FSCS Financial Services Compensation Scheme

FSCS CONSUMER RESEARCH: Impact of rising cost of living on finances and pensions

March 2023

www.fscs.org.uk

Promote is a key part of the Financial Services Compensation Scheme's (FSCS) strategy. Our ambition is that the full range of FSCS protection is known about and trusted. Promoting the protection we offer helps consumers to make informed and confident financial choices. Our Promote to Prevent work centres around raising awareness and helping reduce consumer harm which is driving up FSCS's compensation costs.

This Consumer Research series aims to share the results of our exclusive research on consumer attitudes towards financial products and services. It helps us, and stakeholders across the financial services sector, to identify gaps and opportunities to provide consumers with the essential, accurate information they need about FSCS protection.

FSCS can pay compensation when financial firms go out of business. FSCS can protect deposits, insurance policies, some investments, insurance broking, mortgage advice, self-invested personal pensions (SIPPs), pensions advice, payment protection insurance (PPI), debt management plans and funeral plans. For more information on what we cover, visit our website.

Funded by the industry, we are independent and our service is free to use.

Welcome to the latest edition in our series of FSCS research papers where we share insights from our exclusive consumer research, highlighting opportunities for us all to improve consumer outcomes.

Why we care about the increased cost of living

The increased cost of living, commonly referred to as the cost of living crisis, refers to the fall in 'real' incomes that UK residents have been experiencing since late 2021. We are now almost 18 months into this period, which followed an extremely challenging time as we navigated the Covid-19 pandemic. It could be said that we have experienced a period of multiple crises, as the combined forces of a looming financial crisis, climate issues and the war in Ukraine have also made their impact on society. This is all happening against the backdrop of the UK navigating its exit from the European Union.

Inflation hit its highest level in more than 40 years in October 2022, driven mainly by rising energy and fuel prices. Although it has since slowed, it remains at historically high levels and continues to far outpace wage growth for most. In response, the Bank of England raised the base rate of interest eight times in 2022 and have already done so once in 2023 – taking the rate to 4%, the highest it has been since late 2008. For vulnerable or young borrowers in particular, who perhaps stretched themselves to get onto the property ladder on a cheap fixed-rate mortgage deal, these are challenging times.

Given we have been living in this environment for more than a year now, there has been much discussion and debate on the severity of the situation and how deep the impact is on individuals, communities, and particular groups in society. Figures from the Financial Conduct Authority's (FCA) Financial Lives Survey indicate that 2.2 million more adults had low financial resilience, defined as people in, or at risk of, financial difficulty, in May 2022 when compared to February 2020. Similarly, recent data from Citizens Advice shows that from January to October 2022, more people were unable to keep on top of their prepayment meters than the entire five-year period before that combined.

Conversely, while the FCA's figures indicate that roughly one in four adults have low financial resilience, there remains three-quarters of people who are not facing such financial difficulty. It is important to bear in mind that although rising costs may be hitting all of us, the impacts won't be experienced by everyone in the same way, with some media reports even suggesting that 'for most of us the cost of living crisis is not a crisis at all' – as many of the top banks report billions in additional savings sitting in customers' accounts.

However serious you believe the cost of living crisis to be, it is evident that the numbers of consumers struggling with their finances is concerning and this could contribute to widening inequality. When money is tight, it is inevitable that alongside compromises and budget planning some people are likely to take more risks, which could plunge them further into financial difficulties.

> it's vital for us to understand what consumers are doing today to help us predict what may land at our door in the future.

Why this is important to us

As with the previous research in our series, we have investigated this issue because it is relevant to FSCS and the day-to-day work that we do. As you'll see in this report, we have particularly focused on the impact that the current economic conditions are having on consumers' behaviour towards their pensions. Claims involving pensions and investment advice are now the most common ones we receive, and they are often the most complex and costly to resolve.

Given the lag that typically occurs between consumers receiving advice and making a claim with FSCS, it's vital for us to understand what consumers are doing today to help us predict what may land at our door in the future. Knowing what consumers are thinking and how they are acting and feeling also continues to help us better target our activities when it comes to raising awareness and deepening understanding of FSCS protection.

It is important to note that FSCS is of course not the authority on this issue, and many organisations have dedicated extensive time and effort to thoroughly researching how consumers are impacted and are behaving in response. However, we hope you find the results of our research an interesting contribution to the debate.

Lila Pleban
Chief Communications Officer

Find out more

Sign up here to be the first to know about future research

KEY FINDINGS

We conducted continuous consumer research between September 2022 and February 2023, with a total of 4,479 UK adults age 18+ (2,974 of them with a pension). The key findings show that as a result of the cost of living crisis:

26%

of respondents say they are taking more risks with their money to gain a better return.

23%

of those with a pension have either decreased the percentage they contribute or stopped contributing to their pension entirely over the past few months.

6% of those with a pension who haven't made any changes to their contributions over the last few months expect to either decrease the % they contribute or stop contributing to their pension entirely in the next six months.

Of those eligible to draw on their pensions (age 55+), 29% have moved money out to cover day-to-day costs. A further 17% have opted to move money from their pensions to invest elsewhere over the past few months.

In the next six months, 17% of those eligible are likely to move money out of their pension to cover day-to-day costs, while 12% are likely to do so to invest it elsewhere.

