cushon

It's time to modernise pensions

Delivering pensions that savers actually want

A research paper by Cushon
May 2023

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Foreword

Baroness Ros Altmann,

Former UK pensions minister

Over the past few years, the overriding message coming from pension savers in this country has been getting stronger and stronger: **it's time to simplify retirement savings.** Savers just don't get it – and therefore they don't engage.

It's time to simplify the rules. It's time to simplify the regulations. And it's time to simplify the language.

I'm a huge believer in the importance and value of pensions – and I believe the principle of incentivising employees to save for retirement is the right one. Pensions offer a fantastic way for employees to benefit from 'free' money from both the state and from their employers, and to see this money grow over time. But the complexities around pensions are getting in the way of this core message – and making it hard for people to connect with their pension pots.

This is not a new finding. For years the Government, the pensions industry and employers have all grappled with the problem of how to get employees to engage with their pensions. But to be frank, they have not helped themselves. As Cushon's research shows, people remain just as confused by pensions as they ever have been. They see it as a place filled with complicated rules and confusing jargon – and they're not wrong!

So, why has this problem persisted? For a long time now, the pensions industry has been too inward-looking and Government has made decisions without fully consulting the people who really matter: pension members. This has created a disconnect between what people want from their pensions and what their employers are offering. Employees want simple pensions, that are easy to understand and which align with their personal values.

But successive governments have been far too fixated with "tinkering at the edges" with never ending policy changes, that have created a baffling maze of complexity that stops employees connecting with their pensions and engaging. Only by listening to what people want will we be able to get people to connect with their pensions throughout their working life and therefore help more employees have enough money to secure a comfortable retirement.

Time for a fresh start

Steve Watson,

Director of Policy & Research at Cushon

Pensions in the UK are in urgent need of an overhaul.

Over the past 20-plus years, the country's pension system has come to resemble a mass of mismatched parts, bolted together by successive Governments without a cohesive strategy. The result is an assembly of confusing language (e.g. net pay arrangements) complex rules (e.g. tapered annual allowance) and unintended consequences (e.g. small pots), that has served to present the people that really matter – pension members – with a bewildering proposition.

The result?

- **Employees don't understand their pensions**
- **Employees don't engage with their pensions**
- **Employees don't save enough into their pensions**

It doesn't have to be this way. Saving for retirement should be simple. We don't proclaim to have all the answers – but we are certain that if we were to sit down today and design a totally new system for people to save for their retirement, it wouldn't look anything like what we have today.

The time has come for the Government to act. But rather than tinkering around the periphery, which inevitably ends up adding even more layers of rules and complexity, it's time to take a holistic look at the current system with a view to real simplification.

It's time to modernise pensions and put the voice of the saver at the heart of these reforms.

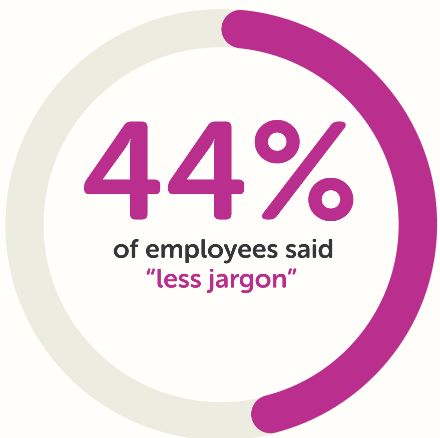
Five problems with the UK's pension system

Our research has identified the following problems with the UK's pension system:

- Problem 1: Confusing language
- Problem 2: Complex rules
- Problem 3: Increasing number of members with multiple pension pots
- Problem 4: Savings restricted to the long-term
- Problem 5: A failure to consider what members want

1. Confusing language

What do you think would increase your engagement with your pension the most?

