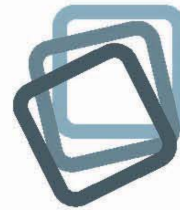

Building a strong, stable and transparent pensions system

The final report of the Workplace Retirement Income Commission

Chaired by Lord McFall of Alcluith

August 2011

Workplace Retirement Income Commission

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Foreword by Lord McFall of Alcluith

This report presents the conclusions and recommendations of the Workplace Retirement Income Commission (WRIC). It sets out areas for action that need to be tackled urgently by Government, the pensions industry, employers and savers themselves.

When I launched the independent Workplace Retirement Income Commission in February, I said the Commission's work would be driven by the evidence. Since then we have been busy gathering that evidence. This report reflects the views of industry, employers, trade unions and above all the consumers with whom we have spoken. It tells it as it is.

It is clear from all that we have heard that for many people, particularly those in defined benefit schemes, pensions have proved a good investment and many people retiring today are part of a "golden generation" of pensioners. But for those who will retire in years to come, the future looks far less certain. There exists an active debate about public sector pensions and about the level of state pension provision. The Turner Commission breakthrough on auto-enrolment and NEST has been a hugely welcome measure, and it is one that is supported by this Commission. But delving deeper, it has been a shock to find out that even after auto-enrolment, up to 9 million people may still fall through the cracks in the system and many will be on course for a very poor old age. In a rich nation such as ours, this is scandalous.

Some people have said to us that any consideration of further reforms to the system can wait. We have been disappointed by this level of complacency, because nothing can be further from the truth. That is why we are setting out our recommendations for action now, to enable these gaps in public policy to be tackled, and a roadmap for action to be agreed and embarked upon.

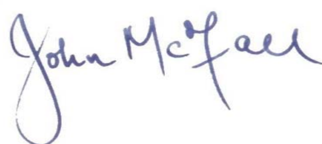
Based on what we have heard, the outstanding questions that remain to be tackled can be grouped as follows:

- **Risk and adequacy:** Is it reasonable or realistic for individuals in DC schemes to be left to manage the risk on their own or to understand the progress of their investment over a 40-year period? Or should we be building a system where understanding the risk is not a matter for the individual but for the trustees or guardians acting on their behalf?

- **Understanding:** Given the complexity and asymmetry of information in the market, is the consumer destined to come off second-best? Is there a need for the market to work better, and for a levelling-out of knowledge between the consumer and the industry? If so, is financial education the way forward or does it take us only so far – are more fundamental supply-side changes needed?
- **Trust:** Do we have a system where mis-selling is in the DNA of the industry? How do we build a system which is both fair and trustworthy, and what responsibility should be placed on individuals, employers, the industry and Government?
- **Value for money:** On an individual level, does the customer always get a fair deal from costs and charges on their pension? Is their money working for them as well as it should? Does the intermediation process help or hinder them in getting a better deal? Is there someone acting as the member-advocate to ensure the scheme operates in their interests, and not the interests of the industry? Should there be structural change to ensure that costs are driven down and transparency increased?
- **Stability:** How can we build a more stable system for pensions when the time horizons for pensions are 45-50 years, yet the time horizons for the political cycle is just 4-5 years?

These issues lead us to make 16 recommendations for further action by Government, the industry, regulators and pension savers. These recommendations cover state pensions, contribution levels, risk management and mitigation, value for money in the savings and retirement income phases, small pension funds, consumer confidence and industry reform, and building a stable environment for pensions policy. If followed through they will create a more stable, stronger and more transparent pensions system in which consumers can have more confidence, employers will be more motivated to contribute to, and – most importantly – will provide better outcomes for our citizens.

I would like to take this opportunity to thank my fellow Commissioners Graham Cole; John Hannett; Chris Hitchen; Paul Johnson; and Imelda Walsh for their enthusiasm and dedication and the NAPF for establishing this Commission and providing a dedicated and professional Secretariat. I would also like to thank Ipsos-MORI for the focus group research that has been undertaken and published alongside this report. Finally, I am grateful to all those who have participated in the Commission's work.



Lord McFall of Alcluith

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Executive Summary

In this Report we set out what we have learned from the responses to our Call for Evidence and the extensive discussions the Commission has held with individuals and industry stakeholders.

Our investigations lead us to the conclusion that there is much that is good about the pensions system in Britain today: pensioner incomes have risen faster than those of working people; pensioners are better off than ever before, thanks largely to the presence of defined benefit pensions and means tested benefits; and pensioner poverty is at the lowest levels on record.

But for future generations of retirees, it is clear from all that we have heard, that the picture looks far less certain.

The introduction from next year of auto-enrolment will be an important step forward. It will ensure that, for the first time, people will have a pension that comes with their job and will receive employer contributions to that pension. But between 5-9 million people – a third of the workforce – could fall through the cracks in the system. These "missing millions" will face a bleak old age. And those that do save could have a rude awakening when they retire if their contributions have been stuck at the new statutory minimum of 8%. The impact of the recession that has taken place since the Pension Commission reported also cannot be ignored. The Pensions Commission foresaw introducing auto-enrolment into a world of low inflation, high real interest rates and rising equity markets. That world has been turned on its head. In a world of greater financial uncertainty, wage freezes, tighter household budgets and lower discretionary spending, heightened mistrust in the financial system and financial services sector, the job of saving for old age has become harder not easier.

The shape of workplace pensions is changing and there seems to be little to suggest that trend will be reversed. It is also clear to us that the UK's pension system is complex, costly and inefficient and that there is too little grit in the system to ensure that it works – and works hard – in the interests of savers.

These are serious issues that cannot be ignored. Auto-enrolment is an important change. But as many people have said to us, it is a step along the way, not the end point. So we need to start to think now about what the changes are that will address these issues in a serious way, and we need to start to set out the issues that will need to be addressed by Government, employers, individuals and the pensions industry. We cannot simply wait until the 2017 review of auto-enrolment to start to think about these issues, as some have

suggested to us. This is far too complacent an attitude, and one that underestimates the severity of the problems the nation faces.

Chapter 1 looks at the state of retirement saving in the UK today and brings the Pensions Commission's analysis up to date. It is a picture of massive change in a relatively short period of time in terms of recent economic and social developments as well as the way people save for retirement and employers provide pensions.

Chapter 2 summarises what the Commission has learned from the responses to the Call for Evidence, our regional round table events and evidence sessions. And it sets out the opinions of those who matter most – working people who are trying to secure their financial futures today.

Chapter 3 analyses the areas for debate and groups our investigations into four main issues that remain to be tackled if we are to have a world-class pensions system:

- **Risk and adequacy:** And the issue of people being left on their own to work their way through the pensions maze and manage that risk.

- **Value for money, costs and charges:** Including the costs and charges associated with annuities, to ensure people get good value for money from saving in a pension.

- **Cultural change:** Getting back the habit of saving for retirement, and the linked question of rebuilding trust and confidence. How can we encourage people to look to the future?

- **Stability:** The need for governments to avoid continual 'tinkering' with the rules to give people saving in pension schemes and the employers offering those pension schemes confidence in the system and its ability to deliver good pension outcomes. In a world where political time horizons are at best 4-5 years, but the time horizon for pensions is 45-50 years, how do we take the politics out of pensions?

These issues are taken forward in our 16 recommendations:

Risk and adequacy

State Pensions

1. The Commission welcomes the proposals for a simpler, single-tier pension, which will give individuals a solid floor on which to build workplace pensions retirement savings. The Government should move ahead quickly to put in place these new arrangements.

Adequacy

2. For many, an 8% minimum contribution will not be sufficient to meet expectations in retirement. This must be reviewed as part of the 2017 review of auto-enrolment, and a clear way must be sought to increase contributions gradually over time.

3. But ahead of any decisions in 2017, the Government should begin actively to lead work with employers and industry to develop and encourage approaches such as 'auto-escalation' that make it easier for people to save more.

Risk Management

4. Greater innovation is still needed to develop approaches that can allow risk and volatility to be managed to ensure good consumer outcomes. The Government must show leadership in encouraging and creating an environment in which employers can feel confident and rewarded for taking on risk. And the financial services industry and Pensions Regulator should jointly develop approaches that help to smooth investment volatility for savers.

Value for money, costs and charges

The 'At Retirement Market' and Annuities

5. Given the detrimental impact on the consumer, further work must be done to understand the causes of significant variation in outcomes when people buy the same type of annuity, and whether these differences can be justified.

6. More could be done to ensure that shopping around really is the default, and that all consumers are getting the best deal. Serious consideration should be given to requiring schemes and providers to direct their members and consumers to an annuity 'price comparison site'.

