For advisers and customers

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Aegon UK Readiness Report

How savers are behaving in the new pensions world

Contents

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Navigating a sea of change in pensions and lifetime savings

To say the pension landscape has shifted over the past five years is something of an understatement. There's been nothing gradual about the pace of change.

More than seven million people are now a member of a workplace pension as a result of the government's auto-enrolment initiative.

The pension freedoms, which deliver greater choice when people start to dip into their pot for retirement income, have been just as widely felt. As this report will show, one in seven people across the UK are now saving more into their pension each month as a direct result of these very welcome new freedoms.

Last April the UK also moved to a new flat-rate state pension and November 2018 will see the controversial increase in women's state pension age to 65, in line with men. It's a significant stretch for women, many of whom now face half a decade longer to wait for their state pension to kick in. And further increases to age 66 and then 67 are already scheduled.

The government is also launching a spate of new tax incentives for saving, such as the Lifetime ISA. Contribution limits for ISAs continue to rise while the amount people can hold tax-free in a pension over their lifetime has been slashed to £1 million. This runs the risk of giving out mixed messages at a time when financial security and personal responsibility, including provision for social care costs, couldn't be more important.

If all this wasn't enough for people to consider, savers must navigate these changing tides in the context of an increasingly turbulent external environment. The UK's decision to leave the EU, the election of President Trump, the prospect of a second Scottish Independence Referendum and a number of upcoming European elections all threaten to leave financial markets shaken and stirred. Meanwhile, UK inflation is expected to keep rising as weak sterling takes its toll on the price of imported goods, and the outlook for interest rates remains uncertain.

Reflecting on these changes, in this the sixth Aegon UK Readiness Report, we study the impact of these developments on people's financial behaviour as they prepare for their futures. In particular, we focus on changes in savings levels, engagement and understanding of pensions. Change, of course, brings huge opportunities and the early signs are that saving behaviours are improving and engagement is growing, providing a springboard for the industry to make saving for retirement a clear and positive process for future generations.

Aspirations – the incomes people are looking for in retirement

Realistic aspirations provide a strong indication that people are in tune with financial reality. Realistic goals are also an indication that people have a plan and are doing something to achieve their retirement income ambitions.

Income Aspirations

Against this backdrop, it should be seen as good news that the annual income people aspire to have in retirement has now come down to a more realistic £32,270. When asked the same question a year ago people were reaching for £37,912 on average, which would undoubtedly leave the majority disappointed. The current figure is still some way above the average UK income of £28,200[1], and a good deal more than the average pensioner income reported in the ONS' Pensioners' Incomes Series[2], but it's a positive sign that aspirations are moving in a realistic direction. These headline aspirations are markedly different between the sexes, with men hoping for £34,611, around £5,000 a year more than the £29,988 women hope for.

Retirement Age

With such a raft of ongoing changes to both the state pension age, and the options available to people when they reach age 55, a large proportion of people (29%) are opting to put off a decision about what they plan to do on reaching state pension age until they are much closer to 65.

But a growing number are now certain they will either choose to, or have to, work full-time beyond state pension age. A quarter (24.5%) of the population now expect to stay in work full-time past 65, a slight increase on the 22.4% that expected to in April 2016, and a further 25.3% anticipate that they will continue working part-time.

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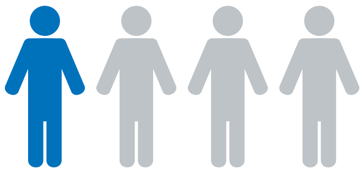

Perhaps surprisingly, just one in ten (11.7%) people are set on stopping work immediately on reaching state pension age, while a further 8.5% hope to have already stopped working by the time they reach 65. Together, that's just one in five people in the UK that expect to have downed tools before or at age 65.

With at least half of the UK population already fairly certain they will continue working into typical 'retirement' years when they get there, the question is how much of this is out of choice, and how much will be out of financial necessity?

1 Annual Survey of Hours and Earnings: 2016 – page 5

2 ONS Pensioners' Incomes Series: An analysis of trends in Pensioner Incomes: 1994/95 – 2015/16, page 3, the average pension is £296 a week. £296 x 52 = £15,392

Preparations – what people are doing to prepare for the retirement they want

On the whole, aspirations are becoming more realistic. How then are these shifting aspirations affecting the way that people are actually preparing for retirement?

Saving Behaviours

Since the pension freedoms launched in April 2015, 14.1% of the UK population are now saving more into their pension as a direct result of these reforms. That's one in seven people that have taken steps to save more each month.

One in seven people are saving more as a direct result of the pension reforms.

A further 15.3% realise that they need to plan better for their retirement, but have yet to take any direct action to do so. This is up from 10.3% in 2016, hopefully because more people understand that they need to take retirement planning more seriously.

Just 6.2% have decided to save less into their pension as a result of the reforms, up slightly from 4.4% in April 2016, suggesting a slight uplift in the number of people perhaps looking for alternative ways to save for retirement.

Encouragingly, the number of people that admit they have never done anything to review or shape their plans for retirement is shrinking. At the time of the pension freedoms launching in 2015, half of the UK population had done nothing to review their retirement plans. This has now fallen by almost 15%, to 35.8%. Indeed, one in five (21.7%) people have reviewed their plans in the past six months alone.