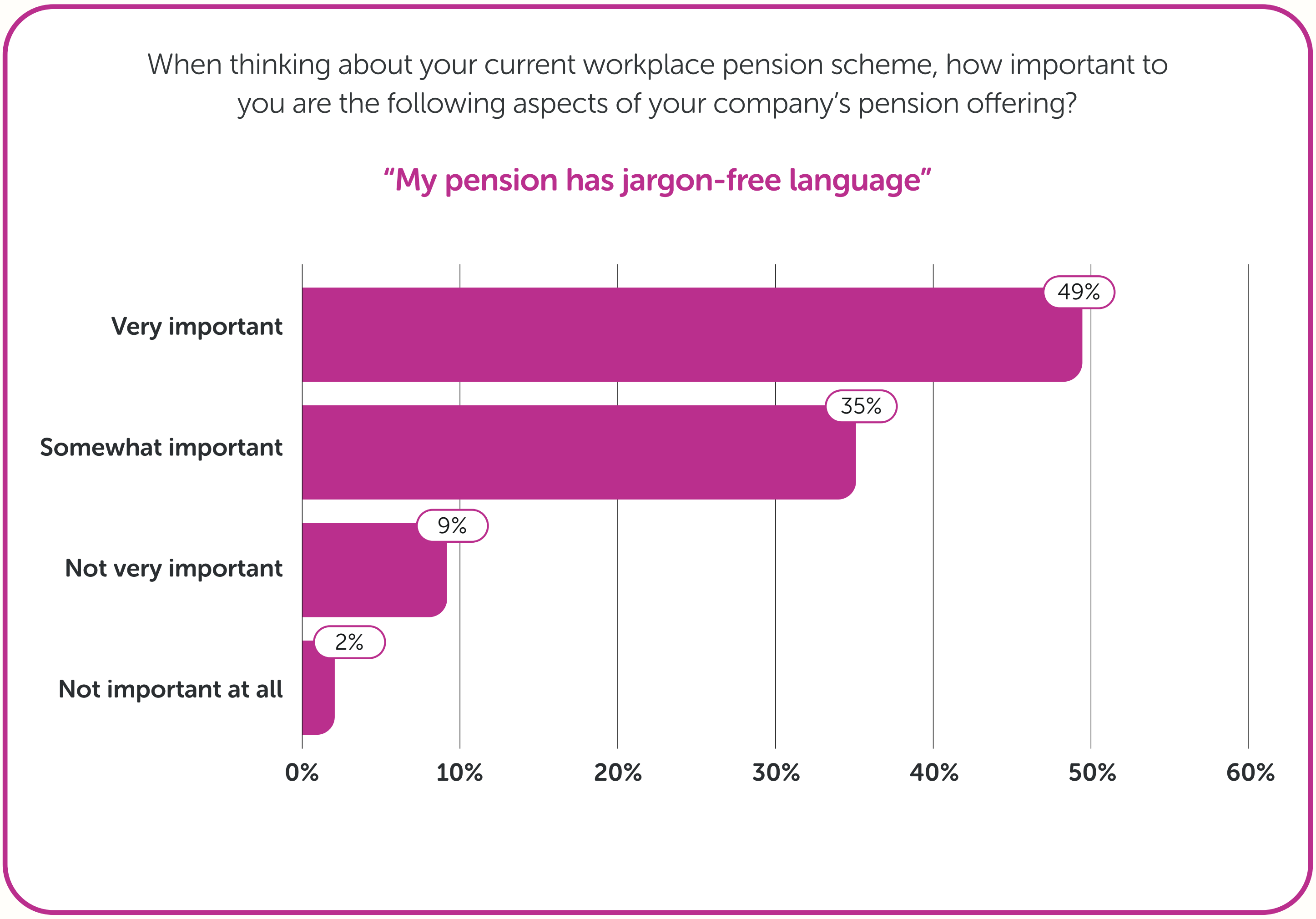


Pensions have a longstanding reputation for being complex and hard to understand. And the reality is that unfortunately, much of this reputation is deserved. In particular, the language used around pensions is often highly confusing and this, more than anything, provides a huge barrier to understanding. Ask any member of the public to explain the meaning of terms such as 'qualifying earnings' and 'pension commencement lump sum' and they will likely look at you as if you are speaking a foreign language.

For years, employers have bemoaned low levels of employee engagement with their retirement savings. And yet the industry and regulators have done very little to address this – including simplifying the bewildering array of expressions, and terminology used across the industry. It's this technical jargon that acts as a massive barrier to understanding.

The results of our research confirm that pension members find the language used around pensions far too complex and difficult to understand. When asked to consider what features make a 'good' pension scheme, for example, employees' number one choice – selected by more than half (51%) of those surveyed – was the use of "no jargon and plain English". What's more, well over eight in ten (84%) respondents tell us it's important for them that their "pension has jargon free language".

Figure 1.1: The importance of jargon-free language in pensions



The solution

The solution is straightforward: the industry must ditch the jargon littered throughout pensions and explain its concepts in plain English. But it must do this in partnership with pension members. They must ensure the language they use is understood by the people that matter – employees.

In recent years, for example, the Pensions Regulator attempted to simplify some of the jargon around auto-enrolment eligibility. The result? It changed the terms 'Eligible jobholder' and 'Entitled worker' for 'Type 1 employee' and 'Type 2 employee', respectively. Essentially, it changed one piece of jargon for another.

It's also a great example of tinkering around the edges. The fact is, without an overhaul of the entire system to make it simpler, we're never going to be able to explain pensions in language that everyone can understand.

The Government's proposed 'Value for Money' framework touches on communications, but it mentions nothing about the need for simplification and using communications to raise member understanding. Yet it's member understanding that leads to engagement – and so we believe this needs to be included as a real measure of success.

2. Complex rules

Around two thirds (64%) of employees say that pensions are too complicated

Over the last 20-plus years, the pensions system in the UK has seen the introduction of a raft of different schemes and rules – very few of which have stood the test of time. In 2002, for example, the Government introduced the State Second Pension Scheme – only to abolish it 14 years later. We have seen similar 'tinkering' with the lifetime allowance. When it was introduced in 2006, individuals were limited to saving a maximum of £1.5 million into their pension pots tax free. In the intervening years, the Government tweaked the limit several times – raising it as high as £1.8 million in 2010 and reducing it down to £1 million in 2016. Then, in this year's Budget, the Chancellor announced that the lifetime allowance is going to be scrapped altogether.

