A bold vision for retirement: pensions in 2030

Policy Pulse June 2018 compendium
This article forms part of the June 2018 EY Policy Pulse compendium. A collection of six articles that cover key topics which will become increasingly important to UK policy makers and regulators, company boards and investors. Policy Pulse aims to help ensure boards know about these topics and the associated changes, challenges and opportunities that lie ahead.

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On 31 May 2018, EY published a Pensions in 2030: building sustainable retirements report1, which sets out the challenges that are driving the need for change in global pensions and retirement systems, our hypotheses for how the successful pensions systems of the future will meet them, and examples of how governments, pension schemes and commercial players are already taking the first steps towards a sustainable, fit-for-purpose retirement model for the 21st century. This article looks at some of the major themes that have emerged from our thinking, namely: the era of tough decisions and why change is necessary; the policy changes needed to create a sustainable system; the potential for innovation in the delivery of pensions; and how to engage individuals in planning for an uncertain future.

More generally, one thing that has become clear to us as we developed our report is that the scale of change required is unprecedented. Reaching an outcome that is successful, sustainable and fair will require tough decisions, compromises and sacrifices. But we are fast reaching the point where the traditional approach of gradual reform to the retirement model, buffeted by shifting economic and political headwinds, may no longer deliver the change that is needed in the time available.

The era of tough decisions and why change is necessary

In March 2018, the Chancellor of the Exchequer made his second successive visit to the dispatch box without tinkering with the UK pensions system. The industry will be relieved after the long string of radical changes kicked off by his predecessor, but the reality is that it is only the calm before the storm. 2018 will see default auto-enrolment contributions beginning to rise – a big test of whether we can use individuals’ inertia to help them save for a better retirement, but much bigger changes lie ahead. In relation to the state pension, the Government Actuary’s Department now calculates that ‘expenditure is expected to exceed National Insurance Contribution (NIC) receipts by an ever increasing amount, equivalent to around 1% to 1.3% of GDP’. This inevitably points to a rise in National Insurance rates, which would be painful in the short-term and unsustainable in the longer term. We are truly entering the era of tough decisions.

Historically, the UK’s response to these pressures has been piecemeal and long term aims have often been diluted by a need to address short term economic pressures. As a result we have a complex, fragmented system that many individuals find hard to understand or trust. We have asked ourselves what might happen if a society began by defining collectively what it wants its pension system to achieve, and if all the stakeholders then worked together to build a fairer and more sustainable solution. In doing so, we have developed nine hypotheses for what pensions might be like in 2030, and found that many aspects of our future vision exist today. However it has also become clear to us that it will take co-ordinated commitment to change from all stakeholders to make it happen.

Policy changes needed to create a sustainable system

Successive governments have tried to reform the pensions system by introducing new initiatives to encourage saving while often, in parallel, curbing the costs of existing provision. This piecemeal approach has had negative consequences: the industry has had to invest to keep up with legislation, and, as a result, there has been underinvestment in modernisation, while individuals find it hard to trust and engage with a complex system where the rules keep changing.

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1 Pensions in 2030
One significant change has already been made, although it will take decades to work through. Traditional Defined Benefit or Final Salary schemes have almost all closed to new members outside of the Public Sector, largely because they place large financial liabilities and risks on the sponsoring employer that can rebound on the members in the event of insolvency. Some high profile collapses have undermined public confidence in pensions as a whole, and affordability remains a problem when schemes are committed to paying an ‘income for life’ to retired employees who could spend decades in retirement.

The future of pensions lies in Defined Contribution, where the member has the security of owning the underlying assets but contributions are often not as generous and the individual carries all the investment risk, often without a clear understanding of what their best strategy is. It is against this backdrop that we have written Pensions in 2030.

We believe that the successful pensions systems of the future will establish clear, agreed target outcomes for the system, and a set of predefined levers that can be used to respond to changing demographic and economic environments. We feel that this will offer a balance between flexibility and predictability that will be essential to unlock the other changes that are needed – but achieving it is likely to need consensus across the political spectrum and potentially taking pensions policy out of the political arena.

It is also clear that attitudes to work and retirement will need to change. Improvements in longevity have left all of us with a very different balance between years of working life and years in retirement and this is a major contributor to the unsustainability of pensions systems. It is likely that many individuals will opt to delay full retirement, possibly working in a second career or in a reduced role, to help improve their retirement provision or to ensure it has a better chance to last the whole of their lives. Governments too will want to encourage later retirement to reduce the stress on the social security system – but to do this they will need to encourage changes to working environments and approaches to working environments and training to accommodate older workers.

The pensions systems of the future will place far more emphasis on individuals to make the right decisions for themselves, but the decisions involved are complex and few individuals have the skill and confidence to make them without assistance. The current UK advice model is recognised as delivering high quality advice, but it is only accessible to the wealthy. We believe that by 2030, regulatory regimes will have shifted to ensuring that all individuals have access to the support that will enable them to make good decisions and achieve good outcomes.
Potential for innovation in the delivery of pensions

The Government made a positive step forward in the 2016 Budget, when it laid out a plan to develop a dashboard which would enable individual users to see all of their pension pots from various providers (including the state pension) all in one place. The benefits of the dashboard for individuals are clear: users will have a more holistic view of their own savings and be encouraged to engage more proactively with their savings and retirement. The industry generally praised the move, although there were concerns expressed around its implementation.

