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ASSOCIATION

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THE PLSA

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

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INTRODUCTION

The PLSA welcomes the FCA's discussion paper on intergenerational differences in the way people accumulate and access their wealth. The PLSA feels that the intergenerational lens is a useful way of understanding the needs of savers and is a helpful perspective through which to consider the wide range of challenges that savers of different ages face. Indeed, much of our recent work has focused on exploring the differences in pension provision between different generations.[1]

It is also clear that concern about intergenerational differences is prevalent in contemporary debates. For example, recent work by the Resolution Foundation found that the vast majority of adults in Britain believe that society should provide for older generations, but such provision should be matched by increasing prosperity for each successive generation. Concerns have arisen in recent years, because there is a widespread feeling that generational progress of this sort is no longer occurring.[2]

Given the PLSA's unique expertise in the field of occupational pensions, this is the main focus of our contribution to this debate. However, this submission also sets out work, where relevant, that the PLSA has done on the contribution of property wealth to retirement savings.

[1] See the PLSA's reports *Retirement Income Adequacy: Generation by Generation*, *Hitting The Target: Delivering Better Retirement Outcomes*, and *Hitting The Target: A Vision For Retirement Income Adequacy*.

[2] Resolution Foundation, *A New Generational Contract: The Final Report of the Intergenerational Commission* (2018).

DISCUSSION PAPER QUESTION RESPONSES

1. **Are there other factors driving changes in the consumer needs of different generations (in addition to those we have listed in Chapter 3 of this paper) that we should consider? What are these?**

The FCA's discussion paper identified five drivers of intergenerational change:

- **Demographic Change:** Data show that there are an increasing number of people approaching retirement age (baby boomers) and the life expectancy of those people is rising.

- **Low Interest Rates:** Rates of return have been lower in the last 20 years compared to the previous 20. This influences the ability of savers to accumulate financial wealth, as low rates of return will discourage people, particularly younger people, from saving or investing.

- **House Prices vs. Real Earnings:** House prices have increased more than earnings over the last 30 years and this has made it difficult for aspiring first-time home buyers to enter the property market. As a result, people are entering the market later, often with support from shared equity schemes.

- **Labour Market Changes:** The changing nature of employment has resulted in a growth in more flexible, but often less secure, forms of work. This affects the ability of employees to save.

- **Student Funding:** Changes in student funding mean that people often start working life with a higher level of student debt than previous generations.

The PLSA agrees that these are important factors that have driven changes in the way in which different generations have accumulated wealth. It is worth noting here that evidence[3] shows that the areas in which young people feel most pessimistic about their life chances, compared to their parents, are:

1. **Home Ownership:** 71% believe they are/will be worse off than their parents;

2. **Retirement Prospects:** 61% believe they are/will be worse off than their parents; and

3. **Job Security:** 54% believe they are/will be worse off than their parents.

These feelings correspond well with the FCA's analysis of the impact of the primary drivers identified in the discussion paper. However, we believe that there are other, additional factors that have contributed to the divergent experiences of generations in their ability to accumulate wealth.

Pensions Market: Structural Change

There has been a structural shift in the pensions market over the last quarter of a century. Defined Benefit (DB) pension provision has declined significantly and Defined Contribution (DC)

[3] Resolution Foundation, *A New Generational Contract: The Final Report of the Intergenerational Commission* (2018).

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arrangements, particularly automatic enrolment provision, have arisen in its place. According to ONS data, only 1.1 million people were active members of a DB scheme (this figure includes both open and closed schemes) in 2017. This is a significant fall from even the late 2000s, when some 2.6 million (2008) people were accruing DB benefits.[4] This is in stark contrast to the UK's active DC member membership, which has surpassed 10 million savers as a result of the success of automatic enrolment.[5]

The ongoing transition in the private sector from DB to DC arrangements has clear consequences for different generations. PLSA research into the retirement income adequacy of different generations suggests that DB accrual plays a significant role in building adequate resources for later life. Of those people currently in the work force, 40% of Baby Boomers likely to hit their Target Replacement Rate (TRR)[6] have some DB accrual, as do 72% of Generation X, and 63% of Millennials. Indeed, once DB accrual is stripped out of our population sample as a whole, only 3% of savers in all generations are on track to hit their TRR.[7] This implies that DC-only savers require additional support in building adequate resources and this is an urgent 'need' arising from the structural change in pension provision.