All this meddling serves to create discontent and confusion among pension members, eroding trust in the whole pension system. When the rules are constantly changing, how can employees possibly plan for a retirement that may be 40 or even 50 years into the future?

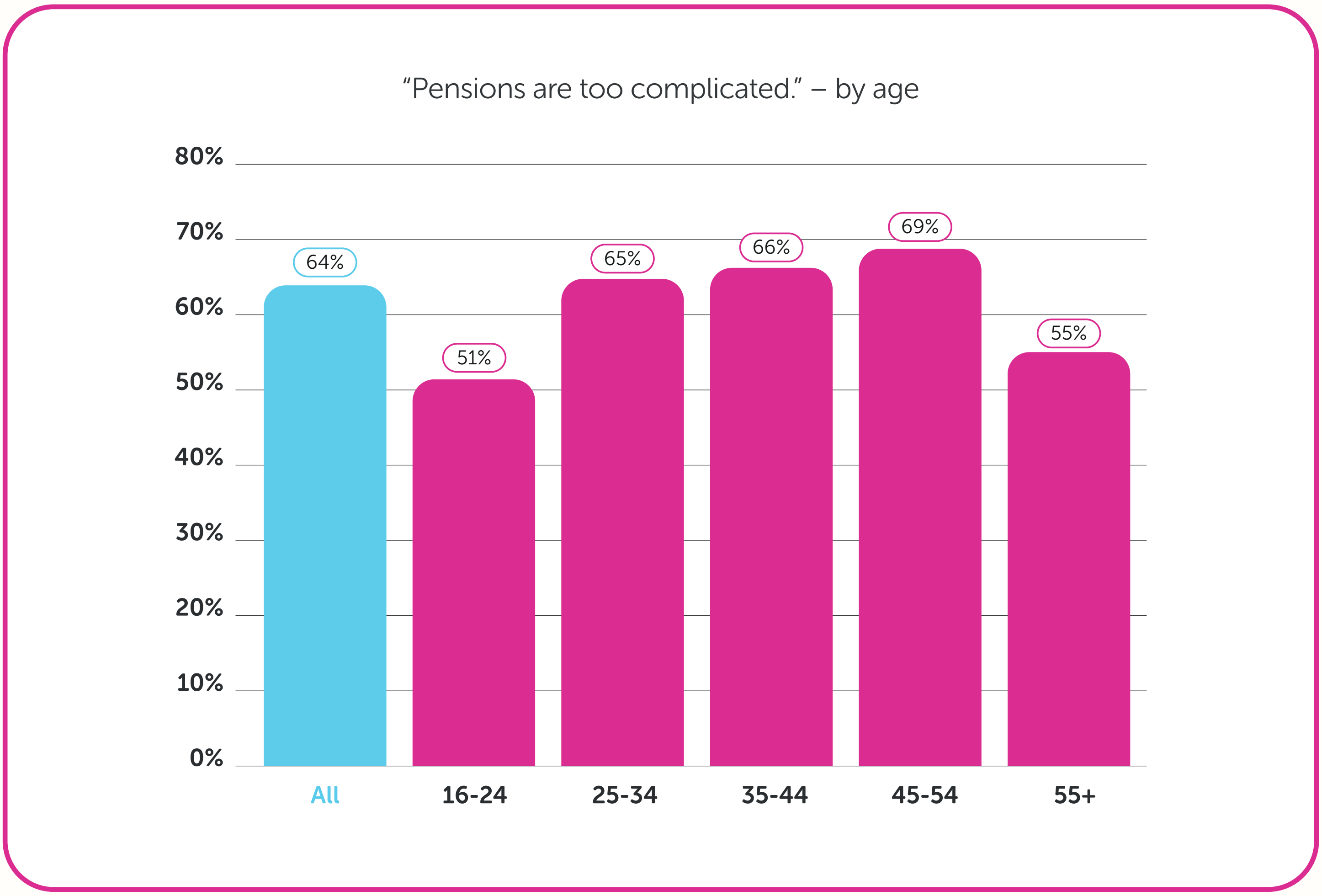
Even the Government's one big success in the last few years – the introduction of pension auto-enrolment – has been compromised by a set of complicated rules and restrictions. Again, the Government could have created a simple scheme, with universal eligibility and straightforward rules on contributions. Instead, employees – and employers – have to navigate a complex system of age limits, qualifying earnings triggers, and jobholder eligibility rules.

The Government could have created a simple scheme, with universal eligibility and straightforward rules on contributions. Instead, employees – and employers – have to navigate a complex system of age limits, qualifying earnings triggers, and jobholder eligibility rules.

Given this, it's no surprise that employees tell us they are confused by the rules surrounding their pensions. Almost a third (29%) of employees say they "don't understand how their pension works or how much they have saved", while almost half (48%) believe that a 'good' pension scheme needs to be "more easily understood". And well over eight out of ten (84%) employees believe it's important for them to receive "greater education on how their pension works".

It's not even the case that employees' understanding of their pensions grows as they get older and move closer to retirement – among our respondents, it's employees aged between 45 and 54 who are most likely to say that pensions are too complicated.