Such innovation is overdue in the industry. We envisage a world in 2030 where a pensions dashboard will combine not only pension information from state and personal pensions, but also other assets, income and expenditures to help individuals understand how the choices they make today impact their living standards in retirement. The financial dashboard of the future would be a conduit to educating and advising individuals, as well as streamlining tasks like tax returns and intergenerational financial planning. Eventually, data from wearables, and other forms of data capture, will undoubtedly join the wealth of data available, enabling the use of health data to help individuals understand how long they might live.

Innovation will also be needed to reduce the cost of pensions and give individuals more of their investment growth. New infrastructure will be essential to enable the collation and communication of relevant data in a safe and secure way. Technologies such as blockchain could help to manage contributions and investment over multiple employments and careers, and provide an auditable, secure record of transactions. If combined with a digital Universal ID, this could efficiently connect an individual’s data so that government, providers, advisers and employers can utilise this information for the financial benefit of the individual.

Many of these technologies already exist, though they are typically only in the early stages of being deployed to improve the financial wellbeing of individuals. Implementing such technologies would require major changes to existing systems and would also require some forward thinking around interoperability, security and scalability. It would also demand that providers implement measures to protect consumer data, building on the ‘privacy by design’ and data portability principles of the General Data Protection Regulation. However, these changes may be necessary to meet the demands of tomorrow’s consumers. The winners are likely to be those who can rise to the innovation challenge, and develop solutions that genuinely contribute to improving financial well-being for today’s customers and generations to come.
How to engage individuals in planning for an uncertain future

One of the toughest challenges in reforming any pension system is how to engage individuals in planning for an uncertain future.

Psychologists know from research that humans struggle with extremes. We have evolved to focus too much on immediate fears and the short term and not enough on what might happen in ten, twenty or thirty years. That made for better survival rates when our ancestors were hunter-gatherers, but it makes it harder for us to plan for how we will save enough to stop working or how we will make it last through a retirement that could last thirty years or more. Faced with a decision we can not process, all too often we just put it off. The successful pension systems of the future will have to overcome this bias. Individuals are increasingly responsible for their own retirements and that means they have to think and act on pensions decisions far more than they do today. We have already discussed some of the changes needed to make that happen. Perhaps one of the most important, as we discussed above, is a stable pensions policy, so that people can regain trust that the money they save will be there to help them when they need it.

Beyond that, changes in delivery channels create an opportunity to increase engagement. Today, people typically engage with their pensions once or twice a year, via a paper statement. Banks have found that as people migrate to mobile banking, people interact with their accounts much more frequently - on average once per day. As pensions become more digital, a similar pattern is likely to emerge. While we are unlikely to see people check their pensions daily, the transition to mobile-led multi-channel access creates the opportunity for much more frequent interaction. A key question will then be how to use the additional contact to achieve better outcomes for savers. We believe that pension providers will have to learn how to deliver education and information in interesting, bite-sized chunks, using video and multimedia to engage, analytics to know when and how to deliver for best effect and infrastructure that lets customers go back and easily find things again at the point of need.

We think that today’s tools and calculators will have to become more rooted in the real world: it’s one thing to know how much my savings could be worth but what I really need is to know is what lifestyle my pension will buy me in retirement and what trade-offs I could make today to improve that lifestyle. We have consistently found that ‘sandboxes’ where customers can play with personalised consequences of their actions make a big difference to their confidence to act.

Ultimately, many people will need advice and a technological solution will be attractive but, despite the ground breaking developments in innovation and AI, we believe that a hybrid approach, with a human advisor available if needed, will become the dominant form, enabling teams of advisors from multiple specialist domains to work together through a shared platform to serve customers.

In the event that the availability of more information leads to a greater dialogue between customers, the industry and regulators may need to be ready with a clear plan for how to moderate that discourse to protect customers from scams, intervene to correct misconceptions and manage the boundary between discussion, guidance and financial advice.

The scale of change required to create a fair and sustainable retirement market is unprecedented. We believe that the only way it can succeed is if all the stakeholders in the system are engaged in agreeing what our pensions system should be there to do, and what price we are prepared to pay to achieve it.

While we recognise that the changes to deliver our vision will not be easy, we feel that it is the right time to ask what sort of pensions system we want to have. The time to start that debate is now, and we hope that our Pensions in 2030 report will help to make that happen, not by dwelling on the deficiencies of today’s problems, but by painting a vision of the system that we could build. We hope you will join the debate and join us on the journey to build a better retirement world.

Conclusion

The policy pulse 2018 A bold vision for retirement: pensions in 2030

2 See, for example “Temporal Myopia: Making Bad Long-term Decisions” by Dean Buonomano Ph.D, published in Phycology Today
Questions the board should be asking itself

► How do we make saving for the future feel like a good investment now?

► How does the Board view pensions? Is it an obligation and a cost, or a component of the talent strategy and employee retention?

► As an employer, how does the Board view its responsibility towards helping employees towards a better retirement and financial wellbeing?
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