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Institute
and Faculty
of Actuaries

Member-led insights from the IFoA

September 2024

# How much could you lose?

## Opening the conversation on closing the pensions gap

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## About the actuarial profession

Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

## About Member-led insights from the IFoA

This is a member-led output from an IFoA working party. The IFoA has over 90 working parties comprised of volunteer members who conduct research and provide policy insights across a broad range of topics through an actuarial lens to inform public policy.


**The Pensions Gap working party are:**

Alexandra Miles (Chair), Polly Cripps, Oliver Payne, Marica Wismeijer, Sarah Abraham, Heather Boucher, Jan Claisse, Alexandra Dias, John Fitzgerald, Gordon Lee.

# Foreword

## How much could you lose? Opening the conversation on closing the pensions gap

The Institute and Faculty of Actuaries (IFoA) has been investigating potential barriers people in the UK may be facing when accumulating retirement savings. The IFoA Pensions Gap working party has been specifically modelling the impact these barriers have on pensions savings and how this results in pension gaps. A pensions gap arises where there is a difference in pension savings and retirement income between two distinct groups. The IFoA wants to draw attention to how these gaps arise and explore how they can be mitigated.

*"Pensions serve as a useful lens through which to assess the result of a culmination of life's inequalities.*

*There has been growing concern across the pensions industry about retirement adequacy and known inequalities in current retirement savings for some time. A few passionate individuals working within the industry were keen to use their collective experiences to make a real difference and shift the narrative. Greater communication and engagement with individual members is one strand. Other key stakeholders such as employers and trustees, providers and Government need to also play their part in order for the right change to happen, and quickly.*

*Exploring some of the hurdles that people face when wanting to save for their retirement, through assimilating proper data and research, from a number of different fields and experts is key to building a case for change. Lots of the information already exists, the power now lies in using this to build an indisputable case as to why the status quo must shift. Improving the retirement savings that an individual is able to accumulate doesn't just have a positive impact on them, but society at large."*

**Alexandra Miles**
IFoA Pensions Gap working party

**Pensions serve as a useful lens through which to assess the result of a culmination of life's inequalities.**

# Executive Summary

Based on modelling of various pension pot scenarios carried out by the IFoA, there are some key moments that individuals should be wary of to make the biggest impact on pensions gaps, these are:

| | |
|---|---|
| Not starting a pension - starting a pension at 35 instead of 25 could mean a pension pot of only £500k at retirement instead of £800k. | **-£300k** |
| Opting out of a pension – opting out for 5 years could cause a £100k reduction in pension pot. | **-£100k** |
| For a typical person, not taking advantage of extra contributions of 1% of their salary for 40 years could result in up to £100k loss. | **-£100k** |
| 6 months maternity leave could reduce a pension pot by £30k or more. | **-£30k** |
| Ignoring pensions on divorce could mean that one party ends up with more retirement income than the other. | **>£<** |
| Moving to part-time - moving to 3 days a week for the second half of an individual's career could reduce their pension by £200k. | **-£200k** |

The IFoA and the Pensions Gap working party have made a range of recommendations to help remedy the problems created by pension gaps.

## Government

The IFoA urges the government to:

1. Explore and engage to understand the potential of new initiatives and policies that may help to close pensions gaps, for example:
    - A specific focus on pensions gaps from advice and guidance support services such as '**Pension Wise**'.
    - Explore a new option to setup household pension plans for joint pensions savings.
    - Review the inequity of current pensions tax relief e.g., it costs £80 for a 20% taxpayer to contribute £100 to a pension vs £60 for a 40% taxpayer.
2. Reinvigorate its public messaging around minimum pension saving levels with a particular focus on those that are currently losing out when it comes to pension equity.
3. Review the minimum Automatic Enrolment (AE) contributions, to ensure that regulations do not accentuate pensions gaps and examine AE options for the self-employed.

## Employers

The IFoA urges employers to:

1. Ensure pension policies are equitable and do not unfairly accentuate pensions gaps, for example: AE policies, parental leave and other career breaks, part-time working etc.
2. Support employees at key life events e.g., joining, becoming a parent, changing to part-time etc. to ensure they fully understand the potential pensions impact of decisions and options to change pension savings.

