BlackRock.

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Work and Pensions Committee
House of Commons
London
SW1A 0AA

Submitted via email to: workpencom@parliament.uk

RE: Protecting pension savers – five years on from the Pension Freedoms: Saving for later life

BlackRock[1] is pleased to have the opportunity to respond to the Work and Pensions Committee inquiry into the impact of pension freedoms and saving for later life.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this inquiry and will continue to contribute to the thinking of the Committee on this and other topics.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

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Executive summary

The introduction of auto-enrolment in the UK has been a resounding success story, bringing millions more people into pension schemes. However, ten years on from its introduction, there is an opportunity to reflect and make changes that will improve outcomes for pension savers across the UK.

As things currently stand, an average workplace DC scheme member's retirement pot will fall short of what many will need to support themselves in retirement, and yet, the societal and political significance of this shortfall is not fully appreciated, nor being adequately addressed by Government.

Savings rates and investment performance are two of the biggest drivers of comfortable retirement outcomes. It is therefore essential that Government looks at these two issues in tandem in order maximise pension savings and ensure comfortable retirement outcomes.

Furthermore, we see a need for increased focus on and support around decumulation to help ensure people are accessing their accrued savings in an appropriate way.

As the manager of pension savings for over 10 million people here in the UK, we want to ensure the best possible retirement outcomes for pension savers. We welcome the opportunity to comment on the issues raised by this inquiry and appreciate the work the Committee is doing to raise them with Government.

1. Do households in the UK have adequate pension savings for retirement?

The introduction of auto-enrolment in the UK has been a resounding success story, bringing millions more people into pension schemes. However, low contribution levels remain one of the largest barriers to delivering comfortable retirement outcomes for people across the UK.

While auto-enrolment has been highly effective in extending the coverage of workplace schemes, in many cases, current contribution rates, combined with the State Pension, will not be sufficient to secure an adequate or comfortable replacement retirement income.

Research from The Investment and Saving Alliance (TISA) shows that an average workplace DC scheme member's retirement pot will be only one-fifth of the size of the equivalent DB scheme member, falling short of what many will need to support themselves in retirement.[2]

Indeed, the PPI report into adequate pension outcomes found that the UK is currently on course for a quarter of people approaching retirement being unlikely to receive even a minimum income, and nearly a half failing to meet a personally acceptable level of income in retirement.[3] Fewer than one in ten can expect to live a comfortable life in retirement.

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[2] See TISA, *Getting Retirement Right: Plan, prepare, enjoy*, February 2020, These figures consider the difference in outcomes for a notional employee with a salary of £28,000 depending on whether average DB or DC contribution rates are used. A DB scheme member with total contributions of 25% p.a. (19% employer + 6% employee) after 40 years has a notional fund value of £487,700, generating a guaranteed income of £18,666 p.a. Meanwhile the equivalent DC scheme member, with contributions of 8% (3% employer contribution + 5% employee contribution) has a fund value of £154,800, generating a guaranteed income of £3,850 – a fifth of the DB figure.
[3] See Joseph Rowntree Foundation, Minimum Income Standard for the UK, In 2020, single pensioners require a weekly budget of £206 and couples require £318 to cover basic costs, excluding rent for those in urban areas outside London

Crucially, many will not realise this fact until it is too late to rectify it, with PLSA research showing that 55% of people believe that the current auto-enrolment minimum savings rate is enough to deliver a comfortable retirement.

It is therefore essential that people are engaged with retirement outcomes and encouraged to save at a higher rate than they currently are.

2. Are changes needed to auto-enrolment to provide an adequate level of pension savings for retirement?

Ten years on from the introduction of auto-enrolment, there is an opportunity to reflect and make changes that will improve outcomes for UK pension savers.

We believe that auto-enrolment should be enhanced by increasing employee and employer contribution rates. In line with this, we support proposals by TISA to gradually increase the current 8% minimum contribution level to 12% by 2030 – split 50/50 between employers and employees.

Bringing forward changes to the eligibility criteria for auto-enrolment would also help to ensure more working people are brought into retirement saving. Implementing the 2017 Automatic Enrolment Review recommendation to lower the age from 22 to 18, would help along this journey.

Beyond these changes, BlackRock believes policymakers should consider auto-escalation, whereby individuals increase their contribution rate when receiving any future pay increases, helping them to reach higher contribution rates.

