Summary
- Studies reveal that a significant portion of pension savers lack confidence in making basic retirement decisions.
- Due to gaps in knowledge, some individuals may prefer investing in property or Lifetime ISAs (LISAs) over pensions, due to these being perceived as more tangible and easier to understand than pensions.
- Auto-enrolment has made saving for pensions easier, but lack of engagement and financial literacy still lead some individuals to opt out.
- Simplifying communication about pensions and emphasising their relevance to individuals' financial goals can encourage better engagement and understanding.

Pensions versus other long-term saving options

In this month's edition of *Pensions Age's* special focus on financial literacy, Paige Perrin examines the complexity of understanding pensions in comparison to other long-term saving products, exploring the factors that contribute to savers' confusion and potential industry strategies to address this

The road to financial literacy is anything but simple. The widespread lack of understanding about pension products among savers has been a significant roadblock in the industry for many years.

Numerous studies by experts have consistently explored the extent of savers' comprehension of various aspects of their pensions. These include knowledge of where pensions are invested, interest rates, and even basic awareness of the existence of their pension plans.

For instance, just over a third (35 per cent) of pension savers are confident in making basic retirement decisions, such as choosing how to access their pension when they reach retirement age, according to a TPT Retirement Solutions study conducted in April.

Additionally, research from Wealth at Work, also conducted in April, found that almost half (49 per cent) of DC scheme members didn't know what their pension was invested in, with 29 per cent of DC savers unaware that their pension was invested in the first place.

Commenting on the research, Wealth at Work director, Jonathan Watts-Lay, says: "It's worrying that our research shows that many people don't realise that a pension is an investment, or even that they have a choice over how their money is invested in their pension and what is particularly concerning is that this worsens for those approaching retirement."

Arguably, this lack of pension comprehension may result in more savers investing in property or a Lifetime ISA (LISA) versus pensions, just due to a gap in their knowledge.

Like pensions, a LISA is also a long-term saving product, but used for saving

either for a house or retirement, whilst property is generally seen by people to be a good long-term investment that can be sold to fund retirement.

Indeed, Hargreaves Lansdown's research in October last year found that over four in 10 (43 per cent) young people hinted that they would use a LISA for retirement planning, including 15 per cent who said they would use a LISA instead of a pension.

Understanding barriers

Just how likely is it that individuals opt for investing in property or saving into a LISA when planning for retirement?

PMI director of policy, Tim Middleton, says that whilst he believes that LISAs have not proved "particularly" successful, property remains a popular form of retirement saving.

"Many people are confident that they understand property as an asset class and feel more comfortable investing in it than they do for pensions," Middleton explains.

My Pension Expert policy director, Lily Megson, acknowledges that: "It's a lot easier for pensions, which are seemingly so far in people's future, to be kicked down the road. Mortgages for a lot of people, particularly younger generations, are more immediate.

"It can be a lot harder for younger generations to visualise their pension as they can't touch it until they are 55. That contributes to people engaging more

in mortgage products as opposed to pensions."

Watts-Lay echoes this, saying: "People don't have the same motivation for pensions as they do for mortgages. The mortgage process is completely driven by the end goal – getting that house, whereas with pensions the end goal is just not as tangible as a physical item, which is why people don't engage."

Quietroom director, Simon Grover, however, emphasises that the "oddity" of pensions is that they are "at heart, incredibly simple".

"It's a lot easier for pensions, which are seemingly so far in people's future, to be kicked down the road"

"Build up money now so that you have a better life when you're older. Most people have no problem getting their heads around other savings products that basically work the same way, but which don't include the free money bit," he explains.

"Mortgages and loans are the same, just in reverse. They're easier to love because you get the benefit first, then pay later."

Whereas BNY Mellon IM head of retirement, Richard Parkin, argues that pensions are "definitely" more complicated than other financial products, due to the constantly evolving regulations surrounding them.

"They have more moving parts and are subject to much more regulation, which is constantly changing," he states.

Society of Pension Professionals council member, Mark Bondi, adds there is a "common misconception that property or ISAs are a preferable investment option, but this will only be true for a relatively small number of people".

"If people were given the skills and confidence to better understand not just pensions but a whole host of other financial products, from credit cards to mortgages, then more informed financial decisions could be made – benefitting individuals, pension providers, and the wider economy," he says.

However, auto-enrolment (AE), means saving for a pension is easier than ever. Megson highlights that pension saving is not always an active choice and "the real" benefit of AE is that people can save for retirement without really having to think about it.

She stresses that "because of the lack of engagement and financial literacy surrounding pensions there are a number of people who just opt out *[of workplace pensions]* or don't understand that in the long term, this is incredibly beneficial for people's financial future".

So, what are the positives of saving into a pension that people may miss due to a lack of understanding around pensions?

Grover explains that there are three main benefits that people forget when it comes to pensions, and he believes they add up to "a pretty unbeatable proposition".

"The obvious one is employer contributions. You not only miss out on these if you opt out of your workplace scheme but also if you fail to take up any contribution matching that your employer offers.