## Individuals

To better protect against pension gaps, individuals can:

1. Identify personal pension gap between their projected pension savings at retirement and the income they will likely need e.g. by using available tools such as the IFoA '**savings goals for retirement**' and the Pension and Lifetime Savings Association (PLSA) '**retirement living standards**'
2. Ensure pensions are not forgotten at key life moments including starting new jobs, becoming a parent, divorce, moving to part-time etc.
3. Refer to strong consumer guidance on pensions such as *MoneySavingExpert's* '**pension guides**', **Pensionwise**, and **pensions tools and information** from *Which?*.

# Introduction

## Automatic enrolment – the power of inertia is not always enough.

Automatic Enrolment (AE) has been praised for getting more people saving into a pension, with over 10 million new savers now enrolled, and the IFoA agrees that this is a good thing. Modelling from the IFoA Pensions Gap working party shows the average pension pot for an employee who's contributed to their pension at a 10% contribution rate for 40 years could be as much as £800k, or even more at retirement[1].

However, not all workers in the UK are eligible for AE and, even for those that are eligible, the power of inertia that has supported the success of AE means that people are not engaging with the question 'How much (more) do I need to save for my retirement?' to then be able to take appropriate action. The IFoA is concerned that a lack of awareness and engagement means that people in the UK may not be fully engaged on the relationship between their decision making and their pension – either not saving enough or making other adverse decisions.

For an individual it is very easy to forget, or delay thinking about pensions and sometimes that is the best thing to do. The strength of auto-enrolment and default investment strategies is that they are designed to help a pension pot build up without any action. However, there will be a few key moments in an individual's life when mistakes can leave them with far less pension than they may ultimately need.

It is important to recognise that individuals' decisions about pensions do not occur in a vacuum. The choice for many relying on auto-enrolment is not between "do I pay more into my pension or not", but between "do I pay into my pension or save for a house deposit" or "do I pay more into my pension or meet my current household needs or debt or pay off my student loans". This becomes a more complicated picture when we consider life circumstances such as age, location and marital status, and other associated costs like the cost of health, childcare and social care.

The IFoA wants to encourage individuals to prioritise their pension where they can and illustrate how decision-making over the shorter-term can have a drastic impact on final pension amounts over the longer-term. Our work aims to draw attention to this shortfall and the general lack of understanding amongst the wider public and explore the ways in which public policy and individual saving habits might help to close the gap.

## Are people confident making retirement decisions?

Since 2020 the IFoA have been exploring the trend to transfer risks from institutions – such as employers, the state, and financial services providers – to individuals. We have coined this term the 'Great Risk Transfer'. You can read more on the campaign **here**.

Evidence of this shift exists in several areas of public policy and actuarial work. It amounts to a profound change in the way that individuals organise their life and finances and represents one of the most significant yet little understood social, financial, and political challenges of our time. While it is true that levels of numeracy, financial literacy, and understanding of risk are generally low, even many of those who consider themselves more financially aware feel ill-equipped to deal with the risks they now face.

In pensions, one of the most calculatable transfers of risk occurred in April 2015. Since the onset of pensions freedoms individuals have had greater flexibility in how they can access their pension benefits. For example, they are no longer required to take an annuity and can now access their benefits as cash or transfer them to a drawdown arrangement. This change offers individuals much more choice and flexibility and raises the question, are individuals making informed choices and good retirement decisions generally? To date, there has been little examination of the success of freedom of choice in the UK.

In 2022 the IFoA carried out a survey of over 2000 55+ year olds and found that there was limited awareness of the reforms, more advice and guidance needed, and a clear trend that individuals did not understand enough about their pension options. You can read the full breakdown of findings from that report **here**.

Only 22% had used Pension Wise

40% took no advice or guidance at all

1 | IFoA Pensions Gap working party, 2024.

# Modelling the cost

Throughout 2024, the IFoA Pensions Gap working party have been investigating how decision making can have an adverse impact on an individual's final pensions pot. Moreover, the group has modelled and calculated the cost based on a set of parameters (see Annex). There are a few choices individuals can make that can have disastrous consequences for their pensions, actuarial modelling shows these to be:

### 1. Not starting a pension

E.g., the self-employed.

It's a simple fact that the biggest pension mistakes an individual can make is to never start one. As mentioned above, not all workers in the UK are eligible for AE and for workers such as those that are self-employed, they must set up their own pension. If an individual does not prioritise their pension (for example because they are concerned about cashflow, or it never makes its way to the top of the "to-do" list) they will miss out on tax relief and the miracle of compound interest (which Einstein described as the 8th wonder of the world).

Never starting a pension could mean that an individual ends up working far longer than they would like. For the average person, starting a pension at 35 instead of 25 could mean their pot is only £500k at retirement instead of £800k. Early contributions have a huge impact.