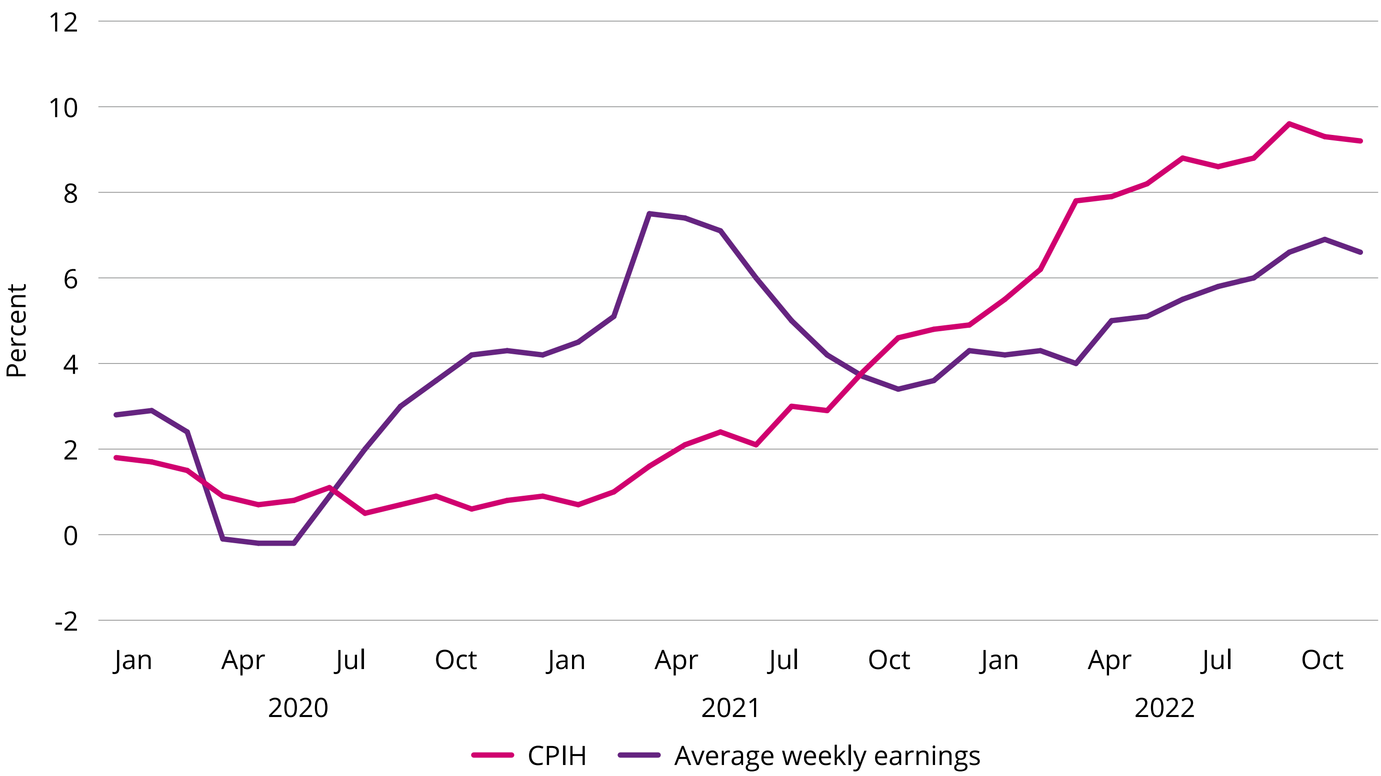
The cost of living crisis in official figures

According to the Office for National Statistics (ONS), inflation reached 9.6% in October 2022, when measured by the Consumer Price Index including owner occupiers' housing costs (CPIH). The CPIH series, which is the ONS' most comprehensive measure of inflation, only began in January 2006, but constructed historical estimates from the ONS indicate the last time inflation was higher was in December 1980.

One of the main contributors to rising inflation has been the soaring costs of electricity, gas, and other fuels, with the energy price cap, later called the price guarantee rate, steeply increasing in both April and October 2022.

Growth in prices has slowed since November 2022, following government intervention such as the Cost of Living Payment for low-income households and discounted energy bills. However, growth in wages has been much slower, with the gap between the two showing little sign of narrowing. This means real household incomes remain squeezed.

Figure 1: CPIH and average weekly earnings monthly change, January 2020–December 2022



Percentage change year on year

CPIH 2015=100

Source: ONS, February 2023

> Growth in wages has been much slower [than growth in prices], which means real household incomes remain squeezed.