7. Greater innovation in the annuity market is required to ensure that income meets spending patterns in later life. Particular consideration should be given to encouraging annuities to be flexible enough to account for unplanned events such as an unexpected increase in income from inheritance, or the need to draw down income for healthcare costs during retirement.

Charges

8. The Commission does not think a 'wait and see' approach on charges is sufficient, given the impact of high charges on pension outcomes. We recommend the Government uses its regulatory powers to apply stakeholder charge caps to schemes that will be eligible for auto-enrolment.

9. Disclosure around costs and charges remains inconsistent across schemes and providers. What is consistent, though, is the opacity of that disclosure. All schemes should be required to disclose costs and charges in a way that is transparent for consumers and which shows the cash impact of charges on the pension pot. The industry should develop a code of good practice on this issue and the government should monitor this and consider taking regulatory action if standards are not improved.

Small Pots

10. Whilst the main restrictions on auto-enrolment and NEST will not be reviewed until 2017, there is a case for lifting the restriction on transfers in to NEST before this date for those with small pension pots below a de minimis amount.

11. Longer term, consideration may need to be given to whether small pots should be defaulted into schemes where they can be managed efficiently, including NEST, which is currently banned from taking them.

Scale

12. Government and the Pensions Regulator should develop a package of measures that would encourage the consolidation of small schemes into larger, better value, schemes to drive down costs and improve outcomes. With many employers actively considering their pension provision in light of auto-enrolment, this is a matter that must be tackled urgently.

Cultural change

Consumer confidence

13. 2012 presents a one-off opportunity to change the way the nation thinks about saving for retirement, and to shift from a society that spends today and pays tomorrow to one where it is in the nation’s DNA to save, and save for the long term. Whilst there will always be limits to the role of consumer empowerment, the overarching message that saving is a good thing needs to be actively promoted by government, employers, the pensions and savings industry and consumer groups. And the communication strategy that accompanies auto-enrolment must be a powerful one.

Trustworthiness

14. For consumers to have more trust in the pensions system, the industry needs to show it can reform itself to be trustworthy. An industry-led drive around disclosure, transparency, clear communication, and driving down costs and charges will help to achieve this. But we have also heard that employers are most trusted when it comes to pensions, and are well positioned to act as an intermediary on behalf of the consumer.

To hold the industry's feet to the fire, the Government and the Pensions Regulator should make it a priority to promote strong and consistent governance and employer engagement with workplace pension schemes, whether trust or contract-based.

Rebuilding employer confidence

15. Employers should be encouraged to confidently engage with their workforce on pensions, including through tax incentives to encourage provision of independent advice, and 'safe-harbours' for discussions about pensions. And employers are well placed to encourage other forms of saving, for example workplace ISAs and feeder funds into pensions, if changes to the tax regime can be made that support these approaches without undermining retirement saving.

Stability

16. The Commission recommends that, in line with the Government's proposal to establish a standing advisory body on longevity and state pension ages, and the original recommendation of the Pensions Commission, an independent standing commission on pensions should be established that can take the politics out of pensions.

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Chapter 1: The pensions landscape today

The starting point for the WRIC's work has been to develop a comprehensive picture of retirement saving today and the likely future trajectory. This chapter highlights how the world has moved on since the Pensions Commission was established almost a decade ago.

Since the Pensions Commission reported, the economic environment has changed radically:

- The world economy has been through a financial crisis and a long and deep recession with consequences for savings.
- The UK has become a more debt-ridden society and the fiscal deficit is the largest since World War II, an average of £42,500 for every household.
- Confidence in long term saving is low, real interest rates are negative, and the household savings ratio remains low.
- Between 2008 and 2011, real incomes experienced their largest fall in 30 years. New pressures are arising (student debt, housing deposits and social care).
- People are living longer: longevity post-65 has grown by 6% since 2004.

It is against this backdrop that the environment into which people save for retirement is evolving, and at a pace faster than that envisaged at the time of the Pensions Commission:

- The number of employees in private sector workplace pension schemes has fallen by over a quarter since 2004. Most private sector workers are not currently saving in a workplace pension.
- Most private sector defined benefit (DB) schemes are closed to new members and many are closing to existing members. Private sector workplace pensions are now mainly defined contribution (DC).
- Annuity rates continue to fall, as life expectancy increases, but also because interest rates remain low. Investment returns have been unusually low with consequences for the actual and perceived value of pension saving.
- Governments have been implementing and building on the broad approach recommended by the Pensions Commission through the introduction of auto-enrolment, mandatory contributions, NEST and strengthening the state system.

But what we are seeing today is the so-called "golden generation" of pensioners (mainly men) whose employers established occupational pensions in the 1950s and 60s. With occupational pensions now in decline, less generous up-rating of some benefits, and the significant financial and social pressures facing households and lack of saving, pensioner incomes may be less healthy for future generations.

Introduction

This chapter:

- reviews how the economic and social environment has changed – and the short, medium and long term implications for retirement saving;
- looks at how the world of pensions has changed; and brings the established evidence base up to date; and
- recaps the key conclusions of the Pensions Commission and recent policy developments.

Economic and social changes

In the years since the Pension Commission reported, the near collapse of the banking system and the worst recession since the 1920s have changed the economic landscape for the UK and other countries. The finances of government, businesses and families have experienced a considerable shock and look set to remain under great pressure for some while to come.

These macro-economic factors cannot be ignored in considering the future of retirement saving. To put this in context, over the course of the recession, the economy experienced a 6% loss of GDP – roughly equivalent to the country's annual expenditure on state pensions and pensioner benefits. The recession has led to a rise in national debt, which averaged £42,500 per household in December 2010.[1]

Falling household incomes

Since 1961, median real incomes have risen each year by 1.6% on average. However, it is estimated that real incomes are now seeing their biggest fall in 30 years[2]. As the Governor of the Bank of England has commented, they are unlikely to recover for some time to come[3].

In the face of tighter household budgets, saving in a pension today for spending tomorrow may get relegated in people's priorities in favour of more immediate consumption needs – people may be more prone to take a "here and now" approach to spending. A YouGov survey for WRIC found that 43% of respondents were not saving because they said they could not afford to do so[4].

[1] ONS, Government debt under the Maastricht Treaty, 2011; ONS, Families and households in the UK, 2011
[2] IFS, Briefing Note, Living Standards during the recession, 2011 (figure refers to median income before housing costs)
[3] *Ibid*
[4] YouGov Survey for WRIC, 21-24 January 2011

Business profitability under pressure

It is not just individuals that have found expenditure under pressure in recent years. The tough economic climate and shortage of credit has also put employers under considerable financial strain. In light of these financial pressures, many employers looked to cut pension costs alongside other costs to their businesses. A NAPF survey at the height of the economic crisis showed that 52% of DB schemes in the private sector open to new members said they might be forced to close because of prevailing economic conditions[5]. This prediction has largely been borne out: the 2010 NAPF Annual Survey showed continued decline in open DB provision and acceleration in the number of schemes closing to existing members. Further changes are on the horizon: 23% of open DB schemes said they were looking to close their schemes to new members; 10% said they would close their scheme to existing members; and of those who had already closed their scheme to new members, 32% expected to close to existing members[6].

Low interest, low return, high inflation environment

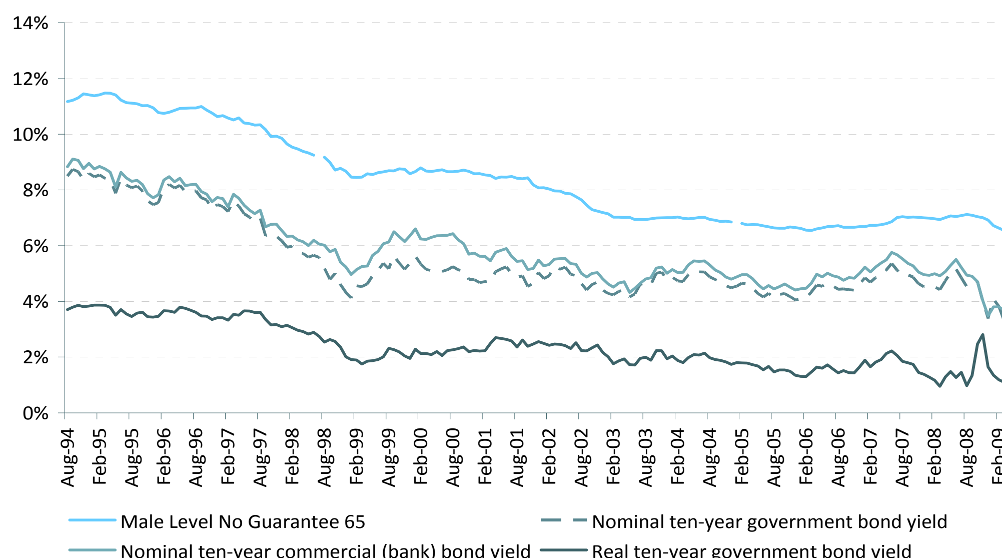
Interest rates remain at historically low levels and the Bank of England base rate has now remained at 0.5% for 27 consecutive months. At the time the Pensions Commission reported nominal interest rates were at 4.5%. Real interest rates (the lending interest rate adjusted for inflation) were consistently positive, compared to the low, and now negative, real interest rates the UK has experienced since the start of the downturn in 2007[7]. A low interest rate environment impacts on the investment position of both DB and DC schemes, on individuals' incentives to save, and on the income pensioners receive in retirement.