Figure 2.1: Pension understanding does not improve with age



The solution

No other savings vehicle works like a pension – it's far more complicated than any other product out there. People are happy to pick and choose their own bank account, or to research mortgages when buying a home. But the rules around pensions can make them seem impenetrable – and so people are unwilling to engage with them.

Again, it does not have to be this way. Pensions, as a concept, are very simple: employees, their employer and the Government put money in; the money is invested; and, at retirement, employees can take the money out. We need to get this basic message out to the general public – but first, we need to remove all the obstacles that currently stand in the way.

Complicated eligibility thresholds could be easily overcome by opening auto-enrolment to everyone, regardless of their age or earnings. Complex guidelines around 'qualifying earnings' could be surmounted by simply treating all of an employee's pay as pensionable. And difficult rules around tax relief could be avoided by instead giving employees a 'bonus' on top of their contributions, in a similar way to a Lifetime ISA.

Nothing is perfect, of course – but the current UK pension system needs an overhaul – Government needs to make it a lot simpler.

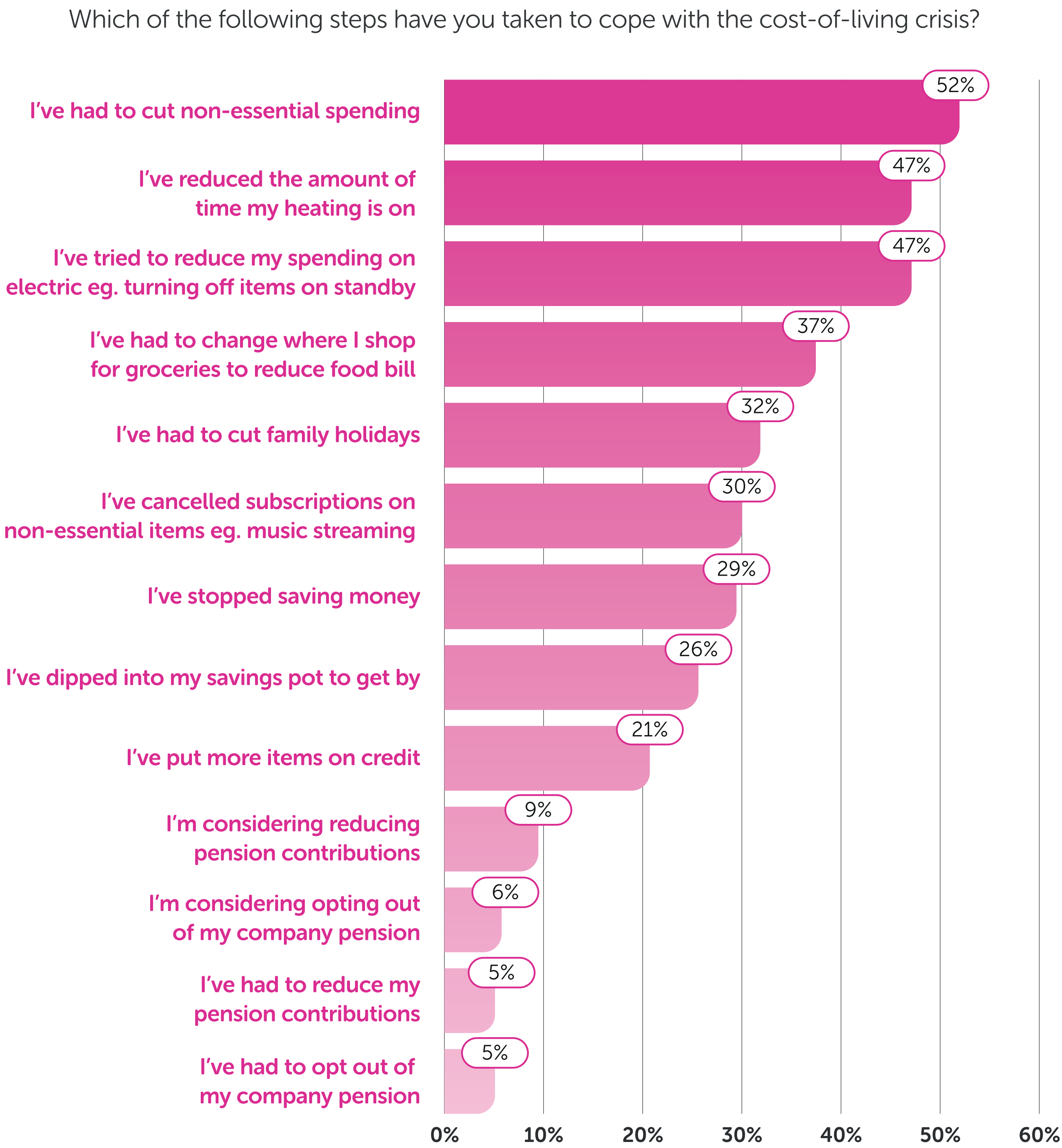
Pensions are viewed as important

It's encouraging to see that – despite not always fully understanding their pensions or believing that they fully meet their needs – most employees still see the importance of saving for retirement. This is evident in two important findings from our research.