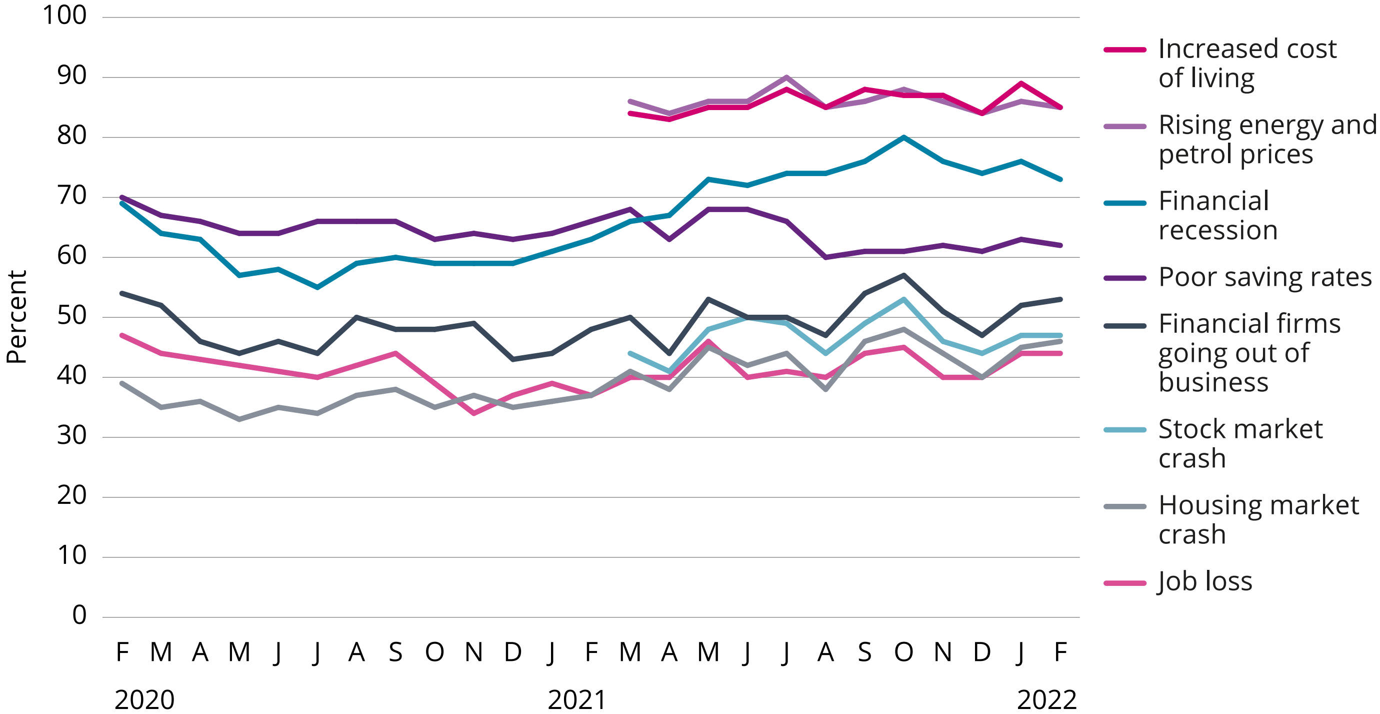
Cost of living tops financial concerns

In February 2023, 85% of consumers were concerned about the increased cost of living. Rising energy and petrol prices and the overall increased cost of living have dominated consumers' financial worries ever since we started including these metrics in our tracker in March 2022.

Similarly, fear of a financial recession markedly increased over the course of 2022, peaking at 80% among consumers in October 2022. Although it stood at a lower proportion of 73% in February 2023, this is still significantly higher than the 55% we saw in July 2021.

Figure 2: Financial concerns

"At the moment how concerned do you feel about the following?" – Any concerned – NET*



Monthly bases are as follows: Feb '21 (606), Mar '21 (767), Apr '21 (621), May '21 (1,054), Jun '21 (747), Jul '21 (610), Aug '21 (742), Sep '21 (604), Oct '21 (1,479), Nov '21 (603), Dec '21 (752), Jan '22 (757), Feb '22 (605), Mar '22 (602), Apr '22 (609), May '22 (752), Jun '22 (602), Jul '22 (600), Aug '22 (804), Sep '22 (602), Oct '22 (610), Nov '22 (1,432), Dec '22 (617), Jan '23 (606), Feb '23 (612)

* Those choosing 5, 6 or 7 on a 7-point scale, with 1=Not at all concerned, 7=Extremely concerned

Source: FSCS/Dynata, February 2020 – February 2023

Consumers are taking action when it comes to their finances

Struggling households are taking action in response to higher prices and a squeeze in their real incomes. Beyond everyday shopping decisions, they are also modifying their behaviours when it comes to personal finances.

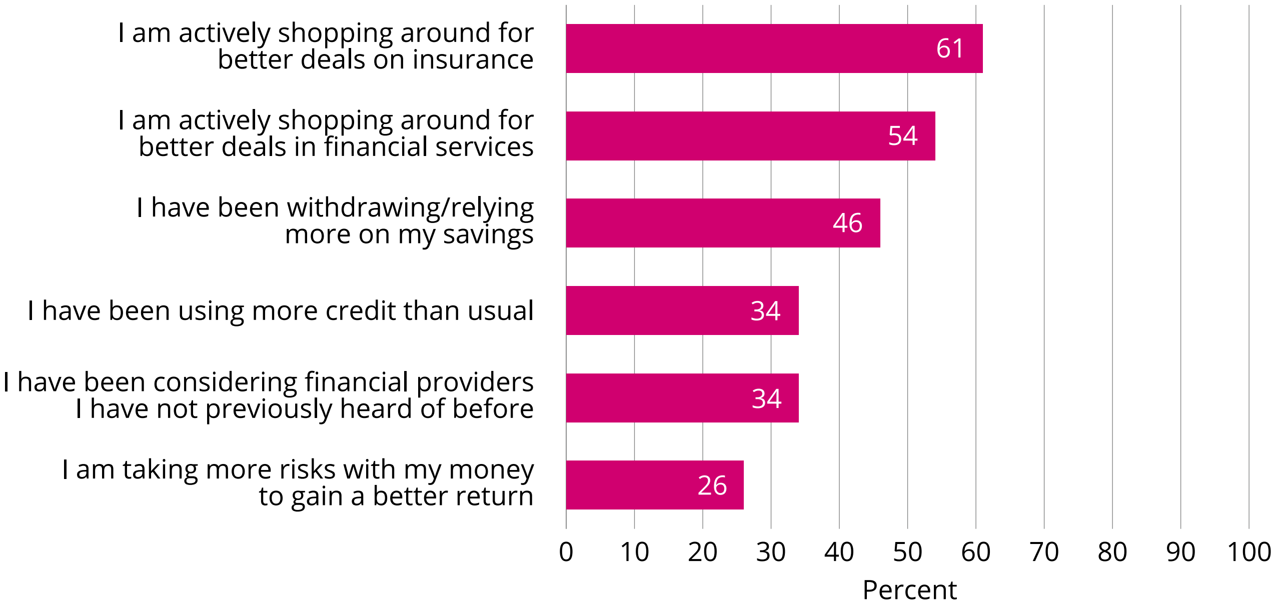
Our survey found that a majority of consumers are shopping around more, either for better deals on insurance (61%), or financial services in general (54%).