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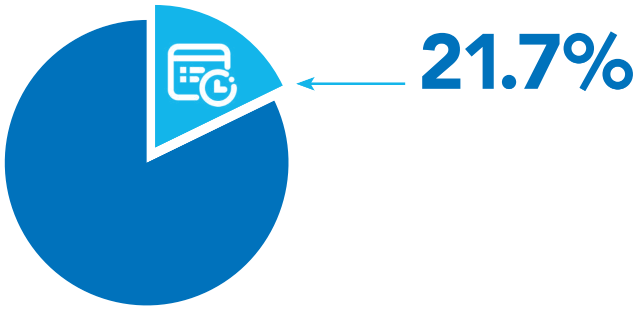

It's a good sign that amid all the media and industry attention, one in seven people have for the first time put in place a tangible retirement plan. However, without taking away from this progress on engagement, it's still concerning that a third of the population, some 14.8 million working age people[3], still confess that they have their heads buried in the sand. This demographic should be a key focus for government and industry over the coming years.

The reasons given for this disengagement are varied, but most people point the finger at the complexity of information, with one in five people (21.9%) claiming they simply don't understand how to review their plans for retirement. This lack of understanding is much higher for younger people, with two in five (42.7%) 18 to 24 years olds feeling locked out by the complexity, compared with 11.6% for those closing in on retirement, which only highlights the importance of getting better at communicating with millennials on the importance of pension saving.

3 ONS, MYE2: Population estimates by single year of age and sex for local authorities in the UK, mid-2015

Total Savings Levels

The impact of this greater engagement on the size of pension pots is already becoming apparent. On average, people have £49,988 saved in a pension, up from £35,614 in 2016, and again from £28,766 in April 2015.

There is, however, a huge difference in the size of pots for men and women. Men have on average saved £73,568, three times the £24,869 held by women, highlighting the need to focus on addressing this worrying gender divide.

The average amount people have saved in a pension is increasing.

Monthly Savings Levels

The average amount people in the UK are saving each month for later life is currently around £195. Men are saving over twice as much as women; £272 a month compared to £119.

Worryingly, of those people that do have a pension, one in five (21.8%) have absolutely no idea how much they are paying into it each month. This could well be a side effect of the rollout of auto-enrolment, which effectively allows employees to save without consciously participating in that saving.

Pensions are, of course, not the only way people can save for retirement. With the annual ISA limit now rising to £20,000, there are indications that overall ISA pots have grown over the past two years and some of these savings may supplement incomes in retirement. The average amount people in the UK report to have saved in an ISA has now risen to £20,392, up on £13,094 at the end of the last tax year and £7,682 in April 2015.

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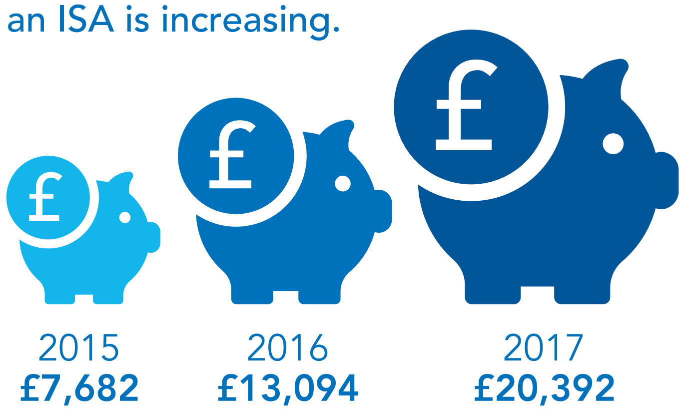

There remain, however, a large number of people, almost half the population (44.7%), that have saved nothing at all in ISAs for the purpose of retirement.

The government's new Lifetime ISA offers people aged 18 to 40 a new dedicated tax wrapper for saving for a first house or for retirement. It will be interesting to track how this changes long term savings behaviours within both pensions and 'traditional' ISAs in future.

Realities at retirement

We have seen that there are positive trends in Retirement Readiness. But there are big challenges ahead, from the shift from defined benefit to defined contribution pensions, to a growing number of income solutions as well as saving and investment options. Tomorrow's retirees face a complex set of decisions, which could become overwhelming for some.

Yet many remain in the dark about the realities of retirement. Over half of the population (56.2%) admit they simply do not know what level of retirement income they will receive at the end of their working life. As it stands, 12.6% of the population are very confident they will be able to retire when they hope to, followed by 37.6% that are somewhat confident. Half the population are either not very, or not at all, confident they'll have their finances in order by the time they want to take a step back from work.

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Conclusion

As the findings of this sixth Readiness Report show, people are becoming increasingly aware of the need to pay attention to their retirement savings and overall engagement is improving at a promising pace. But there is still a long way to go before everyone can say they are financially on track for the retirement they aspire to. In the new pension landscape, the responsibility for saving adequately is personal, but many believe that government and the industry should be doing more to support them.

Half of the population (50.5%) would like to see more clarity on how much state pension they are due to receive personally, while pension tax relief is another area where large numbers still feel in the dark. More than a third of the population (37.4%) simply don't understand the way pension tax relief works. Pensions remain the most tax efficient means for the vast majority of people to save for retirement, but there is a real risk that this confusion could lead to consumers making the wrong savings choices.

The government has had some success in providing greater support and guidance for savers through the likes of Pension Wise. Guidance can act as a safety net for those that can't yet afford financial advice, but it will seldom be a replacement for the personal recommendations that advice offers.

One in five people in the UK would welcome initiatives that improve access to financial advice or guidance, rising to one in four people (23.10%) nearing retirement.

The role of advice is fundamental. Improving access to it for all generations is something the government and regulator should continue to prioritise as the Financial Advice Market Review progresses from recommendations to action.

We should take heart from the news that the UK's readiness for retirement is improving, especially given the pace of change it has had to shoulder over the past few years, and encouragingly, this change has come with an increasing public dialogue on the importance of financial planning. We need to focus on growing this engagement, and government, regulators, providers, advisers and increasingly, individual savers, all have a part to play in making the most of the new financial landscape. By listening to each other, and working together, we have the best chance of ensuring everyone in the UK can secure the financial future they look forward to.