Auto-escalation, also known as 'save more tomorrow' schemes, aims to ensure that people never have to cut their spending to save more. These schemes allow individuals to pre-elect a percentage of any future pay increases for investment into their pension pot, based on several default pathways. As salaries rise, savings are increased automatically, and savers are not forced to make the decision of where and how to cut their spending.

In the US, such nudge techniques have helped overcome the problem of savings inertia. Replicating these schemes in the UK could bolster the success of auto-enrolment, allowing people to start at the minimum contribution rate and individuals gradually saving more each time they receive a pay rise. This relatively simple change in the way that companies approach their schemes could facilitate a sea-change in the pension outcomes for millions.

The Government should encourage firms to adopt auto-escalation schemes for their employees, taking account of varying degrees of utility across income levels, while developing best practice for employers on these schemes.

In the longer term, we would support the setting up of an independent commission tasked with regularly assessing the auto-enrolment minimum contribution rate and adjusting it over time.

3. What advice and guidance do people need when saving for retirement?

For members invested in DC schemes through their workplace, having the responsibility for decision-making for their pension on them, rather than the employer, is a cause of uncertainty.

Recent analysis from Scottish Widows showed that two-thirds of people do not feel adequately prepared for retirement and are worried about running out of money. This data is very similar to our own, as highlighted in our latest DC Pulse survey.[4]

While the Government's recent announcement around delivering a Stronger Nudge to pensions guidance is a welcome step, there is a need to engage consumers much earlier in the retirement journey.

Broadly, there is a lack of understanding that by maximising contributions, especially in early career stages, members can capture the long-term growth prospects of equities and give themselves a real chance at building an adequate retirement pot.

Employers should look to support their workforce in this area. BlackRock is an advocate of financial health checks and Midlife MOTs, and would welcome an obligation on large employers to offer these to their workforce, with smaller employers supported through a Government resourced initiative.

While Midlife MOTs - whereby people in their 40s, 50s and 60s are encouraged to undertake more active planning in the key areas of work, wellbeing and money - are offered by some workplaces in the UK, financial health checks are less common.

At a basic level, financial health checks involve a regular but infrequent nudge from a trusted source (such as employers) for individuals to take a quick online financial health check at a particular age or at a specific life stage or life event (such as starting work, getting married, buying a home, or having children).

These high-level health checks would encourage people to think about basic concepts of financial hygiene (such as budgeting, saving and long-term planning) and direct them to relevant financial information about basic financial concepts, themes, and products.

The important distinction between the concept of financial health checks, and existing financial education programmes, is that health checks provide regular nudges to individuals helping to combat some of the inertia around pensions and saving.

BlackRock has been contributing to the research of a leading thinktank on this concept, due for publication later this month. We would welcome the opportunity to speak to the Committee in more detail about the benefits of these programmes and how they could be rolled out in the UK.

4. Could retirement income targets help savers plan for retirement?

Yes. PLSA research shows that 74% of people believe that retirement income targets would make it easier to plan for retirement and that 70% of people believe that retirement income targets would encourage them to save more for retirement.

[4] See BlackRock 2021 DC Pulse, 56% of DC pension savers feel unprepared for retirement.

The PLSA Retirement Living Standards can help people plan for retirement by quantifying how much income may be needed to live the type of lifestyle they have envisaged. However, we would suggest that, in order to future proof any further work on targets, these values should be quantified in percentage terms of current income, rather than monetary value. This would help to guard against rises in inflation.

5. **Apart from increasing contributions, how can the Government improve outcomes for savers?**

Retirement outcomes are a product of both the savings rate and investment performance and, in addition to the areas we have already discussed, there are also measures the Government can take to improve investment performance.

Beyond this, further focus on decumulation would help to ensure people are accessing their accrued savings in an appropriate way.

Investment performance

In addition to savings rate, investment performance is the other significant driver of retirement outcomes. Successive UK Governments have brought forward initiatives to facilitate pension savers benefiting from the returns associated with private assets by seeking to enable more DC scheme investment in private markets.[5]

One significant development is the new framework for UK Long-term Assets Funds (LTAFs), finalised by the FCA in October 2021.[6] The LTAF option provides a vehicle tailored to the needs of DC schemes, allowing asset managers to begin developing custom-made private market strategies.