However, different demographics have been impacted more severely than others, with some groups really struggling to make ends meet (see Figures 4 and 5). Overall, 46% tell us they've been relying on their savings, while 34% have been using more credit than usual.

The cost of living crisis is also resulting in 34% of respondents considering financial providers they haven't heard of before, while 26% are taking more risks with their money to gain a better return. In times like these, awareness and understanding of FSCS protection is particularly important to help consumers identify providers and products that are safe to use. For more information on what we cover, visit our website.

Figure 3: Impact of cost of living crisis on personal finances

"We would now like to ask you a few questions about the impact of the cost of living crisis on your financial decisions. How strongly do you agree or disagree with the following?" – Any agreement – NET*



Base: 4,479 UK adults aged 18+

* Those choosing 5, 6 or 7 on a 7-point scale, with 1=Strongly disagree, 7=Strongly agree

Source: FSCS/Dynata, September 2022 – February 2023

Younger consumers are more likely to be relying on their savings...

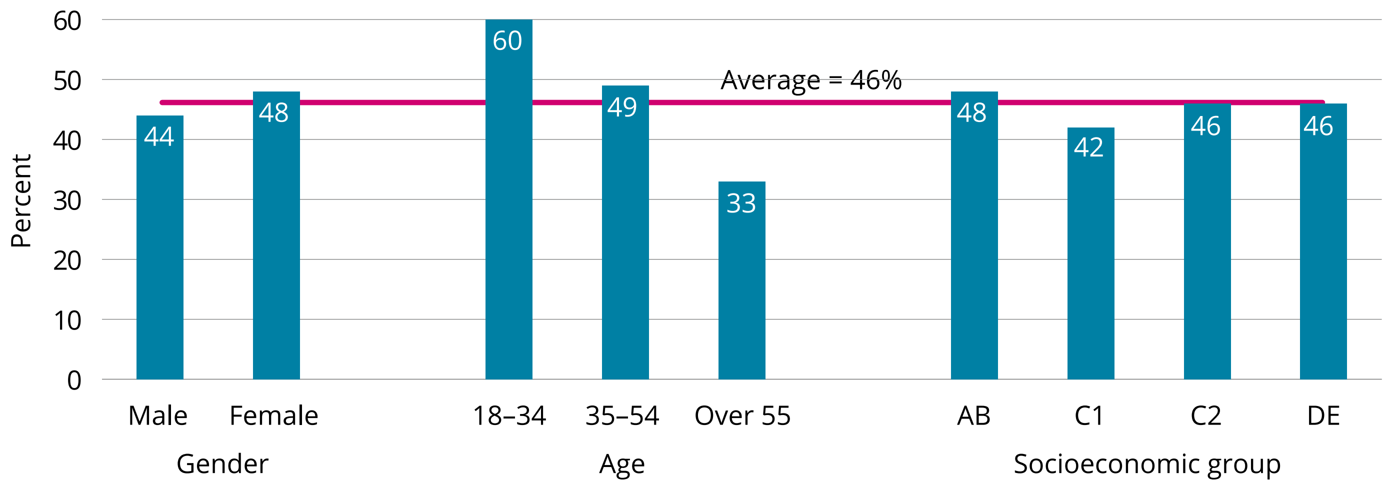
Under-35s are significantly more likely to be relying on their savings as a result of the cost of living crisis than the average for all adults (60% vs 46%). Differences by gender and socioeconomic group are less marked.

According to figures from the ONS, average household savings rates reached record highs during the pandemic, when spending opportunities were severely restricted by lockdowns. This was more likely to benefit people who were able to continue working from home, many of whom will still have access to a savings pot that can help cushion the present crisis.

> In times like these, awareness and understanding of FSCS protection is particularly important to help consumers identify providers and products that are safe to use.