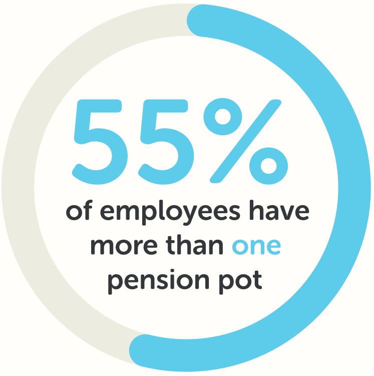
First, nearly **eight in ten (78%)** employees say that "a company's pension offering is important to them when looking for and choosing a new job". And second, employees were largely reluctant to stop or reduce their pension contributions to help them cope with the cost-of-living crisis. While **more than half (52%)** said they have had to cut non-essential spending, for example, and **large numbers have cut spending on family holidays (32%) and cancelled TV and music subscriptions (30%), just one in 20 (5%) employees have reduced or opted out of their company pension.** Indeed, less than one in 10 respondents told us they had even considered reducing their pension contribution **(9%)** or leaving their scheme altogether **(6%)**. It's positive to see that the numbers opting out remain low, even in the face of soaring day-to-day living costs, yet if the economic situation worsens and people do not see the value in their pension these numbers could well rise.

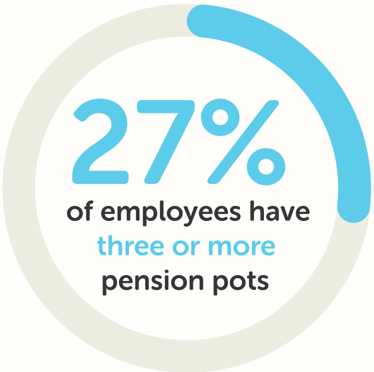
It's clear that the issue of low engagement levels is not about convincing employees of the importance of long-term savings. The challenge is getting them engaged and a good start might bet giving them a product that actually meets their wants and needs.

Figure 2.2: Pension contributions have remained resilient through the cost-of-living crisis



3. Increasing number of members with multiple pension pots





The idea of people having a 'job for life' has become a somewhat outdated notion in the last 20 to 30 years. It's now commonplace for people to switch careers several times throughout their working life – and, as a result, they often accumulate several different pension pots along the way.

According to the Pensions Policy Institute, there were around eight million deferred pension pots across the UK in 2020 – and this could rise to some 27 million by 2035.

Our research backs this up. Less than half (45%) our respondents have just a single pension pot – the rest have several, collected from different jobs over the years. Just under a quarter (23%) of employees have two pots, but some have as many as ten in total.

The Government is currently conducting a long-overdue consultation with the pensions industry about how to solve this issue of multiple pension pots, but it has disappointingly limited the scope to 'small pots' – the definition of which is yet to be clarified. What has been missed is that the issue of multiple pots is not about pot size, it's about the complexity of the transfer process. Simplify this process and more people, regardless of pot size, will consolidate their pots and bring their money together.

Our research shows that around two-thirds (65%) of employees with more than one pension pot would prefer to have all their different pots in one place. Once again, however, we are seeing a disconnect between what employees want from their pension and what employers think they value. When it comes to selecting a pension provider, for example, less than a third (32%) of employers believe it's important to consider how easily employees can transfer their previous pension pots.

So, while we welcome the Government's consultation, we are concerned that it will not directly address the needs of all pension members. Indeed, we think there is a very real danger that any reforms implemented because of the consultation may end up being more complicated than the problem they are designed to fix. Let's not forget that, although the number of small pension pots out there is huge, the total amount of money saved in these pots is relatively small. The Association of British Insurers found that there are over 2.2 million pots worth less than £1,000 currently being held within contract-based pension schemes , for example. By devoting so much time and energy to developing a complicated solution, the Government may be attempting to crack the proverbial nut with a sledgehammer.

The solution

Our proposed solution here is twofold.

First, if someone leaves a job with a small pension pot, they should be given the option of having it refunded to them. Some of these pots are tiny – often just a few hundred pounds. Forcing people to complete complicated consolidation procedures – perhaps more than a dozen times during their lifetime – is a sure-fire way to cause further frustration and lower engagement with pensions yet further.

And second, the pension transfer system needs to be made easier and digitalised. There are still too many pension providers who are clinging onto drawn out paper processes that just act as a barrier to consolidation. The pensions industry needs to help those people who want to retain their pension savings – no matter how large or how small – to bring their various pots together much more easily.