For DB schemes, low interest rates mean that lower discount rates are used to assess schemes' future liabilities. This results in a worsening of the funding position and, in many cases, higher scheme deficits. Therefore schemes are faced with either increasing scheme contributions, or considering riskier portfolios if they are to make the same returns. To give an indication of the effect, a 1 percentage point rise in yields could reduce pension schemes' reported accounting liabilities by 30% for a young scheme; 25% for a medium scheme; and 15% for a mature scheme[8].

Low interest rates impact on DC schemes in both the saving and retirement phases. Again, low interest rates mean that investors need to take on more risk to generate the same return. Annuity rates are closely linked to interest rates via government and corporate bonds. Low interest rates, and the corresponding low yield on bonds, mean lower annuity rates. Figure 1 shows the relationship between bond yields and annuity rates.

[5] Pension Provision and the Economic Crisis, NAPF, 2009
[6] 2010 Annual Survey, NAPF, 2011
[7] World Bank
[8] NAPF, Pre-Budget Report, 2009

Figure 1: Comparison of annuity rate with bond yields



Source: Cannon, E.S., and Tonks, I. (2011) "Compulsory and Voluntary Annuity Markets in the United Kingdom" in "Revisiting Retirement Payouts" edited by Mitchell, O.S., Piggott, J., and Takayama, N. (Oxford University Press).

Low real interest rates also reduce the return on savings, and many pensioners rely on such savings as a key part of their income in retirement. On average, pensioner couples received £49 per week from investment returns in 2009/10[9]. However, the distribution was highly skewed, with half of those who have income from investment receiving only £5 a week, and 29% of pensioners receiving no income from investments. A pensioner with £10,000 of savings could have expected to get a return on those savings of £457 over twelve months in 2005 with an interest rate of 4.48%. Now, with rates at 0.55%, the same savings will only deliver an income of £55 – a difference of over £400.

The relatively high inflation we are experiencing compared to recent years is also having an impact on pensioner households. IFS research estimates that retired households with some form of workplace pension had an effective inflation rate of 4.3% between 2008 and 2010, compared with 2.9% for working age families[10]. During periods when energy and food prices are rising significantly, the inflation of pensioner households tends to be higher than for the rest of the population since pensioners tend to spend a higher proportion of their income on food and fuel.

Inflation also impacts on the liabilities of defined benefit schemes. Schemes that offer full inflation proofing will need to fund additional liabilities arising from increased inflation. For

[9] ONS, Pension Trends, 2010

[10] IFS, Poor experience higher inflation than rich, 2011

those that cap indexation in line with legislation, periods of higher inflation will reduce real scheme deficits.

Low appetites for saving

Despite changes in people's behaviour since the start of the downturn, saving rates in the UK are still historically low. The household savings ratio – the share of disposable income that people either save or use to repay loans and debt – was 4.6% in the first quarter of 2011. It has seen a gradual fall again in recent months, compared to a high of 7.5% in 2009 (which followed a dip to zero at the start of 2008). The ratio for the last decade has been low compared to the average of 9.2% in the 1990s and 8.7% in the 1980s[11].

A recent ONS report[12] indicated that, in response to the downturn, longer-term saving for retirement may be under further pressure:

> "The financial crisis and subsequent recession had a significant impact on households. Besides the impact of lower employment and rising unemployment, households have been affected by modest wage growth, reduced access to borrowing, falls in house prices and equity markets, and, more recently, through high inflation which has eroded the real spending power of their incomes…
>
> "As a result, the real spending power of household incomes has been eroded, with implications for household spending and saving, and therefore economic growth and the economic wellbeing of households."

Confidence in the financial services industry and attitudes to saving

The near-collapse of some major financial institutions in 2008 and people's deteriorating confidence in the security of their savings, together with historic financial scandals such as Maxwell, Equitable Life and pensions mis-selling continue to undermine confidence in both the financial services industry and in long-term pension saving:

- In September 2010, 48% of employees were very or fairly confident in pensions compared to other ways of saving, down from 52% in 2009 and 58% in 2008[13].

- Attitudes to financial companies, banks and building societies as potential pension providers have become much more negative; the proportions who believe that banks and building societies will act with competence has declined by 8 percentage points and with care by 18 percentage points since 2006[14].

[11] Office for National Statistics
[12] ONS, The Impact of the Recession on Household Income, Expenditure and Saving, 2011
[13] NAPF press release, 2010 Pensions Workplace Survey Summary, 2010
[14] DWP, Attitudes to pensions: the 2009 Survey, 2010

However, only 8% of respondents to a YouGov survey for the WRIC quoted lack of confidence in financial products as a reason for not saving[15]. Recent DWP attitudinal research[16] into the public's attitudes on pension saving shows that people's understanding of pensions is still very low – only 23% felt they know enough about pensions to decide with any confidence how to save for retirement.

Housing wealth dented in the short term

Levels of housing wealth – seen by many as a potential source of income in retirement, particularly in the face of rising social care costs – have also been adversely affected by the downturn.

Research by the IFS[17] showed that the first half of this decade was characterised by strong growth in housing equity fuelled by house price increases which dwarfed the very low levels of active saving into liquid assets. Those with the most housing assets to start with gained most – typically those with higher incomes and older households approaching retirement.

Recent DWP analysis[18] predicts that the downturn will have caused significant losses in wealth due to falling asset and housing prices. Whilst the losses are greatest amongst higher income households the highest *relative* losses in housing wealth are expected amongst low to middle income groups. Some people are experiencing losses of between 5% and 6% driven largely by house price changes. This will be more significant for those nearing the end of their working lives.

Over the longer term, the Pensions Policy Institute (PPI) estimate that the value of housing wealth owned by the over 65s could increase by 40.5% from around £900 billion to £1.274 trillion in 2030[19]. Despite common perceptions that property will be used to fund retirement, most research concludes that households in the UK remain reluctant in practice to turn their housing wealth into income or to downsize. However recent research has shown that increasing numbers of pensioners are now selling their homes to pay for their ongoing care[20].

The changing social landscape

The social landscape has also been changing over the years since the Pensions Commission reported.

[15] YouGov Survey for WRIC, 21-24 January, 2011
[16] DWP, Attitudes to pensions: the 2009 Survey, 2010
[17] Institute of Fiscal Studies, The wealth and savings of UK families on the eve of the crisis, 2011
[18] DWP, "What does the distribution of wealth tell us about future retirement resources?", 2010
[19] PPI, *Retirement Income and Assets: Outlook for the Future,* 2010
[20] Laing & Buisson with the House of Commons Library, 2010

The growing importance of student debt: With growing numbers of school leavers now going to university, a large proportion of the population will begin their working life in debt. Following the Government's reforms to student loans, debts will be repaid at 9% of income over £21,000 a year[21]. For some this may represent a reason not to begin saving for retirement until the debt is cleared, possibly well into their thirties and forties (the proposed repayment period before debt is written off is thirty years). For those earning £30,000-£35,000 a year a 9% repayment on income above £21,000 is equivalent to a 4% contribution on income above the auto-enrolment threshold. Whilst auto-enrolment from age 22 is intended to encourage people to 'get the pension saving habit young', significant amounts of student debt may, in reality, mean higher than anticipated opt-out rates amongst younger people. Failure to save at younger ages will mean that people will need to save harder when they are older if they are to have an adequate retirement income. And it may be a rational decision – disposable incomes are likely to be higher at older ages and once children have flown the nest. However, it is also the time when labour market insecurity can increase: for both men and women inactivity due to sickness or disability rises into the double digits just before retirement[22]. And making up for lost time to build up a reasonable pension pot may still be unaffordable for many, as Table 1 demonstrates.