Figure 4: Impact of cost of living crisis on reliance on savings, by demographics

"I have been withdrawing/relying more on my savings" – Any agreement – NET



Base: 4,479 UK adults aged 18+

Source: FSCS/Dynata, September 2022 – February 2023

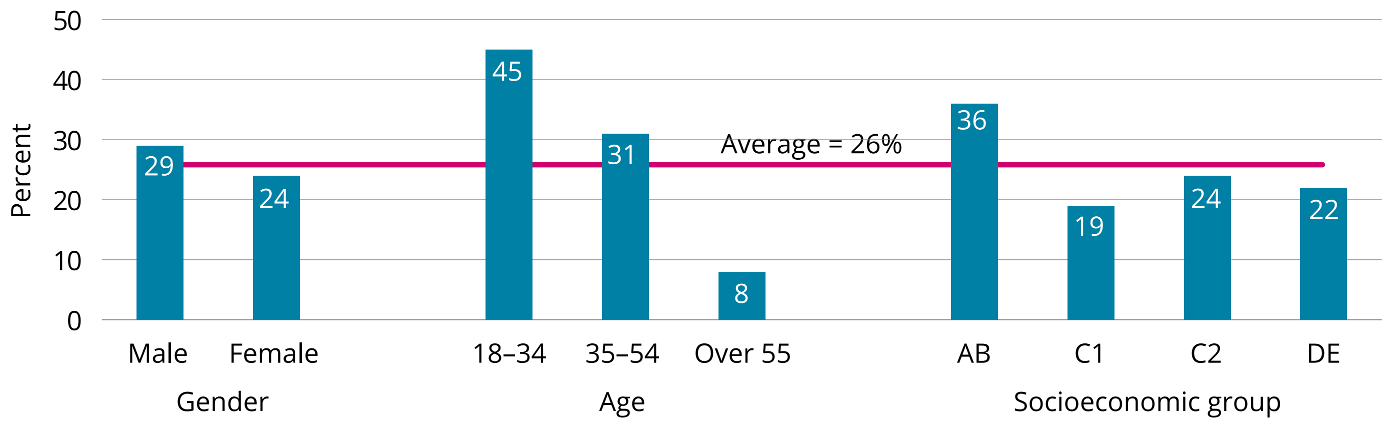
… and taking more risks with their money

Although interest rates are at a 14-year high, making the savings market more competitive, there is evidence to suggest that hikes in rates aren't always fully passed on to consumers and inflation continues to outstrip them. This erodes any returns from easy access and even fixed term products, which means consumers with more than an emergency fund have limited options to make their money grow in real terms. Many of them will be looking to invest to make the most of their savings.

Under-35s are also significantly likelier than the average (45% vs 26%) to say they are taking more risks with their money to gain a better return. This is also the case for the wealthier households in the AB socioeconomic group (36%), where the main income earners are likely to be highly educated and in high-paying occupations.

Figure 5: Impact of cost of living crisis on taking risks with money, by demographics

"I am taking more risks with my money to gain a better return" – Any agreement – NET



Base: 4,479 UK adults aged 18+

Source: FSCS/Dynata, September 2022 – February 2023

Younger consumers with limited or no experience of investing could be more vulnerable to specific risks when selecting providers and products they are not familiar with. This is why FSCS is committed to working with our partners to raise awareness and understanding of our protection and help ensure that people are making informed decisions about their finances.

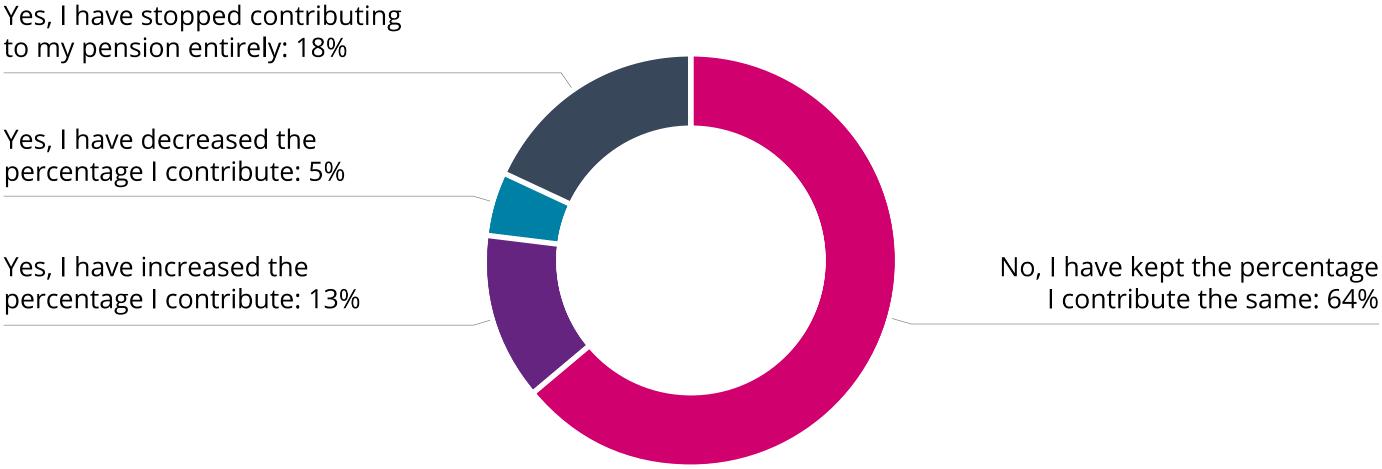
23% have decreased or stopped pension contributions

The rising cost of living is also resulting in more than a third of people adjusting how much they pay into their pensions. 13% of those with a pension say they have increased the percentage they contribute. However, a further 23% have either decreased their contributions (5%) or stopped them altogether (18%).