4. Savings restricted to the long-term

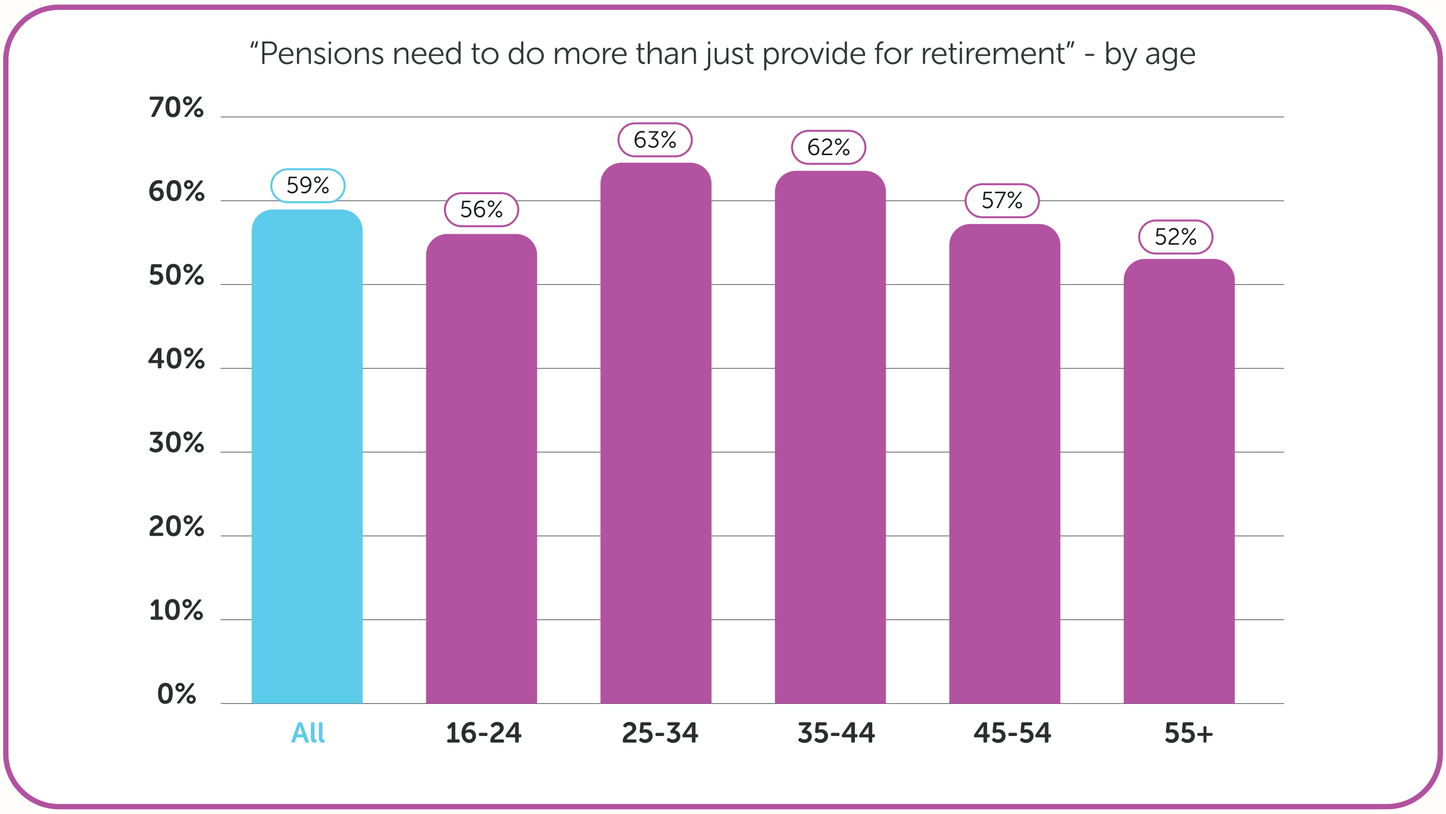
"Pensions need to do more than just provide for retirement"

59% of employees

One of the great strengths of pensions is their status as a long-term savings vehicle. They are designed with just one goal in mind: to provide a pot of money for employees to support themselves in later life. But this is also one of their greatest weaknesses and fails to recognise the competing financial needs of UK savers. Young people particularly can sometimes question the value of putting money aside for retirement when they have more pressing short- and medium-term financial goals, such as paying off student debt or saving to buy their first home. It can almost feel like any cash they set aside in their pension is not really 'their money', as they cannot access it until they are at least 55.

This lack of ownership can lead to a feeling of detachment for pension members – many just see their pension as something that takes away part of their salary every month, rather than engaging with the process of saving and growing their retirement fund. This is clear in the startlingly high number of employees who see pensions as "just like another tax coming out of my salary before I'm paid" – nearly half (49%) of all employees agree with this statement, and the figure is even higher among 16- to 24-year-olds (52%) and 25- to 34-year-olds (56%).

Figure 4.1: An appetite for more flexible retirement savings



The solution

The key to helping employees feel more connected to their pension funds is to offer more flexibility. But this does not have to be within the pension itself. Flexibility can be added by employers widening their view of what is meant by 'Workplace Savings' to go beyond pensions and to take in additional products – such as workplace ISAs. This would allow employees to choose how much of their existing pension contributions go into their pension pot and how much goes into other savings.