To fully realise its potential, however, the LTAF needs to be accompanied by further reforms to the charges cap, giving DC scheme trustees the confidence to make these allocations should they choose to do so.

Private market investment strategies typically use performance fees, reflecting different cost structures for managing the assets and aligning manager-client interests over the long term. Crucially, these fees are only incurred with genuine outperformance beyond a pre-agreed threshold.

We therefore welcome the DWP's proposal to exclude well-designed performance fees from the charges cap, [7] provided this is accompanied by guidance on appropriate structuring and equitable treatment of members.[8]

Decumulation

[5] See BlackRock, *2022 Private Markets Outlook,* December 2021, P7. For example, over the past decade there has been a consistent positive premium for private credit over public, standing at approximately 2% as of November 2021; and in private equity, while earnings multiples have increased in recent years, they remain attractive relative to the public equity markets.
[6] See Financial Conduct Authority, PS21/14: A new authorised fund regime for investing in long term assets, October 2021.
[7] Department for Work and Pensions, *Enabling investment in productive finance*, November 2021.
[8] For further discussion of our views on performance fees in the charges cap, see our response to Department for Work and Pensions, Investment Innovation and Future Consolidation: A Consultation on the Consideration of Illiquid Assets and the Development of Scale in Occupational Defined Contribution schemes, April 2019; and our response to Department for Work and Pensions, Incorporating performance fees within the charge cap, April 2021.

Beyond focusing on helping savers maximise returns, there is also a need for further focus on decumulation.

When people retire, they have a general sense of how long their assets will need to last, but the reality is that the endpoint is unknown. That is why decumulation is so important – the decisions people make on how much to spend and when are going to affect financial wellbeing for the rest of their lives.

In its 2020 paper on DC decumulation, the PLSA noted that people are not seeking to balance their short- and long-term needs in their decumulation decisions. Instead, people tend to favour immediate access to cash over long-term security. Research by The Peoples Pension found that participants perceived drawdown simply as a by-product of accessing tax free cash and people had given little thought to their remaining pension savings.

In the same way that auto-enrolment used inertia to help nudge people into saving, there is a need to support those who do not engage with, or fully understand, the financial choices they face when they come to retirement. In order to support these people, we back the introduction of default options for decumulation, that could be accessed on an opt-out basis.

We note that during a session with this Committee in November, the Pensions Minister indicated that there would be a call for evidence on this topic in the spring of this year. We would ask the Committee keep pressure on DWP in this area, in order to ensure the best possible outcome for pension savers as they reach retirement.

6. **Can pension providers change the design of pension products to improve outcomes for savers?**

As noted above and in our recent response to the Department of Work and Pensions consultation into enabling productive finance, we support work to get further DC investment into illiquid assets, and we back the Government's efforts to accommodate the performance fees associated with these assets within the charge cap, so that pension savers can make the most of the returns offered by these asset classes.

Beyond this, through our work with clients, we have identified a number in growing trends in terms of DC default design, which are improving the landscape for pension savers.

Sustainability

Most notably, we have seen a growing demand from trustees for the integration of sustainability into investment strategies. It is not surprising that climate change is on their radar, given the regulatory requirements on occupational pension schemes, master trusts and collective defined contribution schemes, to integrate the TCFD recommendations into their processes.

However, for many of the trustees we speak to, the desire to understand the climate risk they are running is something that extends beyond a compliance requirement.

As our CEO, Larry Fink, has continued to reiterate in his most recent letter to CEOs, climate risk is investment risk. As fiduciaries to our clients, it is our job to ensure that the funds we manage are not taking on too much risk, while helping clients to seize the opportunities afforded by those companies developing solutions that help us manage the climate crisis and transition to net zero.

De-risking

We have also seen a desire to move toward a more gradual approach to de-risking, as savers approach retirement.

Traditionally, de-risking has tended to happen in the last 10-20 years of a savers' retirement journey. As a result, many schemes automatically move savers into cash and bonds in the lead up to the current standard retirement age. However, the confluence of market volatility and inflation, may leave savers more at risk of locking in losses just as they reach retirement.

In response to this, there has been demand for a more gradual approach to de-risking. This is something we offer clients through our LifePath target date funds.[9]

LifePath aims to reflect changing investment needs over a member's lifetime, by gradually altering its investment mix as members near their target retirement date. This means de-risking happens over a 30-40 year period, rather than just as a saver approaches retirement. LifePath helps members take the right amount of risk at the right time in their lives, from a focus on growth when they are young, to protecting their wealth near to and in retirement.