The transition from DB to DC arrangements has also placed greater decision-making pressures on savers at the point of decumulation. This has been reinforced by the Government's Freedom and Choice reforms to the pensions market, which removed the requirement for most savers to annuitise their accumulated pension wealth at the point of retirement.[8]

Consumer research suggests that many people more than six months away from giving up work believe that it is 'scary' to think about how they will manage financially in retirement and prefer to ignore the question until it is entirely necessary to consider it.[9] Inaction and disengagement of this sort can have a considerable detrimental impact on savers' outcomes. This emphasises the need for high quality, widely available guidance and advice services.

To improve the information available to savers of all generations, the PLSA is in the process of developing a series of Retirement Living Standards (RLS), which are due to be released in October 2019. Pitched at three levels – minimum, moderate and comfortable – the RLS will empower people to better understand what kind of lifestyle they can seek for their retirement and offer an innovative approach to helping savers engage with their pension.

The Standards are based on independent real research with real people. They describe a basket of goods and services required to fund a living standard – household bills, food and drink, transport, holidays and leisure, clothing and personal, helping others – and establish associated expenditure levels. They have been designed to act as a practical and meaningful starting point for consumers in engaging with their life in retirement.

[4] ONS, Occupational Pensions Schemes Survey, UK (2017).
[5] TPR, 10 million are in but there is still more to do (2019).
[6] PLSA, *Retirement Income Adequacy: Generation by Generation* (2016).
[7] PLSA, *Retirement Income Adequacy: Generation by Generation* (2016).
[8] HMT, *Freedom and Choice in Pensions* (2014).
[9] LGIM, *Four Pots For Your Retirement: Creating Personalised Solutions* (2018).

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Social Attitudes

Recent research by the PLSA (presented at its Annual Conference in October 2018) examined in depth the attitudes and behaviours of pension savers who started to save for their retirement as a result of the introduction of automatic enrolment ('Generation AE'). This research found that social attitudes in regard to the life course and savings are clear different across the generations. There are three key areas in which these changing attitudes might have implications for consumer needs in different generations, as well as the design and communication of retirement products for both the accumulation and decumulation of wealth.

Firstly, Generation AE has a non-traditional view of retirement. It is seen as less of a cliff-edge than it once was and many believe that they would like to enter retirement gradually by working shorter hours or part-time (either in their current job or in another, less stressful, role).[10] A majority of this cohort acknowledges that the age at which they retire is likely to be unpredictable and they expect to work for longer than those in previous generations.

Secondly, the uncertainty about retirement those in Generation AE feel creates doubt amongst them about whether pensions can be relied upon for retirement. This leads to inaction, which decreases active involvement with AE products and, as a result, the likelihood of increasing contributions beyond the minimum. Contributions at the level of the automatic enrolment minimum, as discussed above, are unlikely to enable savers to achieve an adequate income in retirement.

Thirdly, pension products are not considered to be the premier retirement savings product amongst those in Generation AE. Property is perceived to be the 'new' retirement fund, not to mention a safer and more familiar investment. This indicates that there could be a low level of confidence in pension products amongst those in this generation.

There is also a body of emerging evidence that suggests that people of all generations, but especially younger people, are interested in aligning their workplace savings with their values. For example, surveys suggest that:

- 84% of pension scheme members say they would prefer a pension that uses investments to encourage companies to be more responsible;

- 68% of 25-34 year olds say it is important that people use their money for the good of society and the wider world; and

- Around 50% of people surveyed say they want their pension invested in organisations that reflect their social and environmental views, rising to 55% of the millennial generation.[11]

Although there is no definitive evidence to suggest that savings behaviour is significantly different as a result of consumers' increasing emphasis on ethical investing, this may influence their propensity to engage with their pension savings – particularly amongst younger cohorts, who feel most strongly about investing according to their values.

[10] This is not an entirely new conclusion. The research the Government carried out to support its *Fuller Working Lives* agenda reached similar conclusions.

[11] Share Action, *Pensions for the Next Generation: Communicating What Matters* (2018).

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Technology

The use of digital technology may impact on consumer needs across generations. Different age groups have different levels of familiarity with digital technology. Consequently, digital tools designed to provide financial guidance or advice on mortgages, pensions and consumer credit may not reach all groups of the population. This could affect the ability of some savers to make fully informed choices.

Access to the Internet, which is strongly associated with age, is a good indicator of access to digital technology amongst different age groups. The latest (2016) ONS statistics show that while 88% of people aged 55-64 describe themselves as recent users of the internet, this rate drops to 74% of those aged 65-74 and 39% of those aged 75+.[2] Digital exclusion amongst many older consumers, therefore, represents a clear and present difference in their needs compared to younger savers.