27%

of employees want "a scheme that is about saving for the short term as well as retirement"

22%

of employees want "a pension that could help them with their other financial needs, like getting on the housing ladder"

34%

of employees believe they would be more engaged with their pension if they had "access to their money before retirement if they needed it"

So, what if such a system existed? What if employees could have a workplace savings scheme that consists of both an accessible savings pot and a pension pot? A product where the employer and employee both contribute, and the employee controls how much goes into each pot based on their own financial needs (provided the legal minimum goes into their pension).

This would enable people to save for retirement and for all their other financial needs that might come before that. Pensions would not be viewed as just being about retirement anymore – they would be about someone's entire long term financial journey. Just think how much more engaging and meaningful this would be for employees. Letting them make these decisions would create a real sense of ownership and allow them to set their own financial priorities, creating a real sense of financial wellbeing – not just for today but for the long term too. And it does not have to cost more – it's just about changing the allocation of current spending.

Well, this structure already exists. We implemented it for our own employees a while ago and a number of our clients have followed suit. It's a fantastic structure that really speaks to every employee, regardless of their age. Older employees have more, if not all, contributions going into the pension whilst younger employees have the maximum they can going into their accessible savings pot.

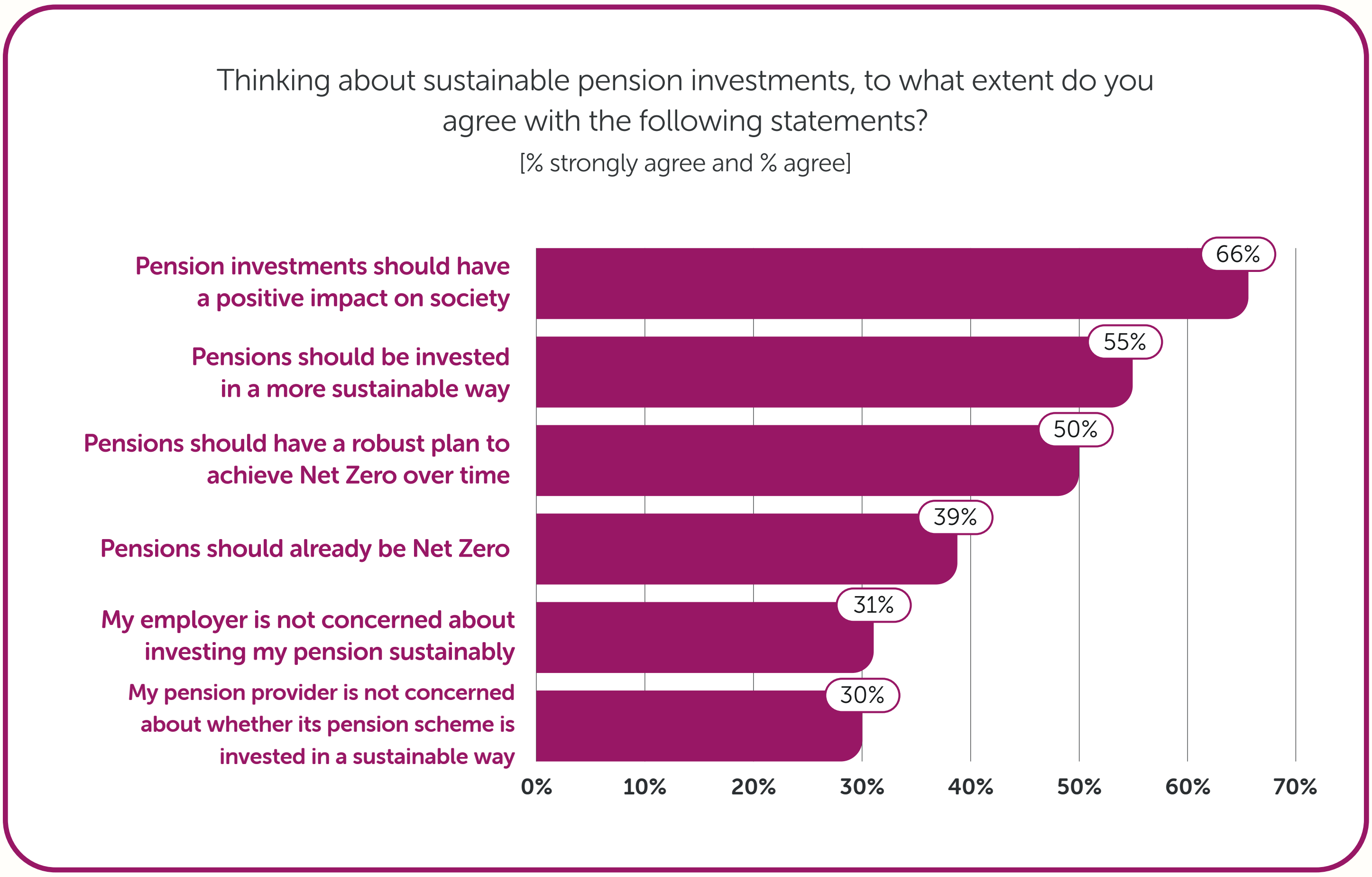
5. A failure to consider what members want

Around two thirds (66%) of employees say that pension investments should have a positive impact on society

Figures from the Office for National Statistics reveal that, in December 2021, the value of total gross assets invested in UK occupational pension schemes reached £2.8 trillion. This is an enormous sum of money – and by investing it in the right places, it could have a hugely positive influence on society. And pension members are alert to this. They recognise the massive impact their savings can have on the wider world – and this is becoming a key concern for them.