Table 1: Required contribution rates for a £100k pension pot at age 65[23]

Age when starting to save	Required contribution rate
25 (40 years saving)	4%
45 (20 years saving)	15%
55 (10 years saving)	38%

Household debt has risen significantly: The UK has become increasingly reliant on taking on more and more debt as a way of supporting current spending. Between 1987 and 2007, household debt as a percentage of household income – the debt ratio – rose from just above 100% to more than 170%. In the two years up to 2009, the debt ratio fell by 11 percentage points, but was still one and a half times higher than the ratio seen in 1987[24]. PwC analysis forecasts household debt increasing from £1.5 trillion in 2009 to £1.9 trillion in 2015, although falling as a percentage of GDP[25].

The era of easy credit for house purchase may be coming to an end: Once again, first time buyers have to save for a significant deposit, often at the same time as paying rent. This too may push retirement saving further down their list of priorities. On the other hand those who do obtain a mortgage benefit from historically low interest rates. However, with low

[21] Direct Gov
[22] ONS, Pension Trends, 2011
[23] Average earnings: 21,024; Investment growth: 3.5% per year; Earnings growth; 2%; Charges: 0.5% AMC
[24] ONS, Social Trends: Expenditure, 2010
[25] PwC economic outlook, November, 2010

fixed rates hard to obtain and a general expectation that rates will rise people may feel inclined to use any spare money for precautionary short-term saving rather than long term/pension saving. In March 2011, the average deposit paid by first time buyers for a mortgage was slightly above £30,000 – on average a 79% loan to value ratio[26]. And the average age of a first time buyer without assistance is now 37 and set to increase further[27] – pushing the costs of repaying a mortgage further into later life as well.

The gradual trend towards having children later: The average age of mothers and fathers when having children is now slightly over 29 and 32 respectively,[28] meaning that parents often have financial responsibilities for their children until their 50s. Again, this may act as a barrier to saving earlier.

At the other end of the age spectrum, there is increased pressure on individuals to finance their own long term care needs: This pressure will grow as the population ages. Some people are able to live independently with modest incomes while others may need expensive care – on average, someone reaching 65 can expect to need care costing £20,000 (median), but one in ten can expect costs over £100,000, and some individuals could spend hundreds of thousands of pounds[29].

The Commission on Funding of Care and Support, chaired by Andrew Dilnot, recently published its final report[30] which made a number of recommendations about how to fund a fair and sustainable care system in England and Wales. The Commission argued that people should be required to contribute to the costs of their long term care needs, up to a cap of around £35,000. The Commission also examined the role long term care insurance could play in funding long term care, and this may be an area where people could use money from their tax free lump sum to purchase insurance towards the future costs of long term care.

How retirement is changing

At the same time, people's experiences of retirement have been changing in terms of their incomes, life expectancy, and working patterns.

Pensioner incomes today

Since the mid 1990s pensioners' incomes have been growing in real terms – and faster than average earnings across the economy as a whole – due to strong growth in incomes from

[26] Council of Mortgage Lenders, Press Release 13 May 2011, authors own calculations
[27] National Housing Association, *Home Truths 2010: Why Investment in Affordable Housing Matters,* 2010
[28] ONS
[29] Commission on Funding of Care and Support, *Fairer Care Funding,* 2011
[30] Commission on Funding of Care and Support, *Fairer Care Funding,* 2011

occupational pensions, investments, earnings and benefits. Increases to wider pensioner benefits introduced by the previous Government such as the introduction of the Winter Fuel Allowance and the linking of Pension Credit to earnings not prices, means that pensioner poverty is currently at its lowest level since records began[31].

But the distribution of pensioners' incomes has also been widening – with the widening gap being mainly the result of increasing incomes from occupational pensions and investments which has seen faster growth for those at the top end of the distribution.

Looking at net income for 2009-10 after housing costs (which tends to be the accepted measure of pensioner living standards given that three quarters of pensioners own their home outright):

- amongst pensioner couples, median income after housing costs was £367 a week, or around £20,200 a year, up from £259 in 1999-99; and

- amongst single pensioners, median income after housing costs was £180 a week, or around £9,400 a year, up from £114 in 1998-99.

The latest Pensioners' Incomes Series publication[32] reports that since 1998-99, incomes for pensioners have risen three times faster than average earnings. Net income after housing costs has grown by 47% in real terms since 1998-99, compared to real average earnings growth of 14% over the same period. This reflects strong growth in benefit income in real terms (up 28%), growth in occupational pension income (up 38%), and very strong growth in personal pension income and earned income, albeit up from a smaller base. It is still the case that only a small minority of pensioners receive any income from personal pensions.

There are some significant and important differences in the distribution of pensioner incomes underpinning the headline numbers:

- For pensioner couples, the median net income of pensioners in the richest fifth (£762 a week) is now around four times higher than for the poorest fifth (£185 a week). For single pensioners the richest fifth had on average around three and a half times more net income than the poorest fifth (£348 a week compared to just £95 a week).

- Income[33] continues to grow faster at the top end of the distribution – the richest fifth of pensioners saw incomes increase by 25% between 1998-2001 and 2007-10, compared to 19% for the poorest fifth of pensioners.

[31] Since 1979 when the HBAI began. DWP, Households Below Average Income (2009-10), 2011
[32] DWP, Pensioners' Incomes Series 2009-10, published 2011
[33] Median net income after housing costs

Those who remain most likely to be at the bottom of the income distribution are older pensioners (whether in a couple or single) and single female pensioners (compared to single male pensioners):

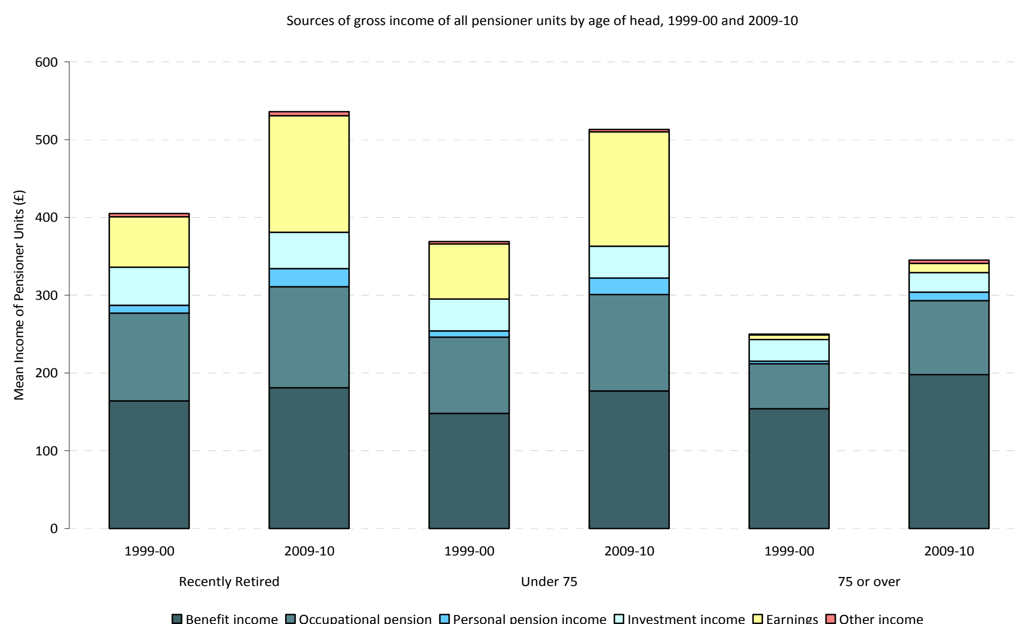
- older pensioner couples (those 75 and over) had a median net income of £330 a week after housing costs in 2009-10, compared to £380 a week for younger pensioner couples; and

- single female pensioners have lower median weekly incomes than single male pensioners (£176 per week in 2009-10 compared to £197 per week).

Pensioner incomes are changing over time

As predicted by the Pensions Commission, average pensioner incomes are likely to continue to hold steady in the short term, with no immediate crisis, as the generation of baby boomers reaching retirement age now will have typically built up good occupational pensions. Today's cohorts of pensioners have higher income, at every age group, than their predecessors ten years before. This is being driven by increases in income from state benefits, and from occupational pensions, personal pensions, and earnings.

Figure 2: Sources of gross income of all pensioner units



Source: DWP, Pensioners' Incomes Series

Comparing the pensioner cohorts today to those born ten years earlier[34] we see strong growth in earned income, occupational pension income and personal pension income for younger pensioners and strong growth in occupational pension income for older pensioners:

[34] DWP, Pensioners' Incomes Series 2009-10, 2011

- For recently retired cohorts (those within 5 years of SPA), benefit income and occupational pension income have grown by 10% and 15%, whilst earned income has grown by 130% compared to their counterparts of ten years ago. The increase in earned income reflects the trends seen in older people's employment rates, with those within 5 years of reaching SPA now more likely to remain in some form of work.