It is worth noting that as of March 2024, there are 4.25 million self-employed people in the UK who do not readily have access to automatic enrolment. Further policy interventions are required to support this segment of the working population.

### 2. Opting out

E.g., opting out for 5 years could reduce a pension pot by over £100k.

All employees are entitled to opt-out of their AE pension. This may seem like a good idea in the short term as they would take home slightly more pay but in the long term they are missing out on:

**a.** Tax relief.

**b.** Employer contributions; and

**c.** Tax free investment returns (an individual might be saving £100 per month by opting out but could easily be missing out on £300+ per month going into their pension).

Actuarial modelling shows that an average person who chooses to opt-out of their pension for 5 years could end up with £100k less pension at retirement. The younger the individual is when they opt out, the bigger the impact becomes.

**Statistics on automatic enrolment** from the Department for Work and Pensions (DWP) show that in August 2022 the proportion of newly enrolled employees within the 12 workplace pension providers who opted-out of their workplace pension was 10.4%, compared to 7.6% in January 2020. It is worth noting these 12 providers covered a total of 15 million savers.

## There are 4.25 million self-employed people in the UK who do not readily have access to automatic enrolment

### 3. Not taking advantage of maximum employer contributions

In some pension schemes, if an individual pays more, their employer will pay more too. For a typical person, not taking advantage of extra contributions of 1% of their salary for 40 years could result in up to £100k less pension at retirement.

Many pension plans automatically enrol employees at a minimum contribution rate. However, there is often an option to increase pension contribution and receive higher contributions from an employer (known as matching). This can be seen as "free money" from an employer and can result in a much higher pension at retirement. Missing out on just an additional 1% contribution from an employer could reduce an average pension by up to £100k at retirement.

### 4. Career break without pension contributions

E.g., 6 months maternity leave could reduce a pension pot by £30k or more.

At some point, most people have thought about taking a career break, either for maternity/paternity or other reasons such as travelling or caring responsibilities. Although pensions may not be front of their mind at this time, it's important to check if pension contributions continue and at what rate. The long-term impact of even a short break from pension contributions (including statutory minimums) could be much higher than anticipated. For example, a 6-month career break with no pension contributions could reduce a pension pot by £30k at retirement.

### 5. Divorce

Ignoring pensions on divorce could mean that one party ends up with more retirement income than the other. This could leave either party short by hundreds of thousands of pounds.

Divorce can be a very painful process and including pensions in the discussion can make it even trickier - the Office of National Statistics (ONS) estimate that 100,000 people get divorced each year. However, pensions are typically the second largest asset in a household after a house. With male pensions typically 30+% larger than female pensions, it's important not to forget pensions when thinking about how to split assets on divorce.

### Pensions on Divorce: Expert Actuarial Advice

In April 2024 the IFoA carried out a **thematic review** on how actuaries provide advice and calculations on pensions in divorce cases. It highlights the challenges of this type of work as well as some key findings on many individuals facing divorce may not be taking appropriate advice. Actuaries provide reports for the courts on how couples can treat their pensions on divorce. This is a valuable service for consumers provided by a small number of actuaries, explaining a labyrinth of rules in largely accessible language focussing on individual circumstances. We estimate such reports are provided for less than 1 in 20 of the divorcing couples in England & Wales each year.

### The gender pensions gap

The IFoA has been working to highlight the gender pensions gap including its causes and how to begin to tackle the issues faced by women in planning for retirement. As part of the IFoA **'Think' thought leadership series**, we published '**Tackling the gender pensions gap - the road to financial equality in retirement**'. This work builds on a **report** published by NOW:Pensions in February 2024, which highlighted that, for women to retire with the same amount in their pension pot as a man, they would need to work an average of 19 years longer. Following starting a family, many women may also choose to begin to work part time which can have a compound impact on future pension pot value.

Please see the short film '**mind the gender gap**' from Ipsos, which combines expert voices and real stories from women at different life stages on the consequences of the gender pensions gap.

### 6. Moving to part-time

E.g., moving to 3 days a week for the second half of an individual's career could reduce their pension by £200k.

There are many considerations when it comes to moving from full time work to part time work but often pensions again get forgotten. As pension contributions are normally calculated as a percentage of pay, a reduction in pay will lead to a corresponding reduction in pension contributions which can have a significant impact overall. For example, an average employee choosing to work 3 days a week for the last 25 years of their career would be paying in 40% less pension contributions and this could reduce their pension by £200k at retirement. According to the ONS, '**Labour Force Survey**', as of January 2024 1.7 million men and 5.1 million women are employed part time workers in the UK.

