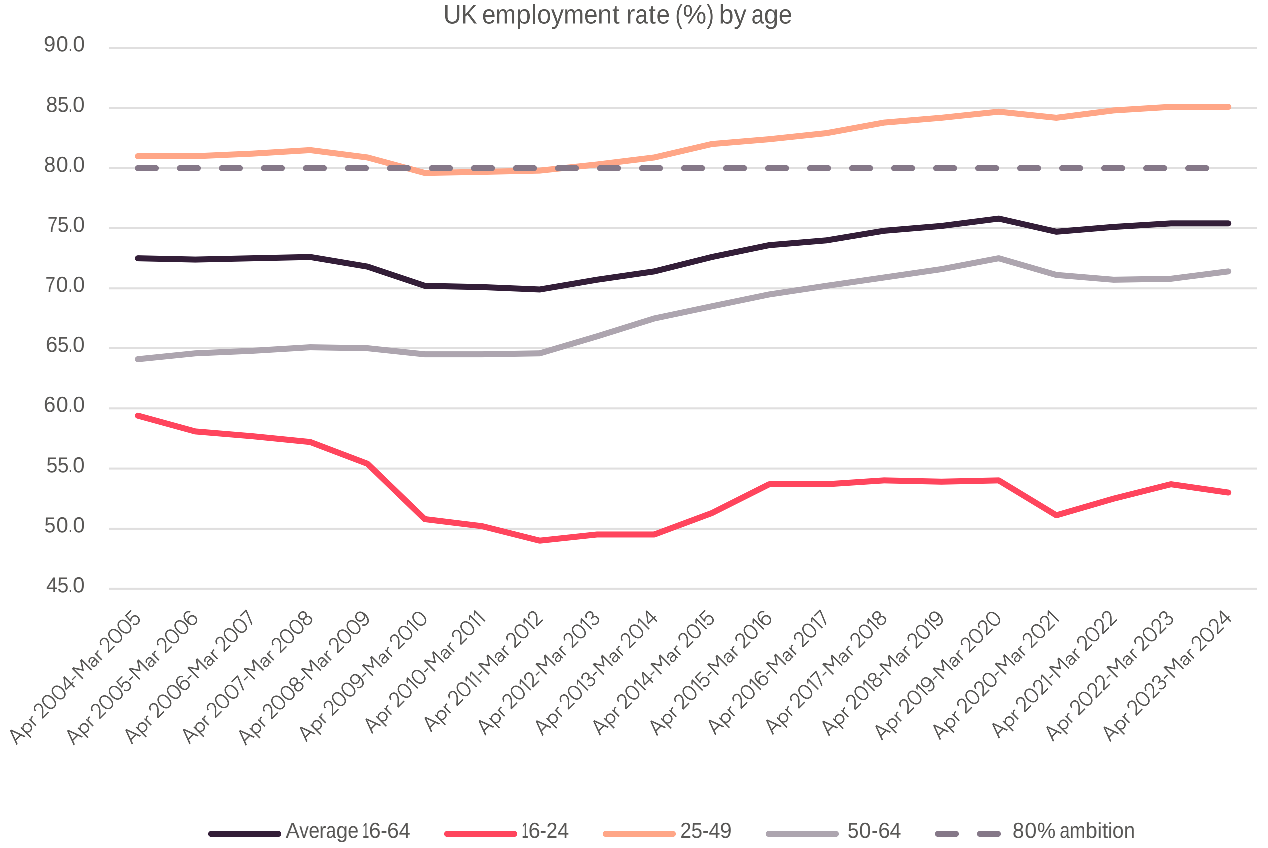
Retirement income adequacy is therefore closely connected to people's ability to remain in good work as they age. The evidence is clear that many people aged over 50 face a range of interconnected barriers to remaining in work including health conditions, caring responsibilities, lack of access to flexible working opportunities, lack of support and advice for career changes, and age discrimination in recruitment processes and in the workplace.[35]

[34] When I'm 64: A Strategy to Tackle Poverty Before State Pension Age (Fabian Society 2024)

[35] See Work | Centre for Ageing Better (ageing-better.org.uk)

The Government has announced its ambition to achieve an 80 per cent employment rate for all working age adults.[36] As Figure 9 below shows, the employment rate for people aged 24 to 49 rarely falls below 80 per cent.