"Tax savings are less obvious, but also important because you lose that saving if you don't save into your pension. And finally, the magic of compound growth."

Parkin agrees that pensions are still the most tax-effective savings vehicle for almost everyone, "yet we don't see people taking full advantage of these tax reliefs". "Many still don't recognise that the long-term benefits of investing, including compounding returns, are likely to outweigh the short-term risks" he says.

Overcoming obstacles

Despite the differing industry opinions on people's preferences for property, pensions, or other saving vehicles for retirement, there is no doubt that there is a consensus that more needs to be done to improve financial literacy and pension understanding.

"While overall financial capability in the UK is relatively low, understanding of pensions specifically is even lower. This likely results from two key factors: The complexity and lack of exposure to pension," Pensions Policy Institute senior policy researcher, Lauren Wilkinson, states.

She says that the lack of exposure to pensions is "because of the long-term nature of pensions and the distance of many savers from retirement, they are unlikely to need to engage with pensions on a day-to-day basis, as they do with other financial products, such as current and savings accounts."

Regarding the complexity of pensions, she cites research from the ABI that found 70 per cent of UK adults feel that pensions can be overly complex and complicated to understand.

Additionally, Grover stresses that "complexity reduces confidence" and if people are being asked to put aside or "give up" money now there needs to be confidence to convince them.

"If they are not confident in the process they are getting into, they will shy away, or at least not get properly engaged. A common mistake for pension communications is to try and explain all the complexity, instead of picking the bits that are important and interesting," he explains.

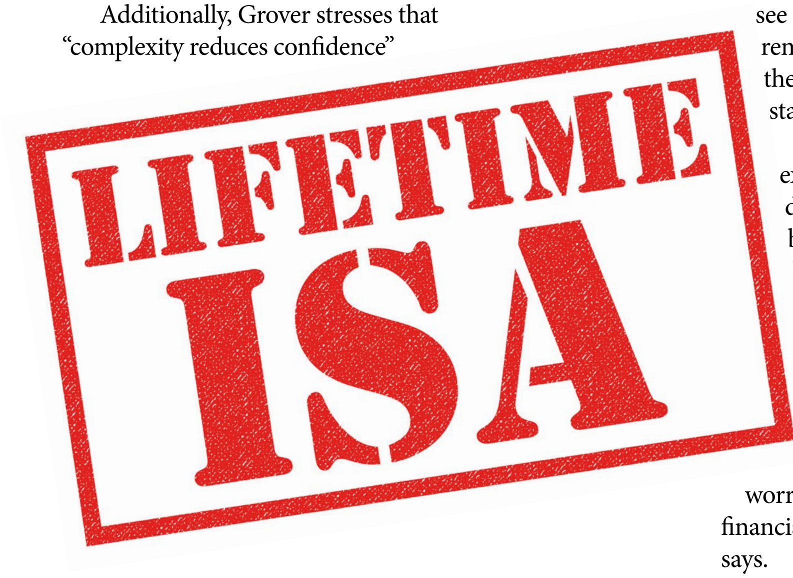
Standard Life head of financial education, Andrew Pearson, emphasises that "breaking down barriers" by normalising conversations around money is a "major step forward".

"It would make aspects of finances like budgeting, mortgages, and pensions feel less overwhelming," he says.

Watts-Lay indicates that employers tailoring advice and guidance to groups of different life stages is "key" and says it is then about "building the pensions story as it's relevant to those different cohorts".

Meanwhile, Parkin reasons that many people find the whole concept of pensions "daunting" and says he is most concerned about the decisions people are making in retirement.

"The FCA retirement income market data shows huge numbers just cashing out at an early age and potentially paying a lot of tax. In my experience, people see pensions as remote and not their money," he states.



Megson explains that for decades, people have never been actively encouraged to engage with their pension. "There is such a worrying lack of financial literacy," she says.

The finish line

While it's all well and good to understand the lack of financial literacy surrounding pensions, and to acknowledge that people are also investing in other financial products for long-term saving, what is most likely to improve understanding of pensions is the industry increasing its efforts to raise awareness. What impact could this have on the industry, and savers?

Pearson stresses that the industry should not just focus on "pensions in isolation" but build financial confidence through supporting savers "every step of the way".

"The use of tools like open finance can help people better understand how their short and long-term financial priorities fit together, boosting their level of financial awareness and understanding, and helping them make the most of their money every day," he says.

Parkin encourages increased education on financial literacy. As he explains: "People would save more. This would clearly benefit individuals who will have a better chance of achieving their retirement goals but will also benefit providers commercially."

Megson thinks improvements in financial literacy will "help to create a sustainable positive engagement in the future generations, which will take a lot of the burden, in theory, off the state. People will understand how to sustain their desired standard of living through their retirement income. They will be able to enjoy their retirement as everyone deserves to."

Grover concludes that people don't want to learn about pensions, but they want to "learn about their pension, their money, and whether they're saving enough for when they might need it. If we can explain that to people, they'll listen".

Written by Paige Perrin