Note, our analysis does not allow for the potential additional impact of a change in career trajectory that is often observed when employees move to part-time (e.g. there are very few part time CEOs).

### The importance of saving goals in the UK

The modelling above illustrates the importance of understanding pension contributions and how they may impact quality of life post-retirement. At present, there is no consistent public narrative or nationally recognised amount to help individuals understand how much they need to be saving into their pension. This is complicated, taking in factors such as whether you live in a single household or not, or even the fact that women live longer than men on average. The IFoA's '**Saving Goals for Retirement**' report aims to address this. Linked to the Pension and Lifetime Saving Association's '**Retirement Living Standards**', the 'saving goals' aim to help people understand what differing contribution levels may produce in terms of quality of retirement – the figures are stark. People saving at the minimum level mandated by automatic enrolment, and with a full National Insurance record, should be on track to achieve the 'Minimum' retirement living standard. Someone on average full-time earnings will need to save around a quarter of their income (26%) to be on track to achieve the 'Moderate' retirement living standard. Someone aiming to achieve the 'Comfortable' retirement living standard will need to save more than double what they'd need to save if aiming for a 'Moderate' living standard.

## The 'saving goals' aim to help people understand what differing contribution levels may produce in terms of quality of retirement – the figures are stark

# Conclusions

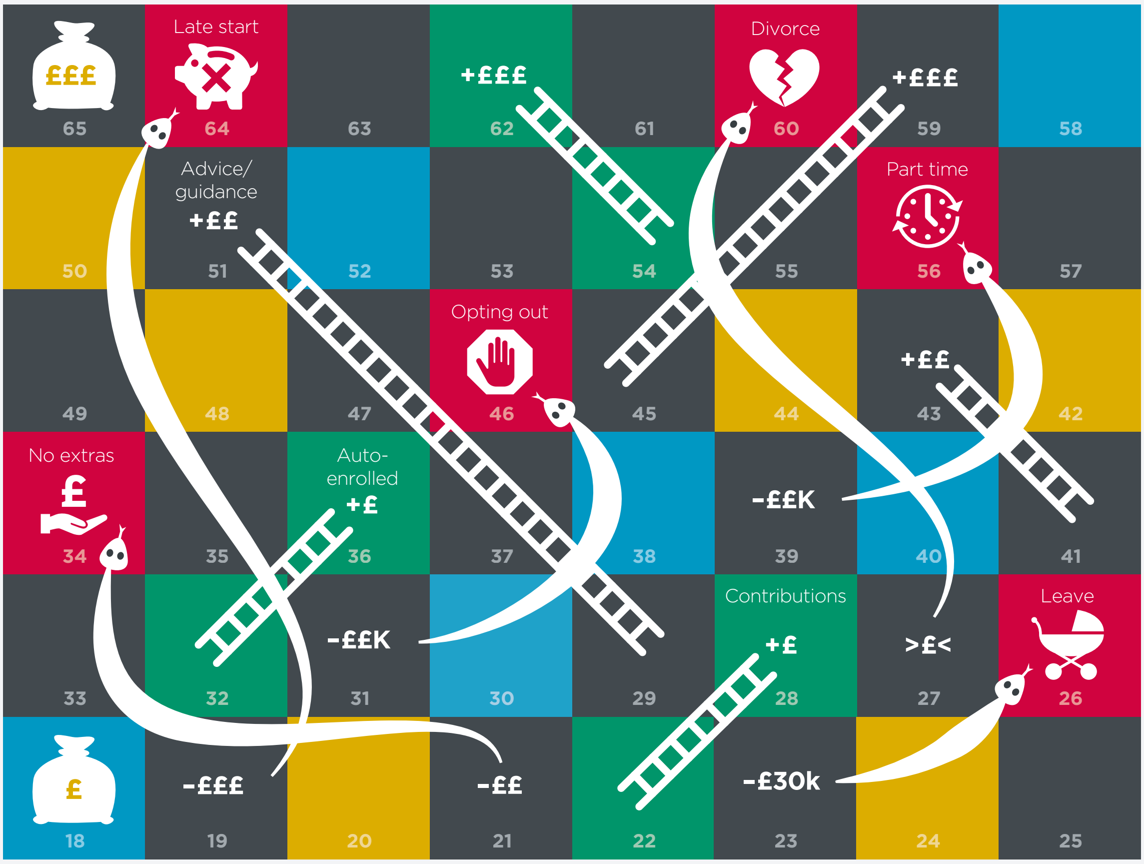
## Taking a long-term view

When considering potential barriers that people in the UK may be facing when accumulating retirement savings, the IFoA believe there is a golden opportunity to reset the policy agenda. As experts in long-term risk management, actuaries are essential in the design and implementation of policies relating to the future of UK retirement provision. Our policy prospectus, '**Beyond the next Parliament - the case for long-term policymaking**' contains a series of recommendations relevant for the new government and beyond to help individuals with decisions surrounding their pension. Taken in conjunction with the 'Great Risk Transfer' recommendations as referenced earlier in this report, the following provides a solid foundation for addressing the problem and avoiding/ mitigating pension gaps.

This will not be an easy nut to crack. To be successful we need all stakeholders to play their part and commit to their role in the change that is needed – government, employers, pension providers, and individual consumers.

## Government leadership and support around saving and pensions.

There is a clear need to raise awareness of the importance of pension saving, and the potential impact of under-saving on individuals' lifestyles and wellbeing when they retire. At present, there is no consistent public narrative or nationally recognised amount to help individuals understand how much they need to be saving into their pension each month to secure a 'good' retirement. We recommend that the new government should reinvigorate its public messaging around minimum pension saving levels – particularly through workplace auto-enrolment pension schemes – to ensure that consumers are not lulled into a false sense of security as to whether their pension saving will be adequate to achieve their retirement income goals. In doing so, government should use expertise and evidence on testing behavioural responses to different messages and channels, to identify those that are most effective in impacting saving behaviour.




