How to close the savings gap

We all know people in the UK are not saving enough – a problem felt most acutely in retirement planning. But it's no good simply blaming individuals for fatalism or a culture of instant gratification. Regulation, government policy and the structure of the savings and investment management industry are all critical to closing the gap

It's not hard to find some quite alarming figures on the scale of the savings gap in the UK. For example, Scottish Widows estimates that there are 6.2 million workers failing to save anything towards their retirement; that's a total of 20% of the population who should be saving but aren't.[1] The savings ratio (the percentage of household income left over after monthly expenses) is just 4.9%, according to ONS figures – the lowest it's been since 2008, in the run up to the financial crisis, and about a third of the level 20 years ago.[2]

The savings gap might be a well-established problem, but it's clearly getting worse. Retirement savings is perhaps the biggest problem. The DWP has warned that 11.9 million UK adults are failing to save enough for an "adequate income" in later years.[3] No wonder the Chartered Insurance Institute estimated the total savings gap – just to deliver pensions at a level most people expect for a tolerable lifestyle – at around £9 trillion.[4]

With increasing life expectancy, rising long-term care costs and clear government aspirations to shift the financial responsibility onto the individual, not only is the gap still big, but its potential impact on the UK is also growing.

The problem for consumers

Unfortunately, the problems don't end there. The Retail Distribution Review (RDR) created much-needed transparency in fees around long-term savings and wealth for consumers. But while it has improved the quality and professionalism of advice available to wealthy customers, it has effectively removed a huge swathe of the market – those with modest savings, who may be most in need of advice – from any kind of contact with the savings and investment industry.

Forty years ago, the mass market of low-income earners was prompted to save regularly by doorstep visits from "the man from the Pru", or his equivalents from other companies. These days if they save at all, they're more likely to base their decisions on tips in the money sections of the newspapers or the latest personality-led investment fund than build a sensible savings portfolio. Neither of those approaches are intrinsically bad, of course, as long as they are part of a considered and appropriate individual savings plan.

At the root of many of these problems is a fundamental cultural issue: a large proportion of the UK population is essentially in denial about the need to save, especially for the long term. Perhaps, collectively, we have become dulled to the problem after 107 years of state provision or employers offering defined benefit pension schemes. That world has fundamentally changed.

Our consumerist society facilitates instant gratification, not long-term planning. It takes minutes to apply for a credit card or buy a car, for example, whereas the paperwork to start a personal pension – let alone keep track of it – is mind-boggling for providers and consumers alike.

Regulatory change, risk aversion and over-complex product sets within the savings and investment industry, lack of consumer engagement, and economic conditions all have to shoulder some of the blame.

Education the key to promote saving

One of the biggest problems is generational. Although there is evidence that saving is becoming more important to younger adults, it's far too easy for them to adopt a fatalistic attitude towards money. It's easy to see why: sizeable student loans and a housing market that in parts of the country is simply out of reach mean even modest monthly saving for retirement is a stretch.

Previous generations benefited from decades of rising house prices and generous workplace pension schemes. Today's workforce has neither.

Young people need a more solid financial education, starting at school. George Osborne's policy as Chancellor is to "create consumer freedom and choice" by shifting the risks and responsibilities for financial planning to the individual from the state. But such a shift demands better-informed and more forward-thinking consumers who understand the basics of managing their money

We need the message about how people should manage their day-to-day budgets – how much to save, why and how – to be given loud and clear. It needs to be delivered early and repeated constantly.

But for that education to be effective, we also need more stability in the system. How do you educate Generation Y on long-term savings when there are regular changes to the rules? How can we encourage consumers to commit to long-term savings if they have no confidence in the way the tax or benefits from savings products might change and when they are constantly presented with attractive ways to borrow money to buy things instantly which they can't really afford?

60

years of state provision or employers offering defined benefit pension schemes

Household savings ratio is just

4.9%

11.9m

failing to save enough for retirement

And, for that matter, how will we encourage the long-term savings and wealth providers to simplify their products, become more efficient and get closer the customer if they're also uncertain about future regulations?