- For all those under 75, benefit income and occupational income have grown by 20% and 27%, whilst earned income has grown by over 100%. This suggests that the under 75s group overall has seen a faster acceleration in their occupational pension incomes over the last ten years than their younger counterparts - suggesting the high occupational pension entitlements built up from the 1950s and 60s onwards are now starting to work their way through the pensioner cohort.

- A similar pattern is seen for those over 75, with benefit income and occupational income having grown by 29% and 64% – as occupational pension entitlements are becoming increasingly common amongst the oldest cohorts of pensioners too.

These trends suggest that many of today's pensioners and those approaching retirement (particularly men) are part of a "golden generation" whose employers established occupational pensions in the 1950s and 60s. The Pensions Commission concluded that there was no current crisis neither for current pensioners, nor for many of those approaching retirement, but that trends in voluntary private pension provision, combined with an unreformed state pension system, would result in major and increasing problems after 2020.

Reforms to both state and private pensions, including increasing the generosity of the state pension and the introduction of auto-enrolment, were legislated for by the previous Government and have been developed further by the current Government. Auto-enrolment in particular is designed to tackle the problem of millions under-saving for retirement.

However, ahead of its introduction, there are many individuals who are already well into their working lives who have not saved anything into a private pension. Table 2 shows that over 30% of those aged 35 to 64 still have no private pension wealth – true of every age group (35-44, 45-54 and 55-64) and, as might be expected, this is higher for women than men. And the distribution is heavily skewed – with median holdings of private pension wealth extremely low relative to the amounts that might be needed to deliver an adequate pension income in retirement. Many of those auto-enrolled from next year will be starting to save in a private pension for the first time. Moreover, as the Pensions Commission's report

highlighted[35], auto-enrolment at 8% contributions will not be enough on its own for most people to achieve the Pensions Commission's benchmark replacement rates.

Table 2: Wealth in £ held by individuals in private pensions: by age, 2006/08

Age Band	Median	% with no private pension wealth
16-24	0	89
25-34	0	54
35-44	8,000	36
45-54	20,000	31
55-64	32,700	32
65-74	29,200	37
75+	8,500	41
All	4,900	43

Source: 'Wealth in Great Britain', ONS, 2009.

Growing longevity

Life expectancy has continued to improve since the Pensions Commission reported. Latest ONS projections (2008 based) have added a further 1.3 years to average male life expectancy at 65 and 1.5 years to that of women compared to the 2004 projections used by the Pension Commission. That represents a 6% increase in the time a pension paid at age 65 would be paid out. Life expectancy (both at birth and at age 65) varies significantly across areas in the UK, being highest in Kensington and Chelsea and lowest in Greater Glasgow and Clyde, Hartlepool, the Western Isles and Liverpool. The gap between the longest and shortest lived areas has increased from 9.8 years to 11.3 years for men and from 8.2 to 10.1 for women. However, the overall trend is one of continuing improvement in life expectancy:

Table 3: Cohort life expectancy at 65

Year	Male life expectancy	Female Life expectancy
1950	12.0	15.2
1990	15.8	19.3
2010	21.3	23.9
2050	25.2	27.7

Source: 2008-based projections, ONS; 1950 figures are for England and Wales only, the later years cover the UK

However, these demographic changes have not always been captured by the latest forecasts of longevity. For example, in 1983, it was estimated that a 65 year old man in 2020 would live for another 15.3 years. But by 2004, this had been revised upwards to 20.9 years, and was revised upwards again to 22.4 years in 2008.

[35] The Pensions Commission, "A New Pensions Settlement for the Twenty First Century: The Second Report of the Pensions Commission", 2005

These changes – and the continued underestimation of improvements in longevity – also increase the costs of providing pensions. For example, one estimate suggests that if DB scheme members live on average for one year longer this increases the DB liability by between 3-4%[36].

Government, employers and individuals have been forced to react.

- **Government:** Successive governments have sought to contain the costs of rising state pension expenditure due to improving longevity. The 2008 Pensions Act increased the state pension age to 66 by 2026, rising further to 67 by 2036 and 68 by 2046. The current government is legislating to accelerate the rise in the state pension age to 66 and it also proposing to accelerate the equalisation of state pension ages to 65 by 2018. A more automatic mechanism for reviewing state pension ages has been proposed for the future. The OBR's fiscal sustainability report[37] predicted that as a result of rising longevity, health spending would increase from 7.4% of GDP in 2015-16 to 9.8% in 2060-61, state pension costs would increase from 5.5% of GDP to 7.9% by 2060-61, and social care costs would increase from 1.2% of GDP to 2% by 2060-61.

- **Employers:** For employers operating DB schemes, the costs of increased longevity fall on the pension scheme and potentially on the employer standing behind that scheme. This has been accentuated by legal requirements requiring schemes to inflation proof pensions for pensioners and deferred members which, as those members live longer, adds significantly to the costs of providing schemes. For example, removing indexation requirements and spouse's benefits for a typical DB scheme with 500 members, an accrual rate of 1/60th, and an average pensionable salary of £20,000 per year would reduce costs by 50%[38]. In response to rising costs, many employers have sought to manage future risk and cost by closing their schemes to new employees and/or existing scheme members. There is now a developing market in financial instruments such as longevity swaps to help schemes manage that risk.

- **Individuals:** The cost of paying pensions for longer has been most noticeably felt by individuals through the cost of annuity purchases. Recent research looking at the period since 1957 shows that for each year of increase in life expectancy, annuity

[36] Coughlan G., D. Epstein, A. Ong, A. Sinah, I Balevich, J. Hevia-Portocarrero, E. Gingrich, M. Khalaf Allah and P. Joseph, (2007), *LifeMetrics A Toolkit for Measuring and Managing Longevity and Mortality Risks*, JP Morgan,

[37] Office for Budget Responsibility, *Fiscal Sustainability Report,* 2011

[38] Fit for the Future: Vision for Pensions, NAPF, 2010

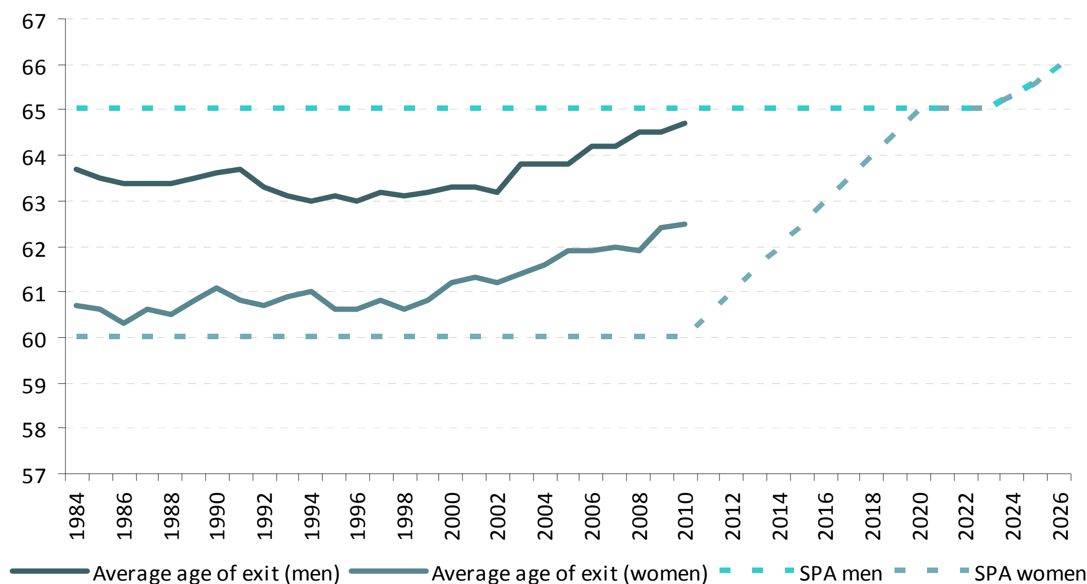
rates have fallen by 0.56 percentage points[39]. A man with a pension pot of £100,000 would have been able to buy a pension of £11,100 a year in 1957 whilst in 2009, it would buy just £6,200.

Working longer

People are working longer. However the rise in average retirement ages has lagged behind life expectancy improvements with the result that the average time people are spending in retirement has also increased.