Figure 9: UK employment rate by age group, set against the 80 per cent employment rate target



Source: Phoenix Insights analysis of Annual Population Survey data

Achieving the 80 per cent employment goal will therefore be critically dependent on successful action to increase the employment rate among people aged over 50. For some time now, successive governments have invested in specific programmes and initiatives to support those looking to remain or return to work over 50, which is welcome. These commitments need to be continued and extended if we are to have a significant impact on employment rates for this age group. Three areas of policy intervention are particularly important. The first is the encouragement of good, age-inclusive employment practices, particularly to support workers who need or want flexible working arrangements, or who need support to manage a health condition or caring responsibilities alongside work. The second is expanding access to good quality careers guidance and advice. Our previous research has shown that one of the strongest predictors of early labour market exit is low and declining job satisfaction in the years prior.[37] Research from the OECD has also concluded that providing support for career mobility in midlife and at older ages

[36] See Getting Britain Working - GOV.UK (www.gov.uk)

[37] Beyond the great retirement: Understanding and tackling economic inactivity amongst the over 50s (Phoenix Insights, 2022).

will be crucial to supporting workers to extend their working lives.[38] We recently supported the cross-party think tank Demos on their new report 'Open Door Policy: Why the new government should introduce an Employment Advice Guarantee', which found that while one in three want to access careers and employment advice, only one in seven have used a public service to get advice in the last two years.[39] The third area for policy intervention is in skills and lifelong learning. Access to training and reskilling opportunities declines with age, and more needs to be done to enable workers of all ages to be able to access adult education and training throughout their careers.

Key policy recommendations:

- Develop a cross-departmental strategy to address unemployment and economic inactivity for workers aged 50 and over.
- Promote inclusive employment practices such as flexible work, paid carers leave and support for health and wellbeing across workplaces to nurture an age friendly culture.
- Create a national strategy for careers guidance and advice that is adequately funded and enables universal access to free independent careers support.
- Fully use devolved powers to ensure local skills strategies reflect local need and demographics.

[38] Promoting Better Career Choices for Longer Working Lives. (OECD 2024)

[39] Open Door Policy: Why the new government should introduce an Employment Advice Guarantee (Demos 2024)

Align plans for workplace and state pensions

The state pension age (SPA) and the level of state pension both have a vital role in deciding whether one can have access to an adequate retirement. Currently the state pension is revalued every year and the SPA is due to increase from 66 to 67 from 2026-2028. Another independent review of the timetable for future increases is scheduled to take place within two years. These fixed-term reviews mean the objectives of the changes to the state pension could misalign with the more regular ones in workplace pensions and employment policies, ending up with inconsistent approach towards adequacy.

There are currently some metrics that the reviews follow, but they do not necessarily prioritise adequacy. In the last two independent reviews of the SPA, some recommended key metrics to set the SPA were 1) a fixed proportion of adult life people should expect to spend, on average, in receipt of state pension; and 2) the proportion should be set at 31-32% of adult life.[40] The Government is also required to inform the public of any decisions to accelerate the increase in SPA with a 10-year notice period so they can be prepared. This is mainly to give people sufficient notice to change their retirement plans, including decumulation options and retirement date. However, based on findings in the previous chapter work policies will also need to adjust accordingly to ensure people can work for longer to bridge the income gap. Missing out from one year of state pension will cause a loss of £11,500[41], and many do not have the extra savings to cover the cost. About 14% of those impacted by the first SPA review's recommendation to increase SPA to 68 earlier do not have the means to bridge the gap or confidence to work for longer.[42] It is important that policies across the state pension, workplace pension and work are all aligned to provide a shared adequacy target and same sets of key assumptions including retirement age.

