PENSIONS POLICY INSTITUTE

# Financial Conduct Authority: Intergenerational Differences

## Response from the Pensions Policy Institute, July 2019

1. This is the Pensions Policy Institute' response to the Financial Conduct Authority's (FCA) consultation on Intergenerational Differences.
2. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique as it is independent (no political bias or vested interest), focused and expert in the field, and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.
3. This submission does not address all of the areas of focus of the consultation discussion paper. Rather, the response provides an overview of the findings of recent PPI research which considers how the changing pensions landscape has impacted across different generations and how the industry has been innovating to accommodate these changes.

### The changing nature of workplace pensions offered by employers

4. In recent years the provision of workplace pensions in the private sector has experienced a widespread shift from Defined Benefit (DB) to Defined Contribution (DC). Between 2006 and 2018, the number of private sector DB schemes decreased from 7,800 to 5,450. Within the schemes that remain, the proportion which are open to future accruals and new members has decreased drastically, from 43% in 2006 to 12% in 2018. 46% of DB schemes are closed to new members but open to future accruals, broadly the same as in 2006, when this comprised 44% of DB schemes. Only 12% of DB schemes remain open to both new members and future accruals, compared to 43% in 2006.
5. The introduction of automatic enrolment has further accelerated the shift from DB to DC, with 98% of employers enrolling their employees into DC schemes.
6. While millennials are likely to have higher levels of DC savings when they reach retirement because of automatic enrolment, they are unlikely to have any DB entitlement (unless they work in the public sector, where DB remains prevalent), and so will be entirely reliant on their DC savings (and other savings and assets) to bridge the gap between income from State Pension and adequacy targets. This means they will be more vulnerable to

the risk of running out of money and relying solely on state provision if they make sub-optimal decisions about how to access their savings.

7. More individuals are projected to reach retirement with moderate to high levels of DC savings and no or low DB entitlement due to the changes to workplace pension schemes. This combination of pension entitlement leaves them most at risk of making sub-optimal decisions that can have a significant negative impact on their retirement outcomes.[1]

8. A further potential intergenerational concern is the impact that calls for funding of pre-existing DB schemes can have on younger generations of workers, most of whom will never accumulate DB entitlement but must rely on the retirement income they can generate from DC schemes. This position is particularly difficult where there are no longer any members of the DB scheme employed by the sponsor, and pay, bonuses and pension contributions of current employees are constrained by DB funding payments. This has been described as a clear redistribution from younger to older generations.[2]

### The impact of automatic enrolment on millennial workers

9. Automatic enrolment has increased millennials' likelihood of participating in a pension scheme. By 2015/16 participation in workplace pensions stood at 72% of eligible 22-29 year olds, compared to a pre-automatic enrolment participation rate of 36% (2011/12). This suggests that millennial participation in workplace pension schemes has doubled as a result of automatic enrolment.

10. Having a pension pot generated by saving at minimum automatic enrolment contribution levels leads to better outcomes in retirement than having no private pension savings, which might have been the case for many individuals before automatic enrolment. However, a contribution rate of 8% is unlikely to be sufficient to allow people to achieve an adequate standard of living in retirement. A median earner contributing 8% of band earnings into a pension scheme every year from age 22 until SPa would only have a 50% chance of achieving the same standard of living that they experienced in working life (from private and state pension income). In many cases, people will not contribute steadily for their entire working life, and would require a higher contribution rate as a result to achieve a 50% likelihood of replicating working life living standards.

[1] PPI (2018) *The evolving retirement landscape*

[2] Resolution Foundation (2017) *The pay deficit: Measuring the effect of pension deficit payments on workers' wages*

11. However, minimum automatic enrolment contributions may be a starting point for greater pension savings. A median earner might need to contribute between 11% and 14% of band earnings to have a two thirds chance of replicating working life living standards if contributing between age 22 and SPa. For people who begin contributing later or who take career breaks, contribution levels could be as high as 27% for people to have a two thirds chance of replicating working life living standards.[3]

### Pension freedoms

12. People in the future, who will reach retirement with different combinations of saving and wealth to today's retirees, will face more complex decisions about how to access their retirement savings and how to convert them into an income that will support them throughout their retirement. The extent to which individuals will be able to achieve positive retirement outcomes under the new pension freedoms will depend on the success of policy makers and industry in providing and enabling:
    - Financial education, advice and guidance; and
    - Innovative product solutions to evolving retirement needs.

13. Innovation has the potential to improve the retirement process, helping people to make better decisions and achieve more positive outcomes. However, product innovation may not necessarily be the best or only way to help people to achieve better outcomes as engaged and informed individuals are able to achieve positive outcomes using the existing products. Instead, innovation should be viewed as part of a portfolio of measures aimed at improving saving outcomes.

14. It is likely to be more difficult to ascertain what level of pension savings is adequate under freedom and choice as people can access their savings in a variety of ways, including combinations of different means of access. Although there has been something of a rush to make use of the new options available through the introduction of freedom and choice, the experience of the last four years is not necessarily representative of the decisions that people will make regarding retirement income in the future. Furthermore, we will not be able to evaluate the outcomes of these decisions for some time.

### Intergenerational comparison of pension outcomes

15. The PPI worked in conjunction with the Resolution Foundation to produce projections of future pension outcomes for the Resolution Foundation's Intergenerational Commission. The projections were undertaken to be able to make comparisons between the generations currently comprising the workforce. The results are considered in the Resolution Foundation's

[3] PPI (2018) *The impact of the introduction of automatic enrolment on future generations*

report As good as it gets? The adequacy of retirement income for current and future generations of pensioners[4] and the PPI's report Intergenerational comparison of pension outcomes.[5]

16. Employee membership of pension schemes has increased since the staging of automatic enrolment. This has presented as a significant increase in the membership of DC schemes, particularly amongst Millennials and Generation X. However, DB scheme membership has decreased in successive generations from over 50% of employees in their thirties from the Baby Boomer generation, to around 40% for Generation X and is currently around 30% for Millennials. DB pension coverage is projected to become increasingly dominated by the public sector rather than the highest earners in certain private sectors.

17. These factors have combined with projected developments in earnings such that men's total pension incomes for new retirees are projected to decrease by around £25 per week (from £310 per week) over the next 25 years before recovering to around £300 per week for those retiring towards the end of the 2050s.[6]

18. Women's pension incomes are not projected to dip. The amounts of private pension wealth of current retirees is set to improve as more women in workforce join occupational pension schemes resulting in women's average pension income consistently increasing between each cohort of future retirees.

19. Across the income distribution replacement rates are projected to be better for millennials than Generation X. The biggest increases between these generations are in the middle of the earnings distribution. Generation X, also known as the "Sandwich Generation", will not benefit fully from the introduction of automatic enrolment, unlike those entering the workplace now for the first time, nor will they receive much in the way of a DB pension.

[4] Available at: https://www.resolutionfoundation.org/publications/as-good-as-it-gets-the-adequacy-of-retirement-income-for-current-and-future-generations-of-pensioners/

[5] PPI (2018) *Intergeneration comparison of pension outcomes*

[6] These figures are shown in 2017 earnings terms.