Increases in employment rates for older groups have meant that the average age of withdrawal from the labour market has risen from 63.8 in 2004 to 64.7 in 2010 for men and from 61.6 to 62.5 for women (Figure 3). However, the Pensions Commission showed that with the average retirement ages now being experienced, the old age dependency ratio is still likely to increase by almost 50% by 2050. If the ratio were to stay close to 2002 levels, the average retirement age for women would have to increase to 67.4 and the average retirement age for men to 69.8[40]. In light of subsequent increases in longevity these figures are likely to now be higher.

Figure 3: Average age of withdrawal from the labour market[41]



Source: ONS, Labour Force Survey

The overall employment rate for men between 50 and 64 stood at around 66% in the early 1990s, reached 70% in the early 2000s and has over the past decade been stable around

[39] Edmund Cannon and Ian Tonks, Compulsory and voluntary annuity markets in the UK, University of Exeter, 2010
[40] Pensions Commission, Pensions: Challenges and choices; the first report of the Pensions Commission, 2004
[41] State Pension Ages as currently legislated for at July 2011

72%[42]. Slightly over 71% of men aged between 50 and 64 were in employment in the third quarter of 2010[43]. For men aged 65 and over the employment rate rapidly drops off to 4.4%, with a cliff edge around the current State Pension Age. Unsurprisingly, younger pensioners are far more likely to be in work than older pensioners. For men between 65 and 69, the full-time employment rate was 11%, and the part-time rate 13%. The respective figures for men aged 70 and over were 1.4% and 3.5%.

Employment rates for older women have also been increasing – compared to 2004, the overall employment rate for women aged 50 to 59 has increased by almost 5 percentage points, from 67.0% in 2004 to 71.7% in 2010. Similar to men, the employment rate drops off at state pension age (currently 60 for women).

The recession did not affect the employment rates for those aged over 65 negatively. In contrast to the under 25s who have seen rising unemployment as a result of the downturn, the employment rate rose by 0.5 percentage points for those aged 65 and over whilst the employment rate for those aged 50 to 64 fell by only 0.9 percentage points between January to March 2008 and October to December 2011[44].

In a speech given in summer 2010, Secretary of State for Work and Pensions, Iain Duncan Smith, stressed the importance of keeping older people in the workforce, saying that extending the average effective working life by just one year could increase GDP by 1%[45].

The workplace in the UK and changes in workplace pension provision

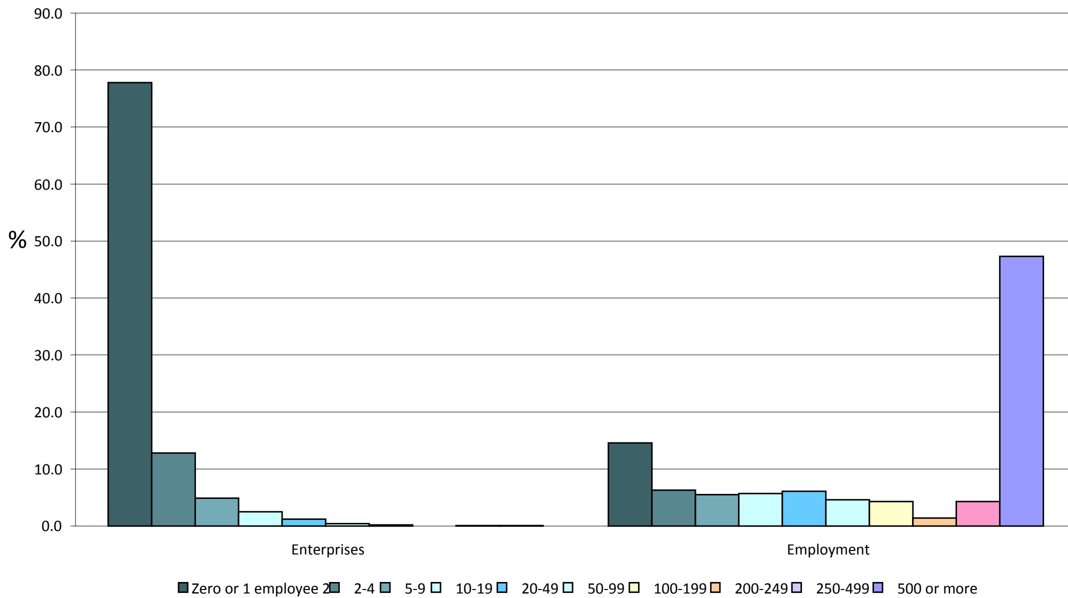
In looking at workplace pension provision it is important to understand the structure of the workplace.

Workplaces in the UK can be characterised by a long tail of very small employers:

- businesses with fewer than 5 employees (nearly 4.5 million, including the self-employed), account for nearly 80% of all businesses but cover only around 20% of all employees;
- a small number of very large employers (some 4,400 employing 500 or more), account for only 0.1% of businesses but over 50% of all employees[46]; and
- 'microenterprises' – with less than 10 employees – account for 95% of all businesses and over 25% of all employment.

[42] ONS, Pension Trends, 2011
[43] ONS, Older people in the labour market, 2011
[44] ONS, Older people in the labour market, 2011
[45] Iain Duncan Smith, Reinvigorating Workplace Pensions, June 2010
[46] BIS, SME Statistics for the UK and Regions, 2009

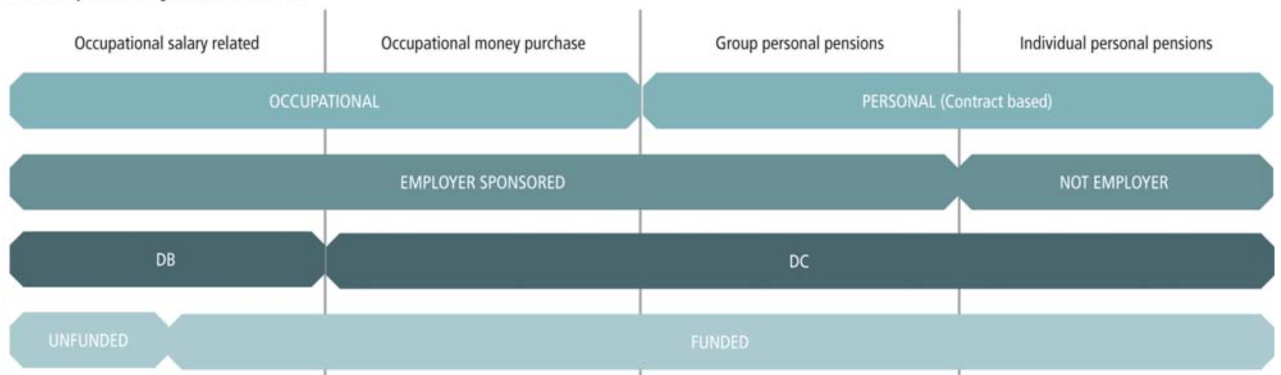
Figure 4: The distribution of enterprises and employment in the UK



Source: BIS Enterprise Directorate Analytical Unit

There are substantial differences in the approaches taken by employers to pensions provision notably: whether the employer chooses to run a DB or DC scheme, whether a pension scheme is trust based (ie 'occupational') or contract based; whether the employer sponsors and actively contributes to the scheme, and if so how much it contributes. Figure 5 sets out the broad structure of different types of pension provision in the workplace.

Figure 5: Private pension system in the UK



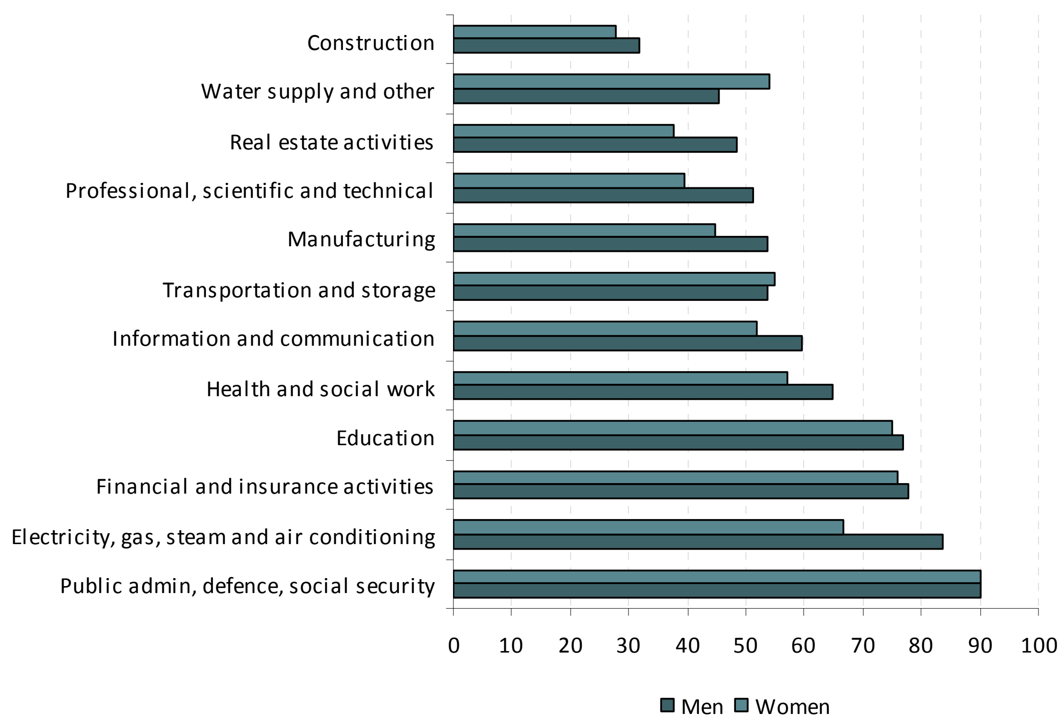
Source: Adapted from 'Pensions: Challenges and Choices, the First Report of the Pensions Commision', 2004