How much could you lose – the impact of pension gaps on retirement

## Looking again at Automatic enrolment.

The stark reality is that current minimum contribution rates of 8% (3% from employers and 5% from employees) are unlikely to be sufficient for many individuals to secure the standard of living they may want or expect. The IFoA strongly urges the new government to review the minimum AE contributions, and to consider carefully how overall saving could be increased, noting that there are various ways of achieving this other than by simply increasing the employee and employer percentages. We acknowledge that there are several ways to tweak the structure of AE contributions and that these too should form part of such a review. Initiatives such as the Institute for Fiscal Studies '**pensions review**' in partnership with abrdn Financial Fairness Trust and recent **work by the Work and Pensions Committee** through its inquiry on saving for later life are good starting points for the new government. It is positive that the government have announced a pensions review, with phase one looking at productive investment and the second phase focusing on pensions adequacy. Automatic enrolment reform should be at the heart of the second phase and the IFoA are ready to contribute.

The power of the default has been proven with the roll-out of Auto-enrolment, and the relatively low opt-out rates we have seen from employees. It is now time to build on this success to make sure that individuals are building an adequate level of retirement savings.

Additional and new policy initiatives, to sit alongside and build on the initial success of AE, focused on the notable 'moments that matter' to an individual when building their retirement savings, mentioned earlier in this paper, would be great to see. The power of the default could well be enacted here as well, shifting the status quo to building adequate retirement savings, harnessing an individual's inertia whilst still providing them the freedom and choice to choose a different path.

How do other countries tackle issues such as pension equity, what can we learn from them? Does the current system of tax-relief lead to optimal results for households planning their retirement savings? How can we help those that are self-employed build their retirement savings? When someone moves to working part-time how do we make sure that they have the information they need to make informed decisions about how this might impact their retirement savings goals? There are many more questions besides these that we should be asking as part of a full review. Time is of the essence. The average DC member is currently 40 years old. We therefore cannot afford to wait. If we wait too long to come up with a plan, we risk jeopardising the very idea of retirement for a whole generation.

# Current minimum contribution rates of 8% (3% from employers and 5% from employees) are unlikely to be sufficient for many individuals.

## Focusing on advice and guidance

The IFoA remains concerned that many UK households are not saving enough for later life, are not accessing free guidance or paid-for financial advice and remain ill-equipped to deal with the risk of running out of money in retirement. Another important consideration in this regard is the future affordability of the state pension. The IFoA believe that free guidance is a valuable option for those who cannot afford advice, and evidence suggests that people who take Pension Wise guidance feel more confident and have better outcomes than those who do not. There is, however, significant concern that the current take-up of Pension Wise is much too low.