In our research almost two-thirds (62%) of employees told us that the environmental or social impact of their pension investments is important to them. This encompasses more than just the 'green agenda' – employees want to know that there is a clear and robust path for their pension pots to be carbon neutral, but they also want them to help support causes that benefit society, such as investing in social enterprises or community projects.

Figure 5.1: Sustainable pension investments are very important to employees



Given the enthusiasm among employees for using their pension pots to positively impact the environment and wider society, it's disheartening to see their wishes being ignored by those responsible for choosing their pension providers.

The solution

It's great to see employees beginning to consider the impact their pension savings can have, not only on the environment but also on wider society. Pension members are starting to realise their savings can be a powerful force for good in the world and they want their pensions to align more with their personal values. And delivering more sustainable pensions that align with people's values is another way to get employees, regardless of age, to feel more ownership of their pensions and to get them more engaged.

Unfortunately, the majority of employers and pension providers are failing to deliver the products that will meet their members' concerns. We need to get employees more emotionally attached to their pension, and greener or more sustainable investments have the power to achieve this.

These types of investments are typically more practical investments, rather than just faceless shares in companies. They're invested in actual on the ground world changing projects, with engaging content that can be shared with employees.

Through ongoing updates on particular projects, employees can see the positive impact their savings are having on the world around them as well as on their own financial future. They create a sense of purpose and especially for younger employees, a sense that their pension is adding value now, not just in 30 or 40 years when they decide to retire.

Employees are starting to understand that their savings have the power to do good in the world and they want their money to do exactly this.

Conclusion

It's time to start listening to employees

How has the UK pension system become so complicated and unwieldy? One major cause is a lack of consultation with the people that really matter in all of this – pension members. While the Government has made a point of liaising with pension providers, consultants and employers before implementing major new policies, it has paid little attention to what employees actually want out of their pensions. And this is a systemic problem that goes right to the heart of why levels of employee engagement with pensions are so low.

Approaching the issue from an employer perspective, it's essential that they get some sort of return on what, for most, will be their most expensive people cost second to payroll. Generating a good return on investment requires employees to be engaged with their pensions – and at the moment, they're generally not. Surely, the obvious answer to this is to give employees what they want? Jargon-free solutions that are easy to keep track of and move jobs with, which allow for shorter-term savings goals, and which are invested in a way that benefits society.

And if we consider pensions from a Government point of view, the challenge is to get pension members engaged with their pensions, so they contribute more to their pots and will have to rely less on the state in the future. Surely the answer to this is to get rid of the barriers to engagement and focus on the things that increase engagement? Again, it's about listening to employees.

It's bizarre that we're recommending what must be to other industries an obvious point: but the pensions industry operates like no other. In no other line of business does the end consumer have so little say in what they buy. Employees have no choice but to accept the pension scheme their employer provides – a decision that typically receives no input from employees.

Inevitably, this leads to a huge disconnect between what employees would like to see from their pension scheme and what they actually get. As a result, while almost four-fifths (79%) of employers believe that their pension scheme offers "value for money", less than half (49%) of employees agree.

When we dig down into the views of pension members and their employers, we can see where they diverge. While both groups agree that the most important element in providing "value for money" within a pension is "good employer contribution levels", after this their opinions diverge. Employees tend to favour elements that will help them understand their pension – while employers are more focused on outcomes.

The ironic point about this gap is that employee understanding of pensions is the first step to getting them engaged – and this is critical to ensuring good outcomes. In other words, employers and employees are actually more aligned than we think when it comes to value – but employers are failing to join the dots between getting employees engaged with pensions and achieving the good outcomes they desire.

The solution to this gap is for employers to stop focusing on costs when considering what a good pension looks like and instead to focus on all the things that create engagement. This is where the real value lies and where they can move the dial on member outcomes.

It's time to listen to pension members.

About Cushon

Cushon is a fintech using its world-leading financial technology to engage savers and empower them to build a better financial future.

Cushon offers a range of investment & savings products via an intuitive mobile app that provides a highly personalised experience and environmentally friendly investments, making it easy for customers to manage their money and invest in a way that aligns with their personal goals and beliefs.

With a solution that fully integrates with payroll and benefit platforms, Cushon's products are delivered via the workplace to reach as many savers as possible. Employers use Cushon to enhance the financial wellbeing of their workforce by providing employees with a simple and convenient way to save into ISAs and General Investments products direct from pay from as little as £10 a month.

Cushon Group currently has over **510,000 customers** with **£1.8bn of assets under management.** Its corporate clients include **250 well known blue-chip companies** including many of the FTSE 100, plus over **22,000 smaller employers** across the UK.

To find out more about workplace savings, get in touch or visit our website:

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About the research

Research carried out in February 2023 by Censuswide Research. **2,006 employees** and **501 HR managers** from companies with **500+ employees** were surveyed.