2. **Are there other ways in which the factors we have identified as driving changes influence how individuals from across different age groups build up and access wealth?**

There are two additional ways in which the factors identified by the FCA as drivers of change in the discussion paper are affecting people's ability to build up and access wealth. These relate to real earnings and low interest rates.

Real Earnings

The discussion presented in the paper analyses real earnings in relation to house prices only. In fact, changes in real earnings have a significant impact on the ability of savers to build wealth and assets of all types. After a long period of consistent growth, productivity in the UK (measured as both output per hour and output per worker) flat-lined after the 2008 financial crisis.[12] Alongside sluggish productivity growth, UK wages have largely stagnated since 2008.[13]

Despite the significant impact of the financial crisis, research by the Resolution Foundation found that intergenerational disparities in wage growth appeared before 2008. Growth was lower for those in Generation X than it had been for Baby Boomers and it is lower for Millennials than it was for both Baby Boomers and those in Generation X.[14] Should this poor wage growth continue over the medium-term, it will have implications for the standard of living younger generations can expect to enjoy in retirement.

Low Interest Rates

The discussion paper highlights the decline in annuity sales following the introduction of the Freedom and Choice reforms in 2015. However, the declining appetite for annuities cannot be attributed to policy change alone. Annuities have also become less attractive due to the persistent low interest rate environment that has existed since the 2008 financial crisis.

An annuity remains the only way to turn Defined Contribution pension savings into a guaranteed income for life. To facilitate this, annuity providers buy government bonds to generate stable,

[12] ONS, *UK Productivity Flash Estimate* (2019).

[13] ECB, *Productivity Growth, Wage Growth, and Unions* (2018)

[14] Resolution Foundation, *A New Generational Contract: The Final Report of the Intergenerational Commission* (2018).

consistent returns. However, low interest rates reduce these returns and, as a consequence, it costs the individual more in retirement savings to set up a guaranteed income of any amount than it would in a higher interest rate environment.

3. **To what extent are financial services providers currently meeting the changing needs across different age groups? How could innovation in product design help meet changing consumer needs of different age groups?**

Pension schemes are innovating to meet the needs of different cohorts of savers. The clearest area in which innovation is occurring is in regard to savers' decumulation choices. There are other markets in which product innovation could improve retirement outcomes as people move through retirement, such as the equity release market.

Pension Decumulation

The FCA's recent *Retirement Outcomes Review* (ROR) project found that many non-advised drawdown customers have lost out on retirement income because their pension pots were invested in cash, even though they did not intend to spend their money in the short-term. It also found little evidence of the market coming forward with new innovations that offer the sorts of features – certainty and flexibility – that savers want from a decumulation product over the course of the retirement journey. [15]

These findings prompted the FCA to take action and require contract-based pension providers to offer customers who do not take advice a range of investment solutions that meet their objectives ('investment pathways'). Investment pathways are aimed at savers who, having received the above prompts to take advice or guidance, decide to access their pensions through drawdown without taking advice.[16]

However, innovation has been occurring in the trust-based sector for a number of years. For example, in 2015 NEST outlined a new blueprint for retirement income that was based on a series of guiding principles for designing retirement pathways for the automatic enrolled generation. The blueprint divided retirement into three distinct phases, each of which would benefit from a different strategy and product suite:

1. **Phase 1:** Mid-to-late 60s to mid-70s. This is when savers first start to move out of full-time work and start to need a retirement income. The aim of this stage is to maximise sustainable real income.

2. **Phase 2:** Mid-70s to mid-80s. The aim of this stage is also to provide a steady, sustainably income that keeps pace with inflation. However, the key difference with phase 1 is that money would be locked down and committed to a mortality pool to a to provide a later life income.

3. **Phase 3:** Mid-80s onwards. This phase would be focused on protecting savers from all or most investment risk and longevity risk.[17]

[15] FCA, *Retirement Outcomes Review: Final Report* (2018).
[16] FCA, *Retirement Outcomes Review: Final Report* (2018).
[17] NEST, *The Future Of Retirement* (2015).

This proposal clearly delineates between different age groups of those in retirement. A good example of one scheme that has developed a solution of this sort is Legal and General Investment Management (LGIM). LGIM has designed a proposition that builds on the concept of mental accounting pioneered by the behavioural economist Richard Thaler and others. This concept posits that people tend, and like, to compartmentalise their money and allocate sums to specific ends.[18] LGIM's research identified four distinct compartments ('four pots') that people tend to divide their savings into.

The proposal is grounded on a three-stage process:

1. **Stage 1:** Get members to identify the kinds of things they are likely to spend their money on in retirement (e.g. essentials, such as food, heating, and clothing, and additional extras, such as holidays, emergencies, and inheritances) and how these spending patterns might change as they move between their active and later years of retirement.