The IFoA is of the view that providing automatic Pension Wise guidance sessions before retirement would help consumers to consider the pros and cons of drawdown at that stage, so that they could later look separately at the choice of which product would best meet their needs.

## The role of innovation

There are many promising interventions that will support the current and next generation of savers, such as pensions dashboards, alongside sources of information and guidance, and new scheme designs such as Collective Defined Contribution (CDC) pensions. The foundations are in place to support greater pensions adequacy; we need to build on what is already there. The pensions dashboard programme should give high priority to how retirement income will be estimated and presented in a consistent way on dashboards, taking account of the wide range of products in the market and assumptions adopted. Furthermore, the new Government should continue to advance CDC schemes by building on existing regulations to consider multi-employer schemes and master trusts.

# Recommendations

## Government

The IFoA urges the government to:

1. Explore and engage to understand the potential of new initiatives and policies that may help to close pensions gaps, for example:
   - A specific focus on pensions gaps from advice and guidance support services such as '**Pension Wise**'.
   - Explore a new option to setup household pension plans for joint pensions savings.
   - Review the inequity of current pensions tax relief e.g., it costs £80 for a 20% taxpayer to contribute £100 to a pension vs £60 for a 40% taxpayer.
2. Reinvigorate its public messaging around minimum pension saving levels with a particular focus on those that are currently losing out when it comes to pension equity.
3. Review the minimum Automatic Enrolment (AE) contributions, to ensure that regulations do not accentuate pensions gaps and examine AE options for the self-employed.

## Employers

The IFoA urges employers to:

1. Ensure pension policies are equitable and do not unfairly accentuate pensions gaps, for example: AE policies, parental leave and other career breaks, part-time working etc.
2. Support employees at key life events e.g., joining, becoming a parent, changing to part-time etc. to ensure they fully understand the potential pensions impact of decisions and options to change pension savings.

A good reference point for employers on the gender pensions gap is the recently published '***Mind the Gap***' report from the Pensions Equity Group.

## Individuals

To better protect against pension gaps, individuals can:

1. Identify personal pension gap between their projected pension savings at retirement and the income they will likely need e.g., by using available tools such as the IFoA '**savings goals for retirement**' and the Pension and Lifetime Savings Association (PLSA) '**retirement living standards**'
2. Ensure pensions are not forgotten at key life moments including starting new jobs, becoming a parent, divorce, moving to part-time etc.

Refer to strong consumer guidance on pensions such as *MoneySavingExpert's* '**pension guides**', PensionWise and **pensions tools and information** from *Which?*.

### Future work

This report has been led by the IFoA Pensions Gap working party and forms the basis of future work on pensions gaps throughout 2024/25, including partnership working with Ipsos. To get involved, or for further information on any of the material in this report, please contact Caolan Ward in the first instance **caolan.ward@actuaries.org.uk**.

# Appendix: actuarial parameters of modelling

### Assumptions for base scenario

- Starting gross pensionable salary of £28k.
- Annual contributions 10% (which would be split between employee and employer).
- Contributions increase with annual salary increases of 4%.
- Average investment return on the pot of 6% pa.
- After 40 years this gives a pot of around £800k.
- Assume individual retires at age 65 so starts contributing to a pension at age 25.
- All pension amounts are shown at a future retirement date, so not in today's money terms.
- The calculations assume contributions from the first £ of salary, with no LEL or UEL applied.

### 1. Not starting a pension

- Assumptions as above but if contributions start at 35, we assume the starting salary is £41,447 (i.e. 28k*1.04^10). This gives a pot of around £500k after 30 years.
- £800k less £500k gives a £300k impact.

### 2. Opting out

- Assumptions as above. Opting out, say from age 55-60, reduces pot by around £100k.
- Any career break earlier than that has a higher impact.
- For exmple, a career break from age 35 to 40 gives a pot of £608k so impact of £206k.

### 3. Not taking advantage of maximum employer contributions

- Assumptions as above. If 1% less goes in from the start, pot after 40 years is around £80k less.

### 4. Career break without pension contributions

- Assumptions as above with annual contribution halved at age 35 and no salary increases whilst off work. This makes a pot around £30k lower at retirement

### 5. Divorce

- This number will vary greatly between couples but can be in the multiple thousands of pounds.

### 6. Moving to part-time

- Assumptions as above plus from year 16 onwards contributions are multiplied by 60%. This gives a pension pot of £640k at retirement of original £800k i.e. £200k impact.

Institute and Faculty of Actuaries

Member-led insights from the IFoA

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