The level of state pension also does not always reflect a specific adequacy target. The Government has committed to maintain the triple lock, which means it is still pegged with earnings, inflation, or 2.5%, whichever is highest. However, the triple lock might not always be sustainable and could be suspended when it is not fiscally affordable, as demonstrated by the previous government in 2022/23. We agree with the IFS's recommendation that there should be a clearer rationale for what target we want to achieve with the state pension to help individual and pension schemes plan their savings and retirement targets.[43] Our state pension system still provides lower replacement rate than most developed countries. Even if we take AE into account, the total replacement rate from both mandatory pensions (i.e. AE and the state pension) is 54.4%, which is still just lower than the EU27 (68.1%) and OECD (61.4%)

[40] State Pension Age Review 2023 (DWP, 2023)

[41] Based on the full rate of new state pension of £221.20 per week in 2024-25.

[42] Understanding the implications of the state pension age review (Phoenix Insights, 2023)

[43] The Future of the State pension (IFS, 2023)

average in the latest data.[44] Again, the review will need to consider AE and the state pension together in considering what role each should play in ensuring retirement income adequacy.

Key policy recommendations:

- SPA review should be conducted with public engagement in mind, to ensure any changes in coverage and level are fair, adequacy and sustainable.
- Use a single set of definition of adequacy across private and state pension policies, especially in defining undersavers and the protection they need.

[44] Pensions At A Glance (OECD, 2023)

Summary of policy recommendations

We need to have a defined set of goals and an action plan to achieve pensions adequacy in the next decade.

Recommended review priorities

1. **Furthering automatic enrolment**
2. **A more flexible and engaging saving system**
3. **Better support for decumulation decisions**
4. **Employment up to the state pension age**
5. **Align plans for workplace and state pensions**

1

- Incrementally increase AE contributions based on an agreed set of economic metrics
- Reconsider how to expand the qualifying criteria in conjunction with any decision to increase contribution rate

2

- Protect lower earners by improving the flexibility of AE, including requiring employers to continue their contribution during opt-out and exploring introducing sidecar products to allow employees to have emergency access to some contribution
- Launch Pensions Dashboards at the earliest opportunity and invest, alongside industry, in their promotion

3

- Reform the current advice and guidance regime to service a wider audience, including allowing new solutions like targeted support to emerge
- Clearly define the requirement to offer decumulation defaults and expand to contract-based schemes if benefits could be demonstrated