Although this could provide a temporary relief and help households cover day-to-day costs, a prolonged reduction in pension contributions can derail retirement plans. In addition to missing out on investment growth derived from compound interest, people who stop contributing to a workplace pension also lose contributions from their employer and tax relief. Some may also lose valuable benefits paid in case of illness or paid to their dependants on death, if opting out of a scheme altogether.

Figure 6: Changes to pension contributions – past few months

"Thinking specifically of your pension, have your contributions changed over the past few months?"



Base: 2,974 UK adults aged 18+ with a pension

Source: FSCS/Dynata, September 2022 – February 2023

Those likely to adjust pensions contributions have already done so

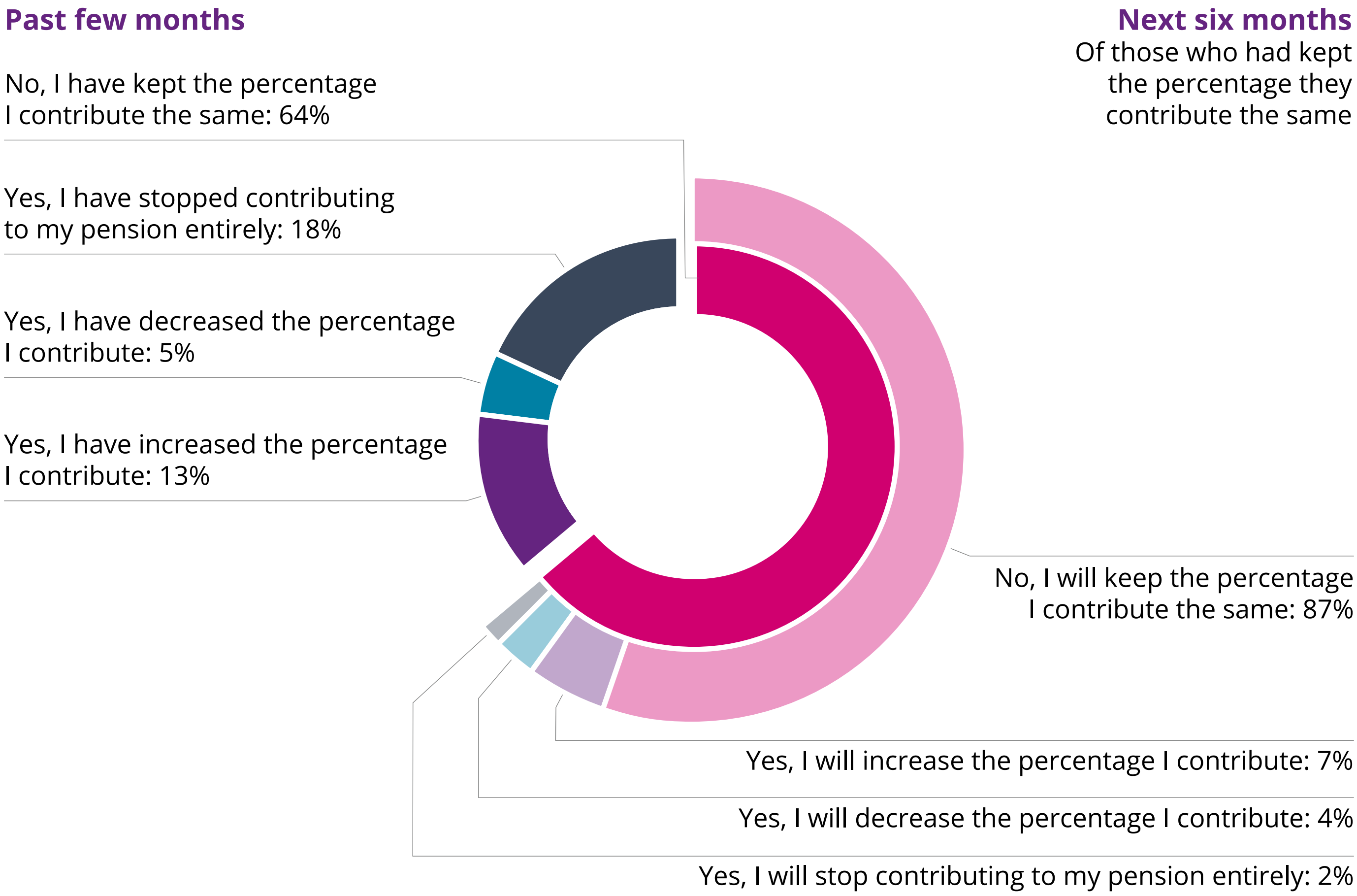
64% of those with a pension have kept their contributions unchanged over the past few months (see Figure 6). Of them, 87% are likely to keep the contributions the same in the next six months. Only a small minority expect to either decrease (4%) or stop contributing altogether (2%). A further 7% are hoping to be able to increase their contributions.

This means consumers are likely to think they have already absorbed the impact of the cost of living crisis when it comes to their pension contributions. Although they remain concerned about the situation (see Figure 2), those who haven't so far had to adjust how much they pay in are optimistic that they won't have to in the near future.

Figure 7: Changes to pension contributions: past few months and next six months

"Thinking specifically of your pension, have your contributions changed over the past few months?"

"Do you expect to change your pension contributions in the next six months?"