The UK's workplace pensions landscape is highly fragmented. DB schemes tend to be associated with large employers, while DC schemes tend to be favoured by smaller employers. The public sector increasingly dominates the DB landscape. Private sector employers continue to close their DB schemes to new members and increasingly to existing

scheme members. In the private sector there is a much greater mix of smaller and larger employers, with a mixture of both DB and DC. However, in terms of membership, the vast majority of active members, whether DB or DC, are in large schemes.

There remain large differences in pension scheme membership by industry and sector: with public sector employers, those in former nationalised industries and utilities, and those in the financial and insurance sector the most likely to be members of an employer sponsored scheme, and those in construction, retail, and hospitality sectors least likely to be member of a scheme. In almost all sectors men are more likely to be member of a scheme than women. These patterns reflect both the likelihood of an employer offering a scheme, and the likelihood of an employee taking up membership in a scheme, both of which also tend to be linked to earnings.

Figure 6: Current pension scheme membership by industrial sector and sex



Source: Annual Survey of Hours and Earnings, Office for National Statistics

The vast majority of pension schemes in the UK are small - data from the Pensions Regulator (Table 4) shows that around 90% of all schemes have 0-100 members, and over 42,000 DC trust and hybrid schemes have fewer than 12 members. However, the vast majority of members are in large schemes: around half of those saving in trust-based DC schemes are saving in schemes with more than 10,000 members.

Table 4: Pension funds by size

Size	DC (trust and hybrid)	DB	Total
0 – 100	44,650 (95.9%)	2,568 (37.5%)	47,218
100 – 1,000	1,150 (2.5%)	3,046 (44.5%)	4,196
1,000 – 10,000	610 (1.3%)	1,016 (14.8%)	1,626
10,000+	130 (0.3%)	220 (3.2%)	350
Total number of schemes	46,540	6,850	53,390

Source: The Pensions Regulator, DC Trust 2010, The Purple Book, 2010

This compares to Australia where the average scheme size is 26,000 members and the Netherlands where it is 10,500 members. In the UK, by contrast, it is just 2,500[47].

A key conclusion of the Pensions Commission was that some employees, particularly those with low earnings, and those working in small and medium firms or self–employed, were poorly served by their employers and/or the market and required further intervention. These employees account for a large number of those estimated to be under saving. The ONS reports that 87% of employees working for companies with less than 12 employees are not offered pensions by their employers[48]. The Pensions Commission also recognised some stark differences in pension provision by gender, working pattern, sector, and occupation: full time employees are far more likely to be a member of an employers' pension scheme. The latest figures[49] show pension scheme membership across all economically active people averaging around 70-80% for those with the largest employers and in the highest occupational classifications, compared to 30-40% for those with the smallest employers and in lower occupational classifications.

Private pension coverage in decline

Since the Pensions Commission reported there has, as anticipated, been a further decline in private pension saving – both in terms of overall coverage, scheme membership, and contributions. This is reflected in the overall numbers saving into a pension. In 2009/10 only 36% (14.0 million) of those aged 16-64 were actively contributing into a private pension (whether a workplace or their own private pension scheme)[50]. Over the previous decade, the proportion of men saving into a pension fell from 49% to 38%, whilst for women it fell from 36% to 33%.

These changes in numbers saving into a pension relate largely to changes observed within private sector pension provision. The public sector saw a gradual increase in active

[47] NAPF, UK Pensions Regulation Compared, 2008
[48] ONS, Annual Survey of Hours and Earnings, 2009
[49] ONS, Wealth and Assets Survey, 2006/08
[50] ONS, Pension Trends, 2011

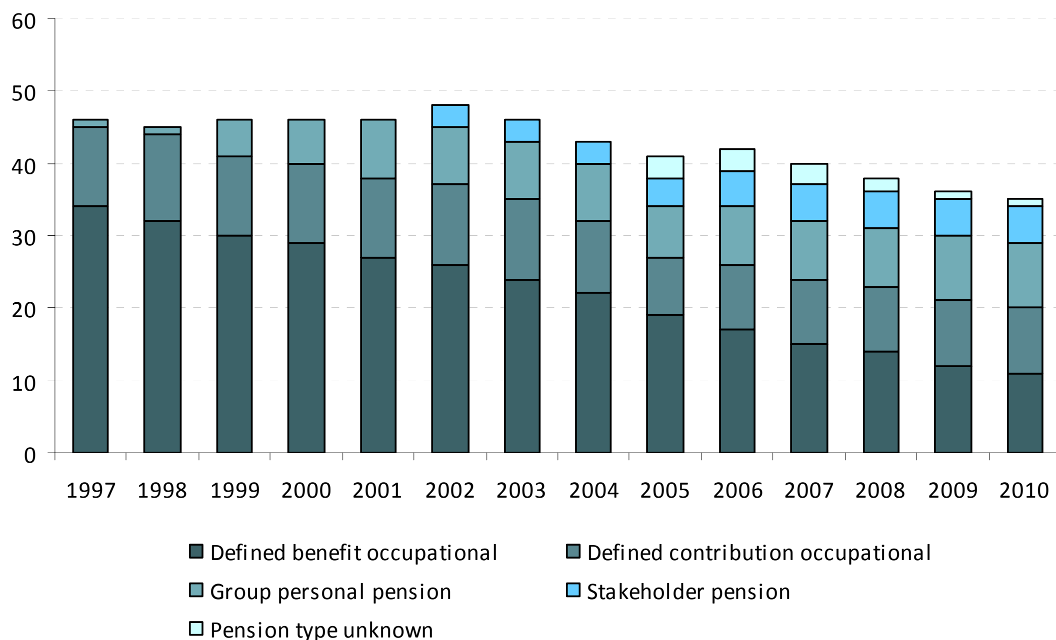
membership of occupational pension schemes from 4.1 million in 1995 to 5.4 million in 2008 as the size of the public sector grew, and public sector schemes continue to have higher employer contribution rates than is usual in the private sector. The key feature of the last decade or so has been the continuing withdrawal of private sector employers from DB pension schemes in particular and more broadly from trust-based schemes.

Key changes between 1997 and 2010 in the private sector include:

- Overall employee membership of workplace pension schemes falling from 46% in 1997 to just 34% in 2010 (falling from 52% to 39% for males and 37% to 28% for females). This is largely driven by a decline in membership of DB occupational pension schemes, from 34% in 1997 to just 11% in 2010.

- Membership of DC occupational pension schemes also falling slightly, from 11% to 9%, despite the general shift from DB to DC. This can in part be explained by the rise in membership of GPPs and stakeholder pensions – 14% in 2010 from 1% in 1997[51].