2. **Stage 2:** The next step is to consider where the money to pay for this expenditure might come from. There are various resources that those aged 55-65 might have, and this process recognises that people will not make decisions about their DC pensions in isolation. They are likely to have a State Pensions, they might have some DB pensions, and some may be in a position to release wealth from housing. Many people will also have savings in other accounts, such as ISAs.

3. **Stage 3:** With the first two stages complete, savers can then think about how they would like to allocate their DC pensions across the four pots. The choice architecture makes no mention of product options, such as annuities, UFPLS, or flexi-access drawdown.[19]

Proposals of this sort are an effective means of engaging consumers in different age groups with different levels of interest and understanding of pension products. They make the decumulation journey more tangible to savers and enable them to conceptualise the different stages (i.e. age boundaries) of their retirement and what their financial needs might be in each of these.

[18] M. Hersh Shefrin, 'The Behavioural Life-Cycle Hypothesis', in *Economic Inquiry*, 26 (4): 609-643.
[19] LGIM, *Four Pots For Your Retirement: Creating Personalised Solutions* (2018).

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Equity Release

For a significant minority of the population, the purchase of an equity release mortgage could provide them with a useful supplement to their retirement income. However, research suggests that a key challenge for providers has been to develop products that can adapt to changes in consumers' needs and circumstances as they move through retirement. Retirees often experience changing needs as they age and greater product flexibility is required to accommodate changes in circumstance.[20]

Considerable progress has been made to offer products with greater flexibility. However, further efforts in this area would help to ensure that equity release products have genuine long-term suitability and avoid limiting their potential as a vehicle for later life finance in the new retirement landscape.

In particular, reducing minimum loan amounts to enable savers to take small sums to supplement income from other sources could improve the uptake of equity release mortgages. Moreover, product innovation that makes it easier to transfer equity release mortgages to new properties, particularly for those who require long-term care, would help to satisfy customers' changing needs as they move through retirement.[21]

4. **Are there any barriers (including FCA regulatory barriers or barriers to competition) that are adversely affecting access to, and use of, financial products that would meet new and changing consumer needs? Are these affecting particular age groups? If so, in what way? How should we address these while ensuring consumers still receive an appropriate degree of protection?**

No response.

5. **Is there anything more that we could do to encourage and enable positive innovation in these sectors, or to enhance competition in the interests of consumers?**

No response.

6. **Is there any market or firm behaviour that causes or may cause potential harm to consumers? For example, is industry failing to recognise varying needs of consumers from different age groups and as a consequence, of this:**
   - **offering products which may be unsuitable to certain age groups.**
   - **excluding, discriminating against, or failing to advance equal opportunity between certain age groups for no legitimate and objectively justifiable commercial reason (or where the reason is potentially legitimate but the approach is not proportionate).**
   - **otherwise treating certain age groups unfairly?**

No response.

[20] L. Overton, *Equity Release Rebooted: The Future Of Housing Equity As Retirement Income* (2018).
[21] PLSA, *Hitting The Target: A Vision For Retirement Income Adequacy* (2018).

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7. Are there areas related to intergenerational issues which fall more appropriately to Government or another public body, but in which, in accordance with our objectives, we can play a role? If so, which ones and in what way?

The labour market issues highlighted by the discussion paper naturally fall within the remit of the Government. Although product providers can develop suitable pension savings vehicles for those in non-typical forms of employment (e.g. multiple job holders, gig economy workers, etc.), they cannot, of themselves, enrol people into them. The fact that a growing proportion of workers, such as multiple job holders, may not meet automatic enrolment criteria is not an issue pension schemes and providers can fix. The PLSA supports non-typical forms of work being included in the scope of automatic enrolment.

Moreover, meeting health care costs in old age is an increasing worry for people. The discussion papers mentions this issue in passing, but does not explore it in depth. Health care costs, particularly those related to social care, are likely to be of some concern to baby boomers and but is we expect such concern to increase for younger generations, as longevity improves (but healthy longevity does not increase at the same rate.[22]

In addition, the discussion paper assumes that younger generations will benefit at some point from an inheritance. However, if family wealth is reduced due to the need to meet health and social care costs, this is likely to reduce the wealth younger generations will have access to. We believe that there needs be a concerted joint government and industry focus on how to support the elderly more effectively during this final phase of their life, with a view to the government setting a more sustainable policy supplemented with appropriate insurance/saving products from the financial markets.

[22] For more information on longevity issues, please see the PLSA/Club Vita report Longevity Trends: Does One Size Fit All? (2017).

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