A lack of advice

There is some good news. As Auto Enrolment kicks in, the numbers in workplace pension schemes has grown. The ONS said last year that 59% of the workforce is now an active member of a scheme, up nine percent from 2013[5].

However, there is a growing army of self-employed who are excluded from such schemes. A more insidious risk is that those who are auto enrolled, but only at the minimum level, will believe that being in their works pension will give them enough to maintain their lifestyle in retirement. This is unlikely to be the case.

Older regulatory changes are still playing out, too. The decline in advice post-RDR is perhaps the biggest issue for the industry. For many people living in austerity Britain, day-to-day concerns over-ride any potential spur to consider whether they could and should save more for the future. And now they're not even getting routine advice when they take out a mortgage or kick off a small pension contribution, for example, the drive to save sensibly is even less.

Adapting to the consumer

Many savings and wealth firms are building their propositions around this tricky regulatory environment – and trying to stay on the right side of often ambiguous lines concerning advice, guidance and information – rather than around a customer outcome.

That's not to say the industry is blameless for the savings gap. Established players in the industry are struggling with the cultural transformation necessary to shift their businesses to focus on the customer rather than product or channel.

Often they are hampered by legacy systems and processes that make it hard to be agile around a customers' needs. Twenty years of reliance on financial intermediaries has also left them less able to connect to customers, and many are stuck with out-dated, over-complex and bloated product portfolios.

New players, and existing Financial Services businesses that have made a definitive move to digital platforms, have seized the critical high ground in the battle for consumer engagement. These are the disruptors, bringing low-cost, low-fee models which emphasise consumer choice, plentiful information and interactivity.

Even these businesses face challenges around advice and guidance, however. Regulation has to adapt to this new environment. While the potential for 'robo-advice' models to reshape the market is clear, the hype currently runs ahead of the reality. '

Retail and digital show the way

Focus on the customer. Make it easy to transact. Make it transparent. These are lessons that many other industries have long since adopted. The internet, online payments, peer reviews and devices such as smartphones have totally revolutionised retail – and made it both customer-centric and efficient for businesses. Imagine being able to make a pension contribution in that kind of frictionless transaction rather than working through complex paperwork and worrying about whether you've made exactly the right decision.

The savings and investment market is more daunting to the average consumer than many of the financial products they are used to purchasing, such as loans or a current account. When dealing in the long-term a "good" investment often looks more risky. We're asking consumers to make a sophisticated calculation. Not only that, we're also asking them to engage with a brand that they don't necessarily know or trust. That's one reason we think the retail banks might have a huge opportunity in the long-term savings and wealth market for the mass affluent, and maybe even mass market… If they, and the regulators, can get the offering just right.

Developing a new business model based around customer lifecycles and lifestyles isn't easy. We're likely to see a lot of pain as businesses plough investment into systems and struggle to adapt to this new market. But this investment should result in market that is easier for the customer to understand.

Given the low levels of financial capability and trust present in the market, advice and guidance are integral to both engaging ordinary consumers and helping them make the right decisions.

For the savings and investment businesses that develop innovative models to deliver this, the rewards aren't just in scale and profitability. They're also going to help generations of consumers prepare financially for all manner of life events, start to close the savings gap and create a financial world that's built to last.

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[1] *http://reference.scottishwidows.co.uk/docs/2015-06-Retirement-Report.pdf*

[2] *http://www.ons.gov.uk/ons/datasets-and-tables/data-selector.html?cdid=nrjs&dataset=qna&table-id=j3*

[3] *https://www.gov.uk/government/publications/scenario-analysis-of-future-pension-incomes*

[4] *http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings-pension-tables/2014-provisional-results/art--2014-annual-survey-of-hours-and-earnings--summary-of-pension-results.html*

[5] *http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings-pension-tables/2014-provisional-results/art--2014-annual-survey-of-hours-and-earnings--summary-of-pension-results.html*

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