Base: 2,974 UK adults aged 18+ *with a pension* and 1,894 UK adults aged 18+ with a pension, *who haven't made any changes to their contributions in the past few months*

Source: FSCS/Dynata, September 2022 – February 2023

Savers have also taken other actions with their pensions...

Beyond how much they pay in (see Figures 6 and 7), people with a pension are also making other pension decisions in response to the rising cost of living.

Of those surveyed, the most common action is to make changes to the funds where the money is invested, with 44% of respondents saying they have done so in the past few months. 28% say they have consolidated different pension pots into one, while 13% say they have changed pension provider. These types of actions can help consumers save money in fees and make the most of their investments. Our results show consumers are likely to continue monitoring their arrangements and making similar adjustments accordingly over the next six months (see Figure 9).

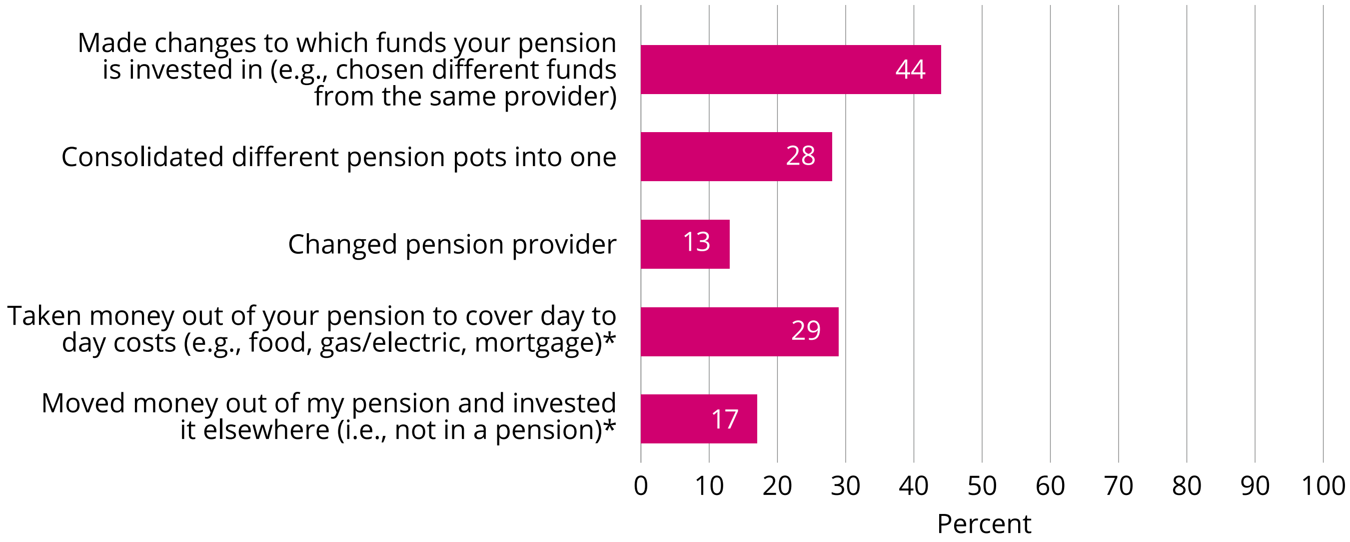
...including accessing their pension pots to make ends meet

Those eligible to do so (aged 55+) are also actively considering accessing their pension pots. 29% have already taken money out of their pensions to cover day to day costs, while 17% say they are likely to do so in the next six months.

As mentioned, some people will have been severely affected by the rising cost of living and are now having to make difficult decisions where their short-term needs are at odds with their long-term goals. Temporarily pausing their contributions or taking money out of their pensions could be the only thing that can keep them afloat. Even if this can have a negative effect down the line, it could make sense if it stops them having to take on expensive debt to make ends meet.

Figure 8: Pension decisions – past few months

"Over the past few months have you..."



Base: 2,974 UK adults aged 18+ with a pension

* Question only asked to those aged 55+. The base is 1,225 UK adults aged 55+ with a pension

Source: FSCS/Dynata, September 2022 – February 2023

17% of those eligible have taken money out to invest elsewhere...

Over-55s are also accessing their pots to make other investments. 17% have already taken money out of their pensions to invest elsewhere (not in a pension) in the past few months and 12% are likely to do so in the next six months. While this group is likely to be motivated by the prospect of making the most of their money, unlike those looking to make ends meet, 8% of over-55s say they are taking more risks with their money as a result of the cost of living crisis (see Figure 5). Whatever consumers choose to do with their money, it's important they make informed decisions and understand if and how their investments are protected.