7. **What should the Government be doing to support self-employed people to save for retirement?**

Research from the Institute of Fiscal Studies has found that in 1998, 48% of self-employed people contributed to a private pension, but by 2018 this had fallen to just 16%. Given this drastic drop in saving for retirement, there is a need for Government to address gaps in pension coverage for the self-employed.

In the absence of an employer contribution, some form of incentive needs to be considered. To help address this lack of employer contribution, the ABI has called for the self-employed to have their National Insurance Contributions increased in line with the employee rate, with the difference diverted to a private pension, so long as they also contribute.

Beyond this, we believe that more nudges would help get the self-employed saving for retirement. VAT payments and tax returns are potential mechanisms which could be used to bring a larger number of self-employed into the pension framework.

If there were a way to include the option to contribute to a pension scheme as part of an annual tax return, or as additional VAT payment, this could help nudge the self-employed into saving, without extra work being required from individuals.

8. **Are different or additional measures required to help gig economy workers save for retirement.**

[9] For more information on LifePath see https://www.blackrock.com/us/individual/investment-ideas/lifepath

Yes. Given that many gig economy workers may be on zero-hour contracts and holding a few different jobs, it is worth considering whether enrolment is needed for multiple jobholders, earning in total over the earnings trigger. Like the self-employed, flexibility is needed for this group.

9. **Are there measures which the Government should consider to close the gender pension gap?**

Prospect's annual report into the gender pension gap identified that the gender pension gap was 37.9% in 2019-20. This was more than twice the level of the gender pay gap that year (15.5%) and represents an average difference in pension income by gender of about £7,000 a year.

Given this marked difference in the pension outcomes of women vs men, there is a need for Government attention in this area. Prospect has called for a statutory requirement for the Government to report to Parliament on the gender pension gap and its plans for tackling it.

We are also aware of a working group within DWP, explicitly focused on solving the pensions gap for self-employed people, and would suggest that a similar working group is set up to help solve for the gender pension gap. Beyond this, it would be worth the Government doing a full audit of other groupings where there may be a gap, to ascertain whether further work will be needed.

While the gender pension gap persists throughout the world, there is a marked variation in the size of this gap, in Denmark for example, the gap was just 7% in 2020, down from 18% in 2010.[10]

One of the ways that Denmark has been able to bring its pensions gap down is by widening the leave options and career breaks for men, to help balance out some of the time women take out of the workforce, usually tied to caregiving responsibilities.

A study on closing the gender pensions gap in the Netherlands looked at this approach to closing the Dutch pensions gap, and found that the creation of more leave opportunities for parents could contribute to women having greater access to the labour market, in turn increasing their pension contributions.[11]

The OECD has also conducted research on this problem at a global level and suggested a number of policy guidelines that could help solve the problem:

- Encourage women's participation in retirement savings arrangements through financial education initiatives tailored specifically to them.
- Adapt the design of retirement savings arrangements to the career patterns of women by allowing more flexibility with respect to contributions.
- Improve the level and frequency of women's contribution to retirement savings arrangements, with contributions from employers or spouses or subsidies for maternity or caretaking. *We note here that awareness of the £3,600 contribution allowance, which allows a working partner to contribute to a non-working partner's pension, is relatively low and more could be done to publicise this.*

[10] For more information on various gender pension gaps across Europe see: https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20200207-1

[11] Kali, Suzanne; Been, Jim; Knoef, Marike; van Marwijk Kooy, Albert *Equal rights, but not equal pension: the gender gap in Dutch second-pillar pensions*, Netspar, 2021

- Increase women's retirement benefit entitlements by allowing spouses to share their pension rights with each other, facilitating the split of retirement benefits in the event of a divorce.

We would suggest that the Government uses these guidelines as a starting point for work in this area. It would be useful if a newly established working group on this topic was able to look at examples globally and make recommendations to Government about innovative policy solutions that could help to tackle this issue.

Conclusion

The introduction of auto-enrolment has brought millions more people into the pensions system, however, there is now a need to review the system to ensure people are saving adequately for retirement.

We appreciate the opportunity to address and comment on the issues raised by this inquiry and will continue to work with the Committee on any specific initiatives which help improve the retirement outcomes for pension savers across the UK.