4

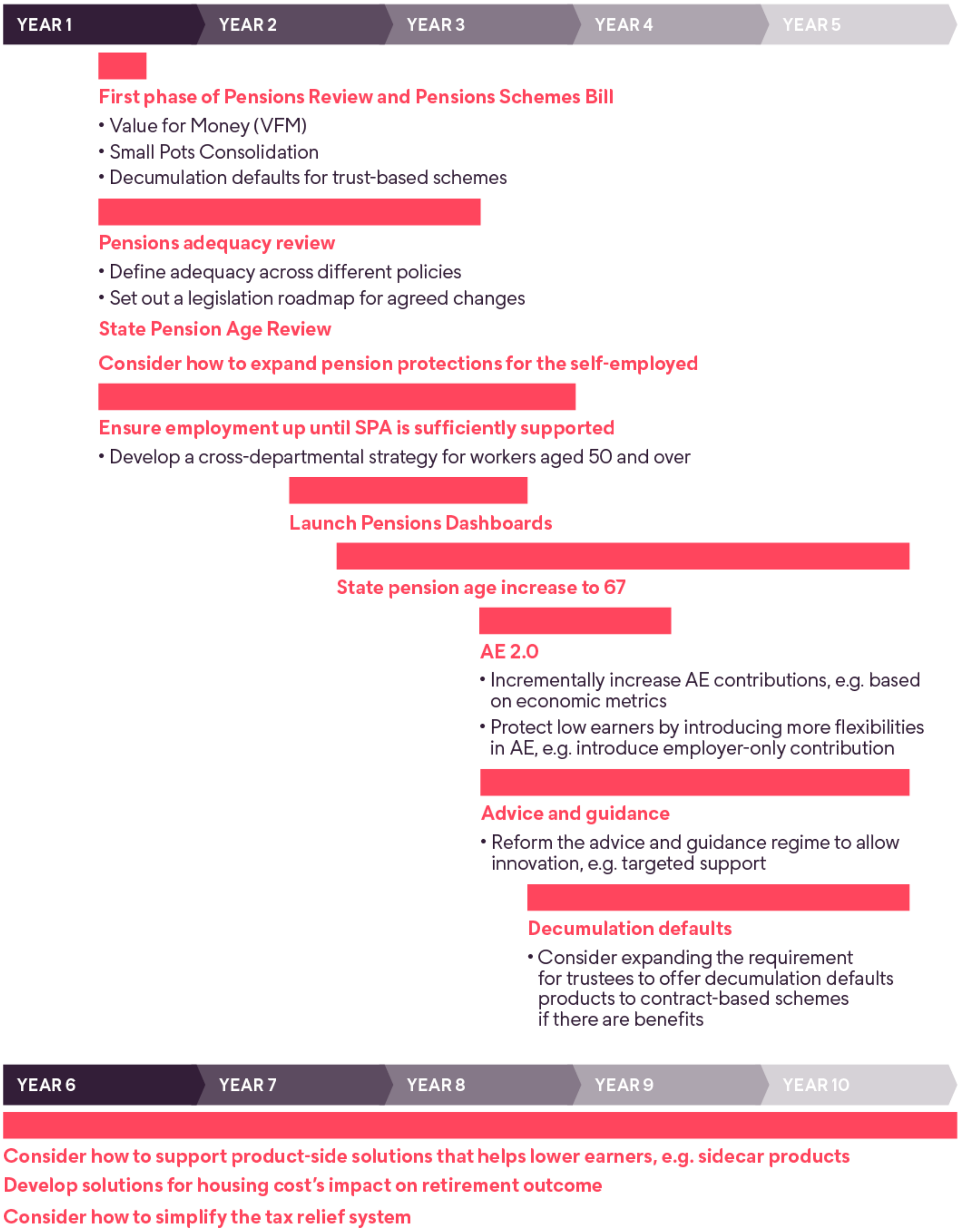
- Develop a cross-departmental strategy to address unemployment and economic inactivity for workers aged 50 and over
- Promote inclusive employment practices such as flexible work, paid carers leave and support for health and wellbeing across workplaces to nurture an age friendly culture
- Create a national strategy for careers guidance and advice that is adequately funded and enables universal access to free independent careers support
- Fully use devolved powers to ensure local skills strategies reflect local need and demographics

5

- SPA review should be conducted with public engagement in mind, to ensure any changes in coverage and level are fair, adequacy and sustainable
- Use a single set of definition of adequacy across workplace and state pension policies, especially in defining undersavers and the protection they need

Roadmap

Implementing the policy options in the appropriate order will be crucial to achieving the desirable outcome of the adequacy review. Based on announced policy changes and policy recommendations based on evidence, we believe implementing the following over the course of 10 years would be practical and effective.



Conclusion

Pensions have long been an area of frequent and significant intervention from governments. Our pensions system today is the inevitable result of layers upon layers of individual policy decisions and interventions, some seeking to address adequacy, some affordability, some fairness and equality. And the time horizons in pensions policy are long. Decisions taken in one decade affect people in the decades to come. It has been twenty years since the last broad and strategic review of our pensions system, and over a decade since automatic enrolment was first introduced. Since then, it has become increasingly clear that that the system is not meeting the needs of a significant proportion of future retirees. Some undersaving groups will reach the minimum age to access their private pensions within the next decade and the window to action for them is narrow. The Government's commitment to a review of retirement income adequacy is an important and much-needed opportunity to make the changes we need to secure decent retirements for future generations.