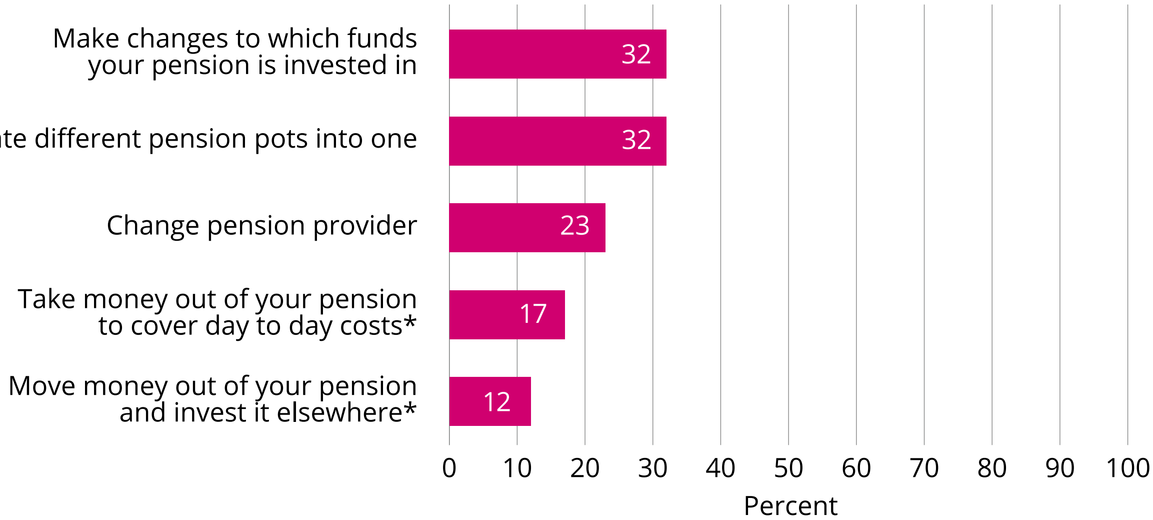
...which can put them at risk

Pensions are complex products and the decision to access one early could have significant implications for a person's retirement plans. Compounding this further are the increasingly sophisticated financial decisions that consumers are being asked to make, particularly about their retirement savings. Increased complexity and choice can bring greater risk, making broader access to affordable, good quality advice services crucial. However, research we have recently conducted on the topic of financial advice found that only a minority of consumers in this market are receiving regulated financial advice (see FSCS Consumer Research: Attitudes towards Financial Advice).

A pension is likely to be the biggest pot of savings and investments that a person will have in their lives. It is important that consumers are empowered with the relevant tools and knowledge to make informed decisions about their pension. Even when using FCA-authorised advisers, which means the advice to move money out of a pension to invest elsewhere may be eligible for FSCS protection, consumers must also understand the limitations of that protection. FSCS is typically able to protect up to £85,000 for investments, which applies to most pension claims. This means that in some cases the money we can return to customers is less than the total amount they lost, something we call 'uncompensated loss'.

Figure 9: Pension decisions – next six months

"In the next six months, how likely are you to do the following..."– Any likely – NET†



Base: 2,974 UK adults aged 18+ with a pension

† Those choosing 5, 6 or 7 on a 7-point scale, with 1=Very unlikely, 7=Very likely

* Question only asked to those aged 55+. The base is 1,225 UK adults aged 55+ with a pension

Source: FSCS/Dynata, September 2022 – February 2023

KEY TAKEAWAYS

> The increased cost of living and rising energy and fuel prices are the top financial concerns among people, many of whom are being impacted by high inflation for the first time.

> Consumers are taking action in how they manage their finances in response to higher prices and a squeeze in their real incomes. This includes taking more risks with their money in order to gain a better return.

> People are also adjusting contributions and making other decisions about their pensions, with some of those eligible opting to access their pots as a result of the cost of living crisis.

> Some are now having to make difficult decisions where their short-term needs are at odds with their long-term goals and retirement plans.

> The risk of consumer harm can be very high when it comes to pensions and investments. This is because the amounts at stake tend to be very large, but also because of the complexity of the products and the lack of knowledge among consumers. Any disruption to pension savings could have consequences for their retirement income plans.

> Even when FSCS protection applies, in some cases the money we can return to customers is less than the total amount they lost, due to our compensation limit of £85,000, something we call 'uncompensated loss'.

> FSCS is committed to working with our partners to improve awareness and understanding of our protection. Engaging with regulatory bodies, financial services providers and other stakeholders is key in helping people make informed decisions that keep their money safe.

FSCS is the UK's statutory compensation scheme of last resort for customers of authorised financial institutions. FSCS is an independent body, created under the Financial Services and Markets Act 2000 (FSMA).

FSCS may only pay compensation, up to certain limits, to eligible customers if a firm (or a firm's successor) is authorised by the Financial Conduct Authority (**FCA**) or the Prudential Regulation Authority (**PRA**) and that firm is unable, or likely to be unable, to pay claims against it.

Very broadly, claims relating to insurance, investment products (including pension plans), deposit-taking, mortgage and home finance broking, general insurance broking, debt management plans and funeral plan activities may potentially fall within the scope of FSCS's cover.

FSCS must determine claims submitted to it under the rules set for it by FCA and PRA as applicable. FSCS cannot pay compensation to a customer unless the customer's claim meets the qualifying conditions for payment under those rules.

About this series

This paper is the fourth of a series that aims to share the results of the exclusive consumer research we regularly commission to support our communications strategy. It helps us to identify gaps and opportunities and to work closely together with our stakeholders to provide essential, accurate information to consumers about the protection FSCS provides.

Find out more

Sign up here to be the first to know about future research

Research methodology

All figures presented in this report (unless otherwise stated) come from our brand tracking and consumer research survey, which is conducted monthly by FSCS in partnership with The Nursery. Research was carried out by Dynata among 4,479 UK adults aged 18+, ranging from 602 to 1,432 per month, between September 2022 and February 2023.

Note: Figures may not add up to 100% due to rounding.

If you would like to discuss any aspect of this report, please speak to your usual FSCS contact, or you can email our Research Analyst irene.salazar@fscs.org.uk

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