Figure 7: Employee membership of private sector employer sponsored pension scheme by pension type 1997-2020 (percentages)



Source: ONS, Pension Trends, 2011

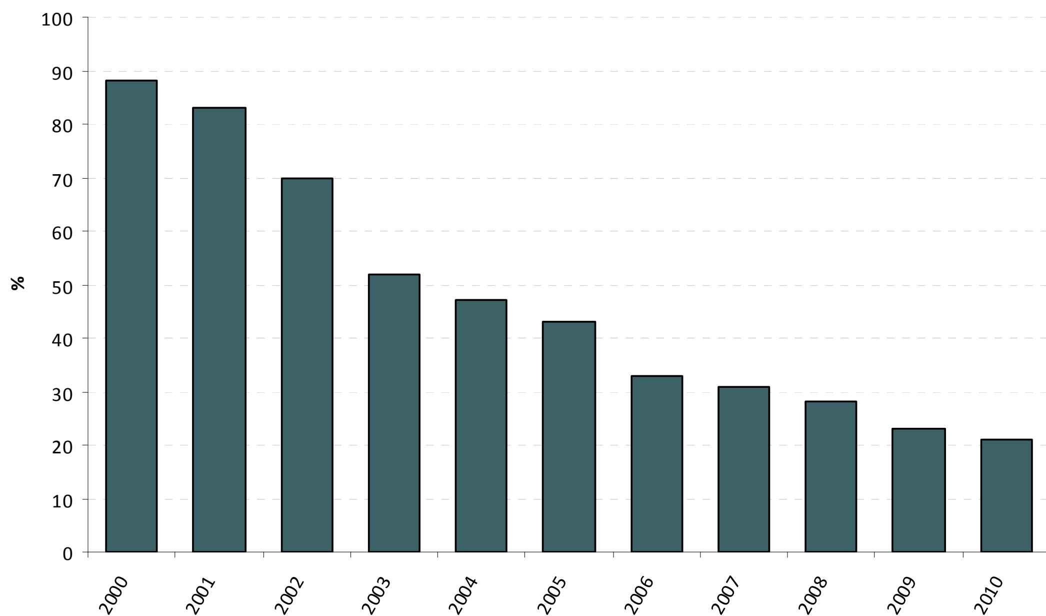
The Pensions Commission predicted this decline. But the reality has been a sharper than anticipated.

[51] ONS Annual Survey of Hours and Earnings, 2010

DB pension coverage

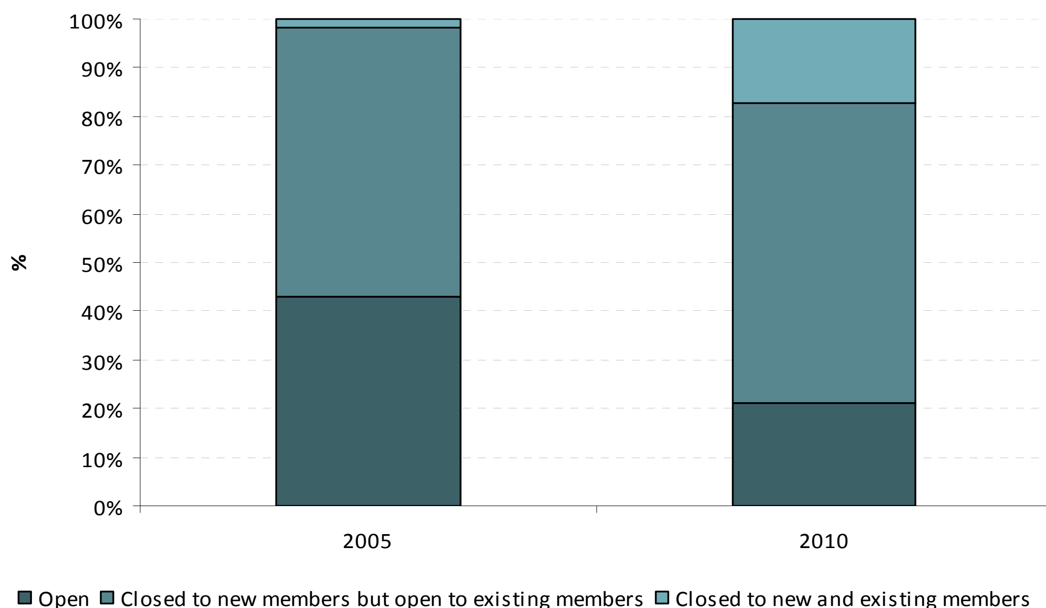
When the Pension Commission reported in 2005, around half of all DB schemes in the private sector were still open to new joiners. But just 5 years later, only 21% of schemes were open to new members. Even more marked has been the trend for schemes to close not only to new but also to existing members – a five fold increase in the last two years alone.

Figure 8: Open DB schemes as a percentage of total DB schemes



Source: NAPF Annual Survey, 2000 – 2010

Figure 9: Defined benefit scheme by status



Source: NAPF, Annual Survey, 2005-2010

There are a number of factors driving DB closure:

- The costs of running DB schemes are rising. According to the Pensions Commission, scheme costs have doubled since many schemes were first set up[52].

- Increasing longevity is adding to scheme liabilities. An increase of one year in longevity could add £30bn to UK occupational pension scheme liabilities[53].

- International accounting standards require schemes to take a short term view on scheme liabilities, influencing the decisions of company finance directors and boards.

DC pension coverage

Whereas initially employers establishing DC schemes tended to do so on an occupational basis (ie schemes established with trustees, where the employer retains a relatively high level of engagement), DC schemes are now increasingly being set up on a contract basis, usually as Group Personal Pensions (GPPs). In this case, the scheme is managed by an insurance or other financial services company, there is no requirement to have trustees and the level of engagement required by the employer is lower – the management and the administration of the scheme are handled by the commercial provider.

The shift from DB to DC schemes is often accompanied by a reduction in employer contributions. Whilst employer contributions to DC schemes have been increasing in recent years, they remain significantly below those paid to DB schemes, on average less than half of those in DB scheme. For defined contribution schemes, average employer contributions stood at 6.4% in 2009, compared to 16.5% for defined benefit schemes. Employee contributions were 3% and 5.2% respectively[54].

Contributions to occupational DC schemes have increased over the last decade:

Table 5: Contributions (mean, %) to occupational DC schemes

Year	2000	2005	2009
Employer contributions	4.3	6.3	6.4
Employee contribution	2.7	2.7	3.0

Source: GAD and ONS; including schemes for which contributions are zero

People in GPP or stakeholder schemes may also receive a contribution from their employer. This tends to vary by size of employer – for people working for employers with fewer than 100 employees, 33% with a GPP and 25% with a stakeholder pension received an employer

[52] The Pensions Commission, "Pensions: Challenges and Choices – the First Report of the Pensions Commission", 2004
[53] Club Vita's Guide to Longevity
[54] ONS, OPSS, 2010

contribution of 6% or more. For those working for larger employers, the figures were 44% and 40% respectively[55].

The difference in contributions paid to schemes will plainly make a significant difference to the final pension outcome. Typically, for a person starting saving today, a full career saving in a DB pension will deliver a replacement rate to a median earner of 50% from a private pension whereas a DC occupational scheme offering 12% contributions will deliver a replacement rate of 22% from a private pension. A scheme receiving just minimum contributions (of 8%) from 2012 will deliver a replacement rate of 15% from a private pension to that same median earner[56].

Regulatory environment

The regulatory environment is designed to protect scheme members and has been partly shaped in response to past problems, such as the Maxwell scandal and later problems with underfunded schemes when members' benefits were put at risk. Nonetheless, it is substantial and complex and there is a significant and growing body of legislation covering every aspect of a scheme's operations. Since 1995, there have been over 850 pieces of regulation directly relating to workplace pensions[57]. Responsibilities for policy development, legislation, guidance, and regulation are split across a number of government departments.

Table 6 : Government Responsibilities in Relation to Pensions and Pension Schemes

Government Responsibilities in Relation to Pensions and Pensions Schemes	
DWP	In addition to overall policy responsibility for state pensions and auto-enrolment DWP produce legislation, regulation and guidance on: • communication with scheme members; • benefits that must be provided and how they should be inflation proofed; • treatment of surpluses and deficits; • measurement of funding arrangements and liabilities; and • interaction of state pensions with occupational pensions.
HMRC	In addition to setting out the tax rules (with HM Treasury) in relation to pension funds' investments, HMRC produce legislation, regulation and guidance on the tax framework for pensions - including how much may be paid in each year and over someone's lifetime to a pension tax free, and what happens if those limits are exceeded.
HM Treasury	HM Treasury lead on savings, taxation, and national insurance policy, European and financial services (including insurance) issues, and have responsibility for: • setting the price cap that applies to stakeholder pensions; and • pensions tax policy.
BIS	BIS have responsibility for administering the Stewardship Code which aims to ensure pension funds are responsible owners of assets.

[55] ONS, Annual Survey of Hours and Earnings, 2009
[56] The figures assume saving over 40 years. For the DC calculation, a real return of 3.5%, earnings growth of 2% and annual management charges of 0.5% are assumed. The full value is assumed to be converted, using an annuity rate of 4.7%. The DB calculation is based on 1/80th accrual
[57] NAPF, Vision for Pensions, 2010

In addition, the International Accounting Standards Board and the UK Accounting Standards Board set out the standards pension schemes and sponsors must use for accounting for pension costs.

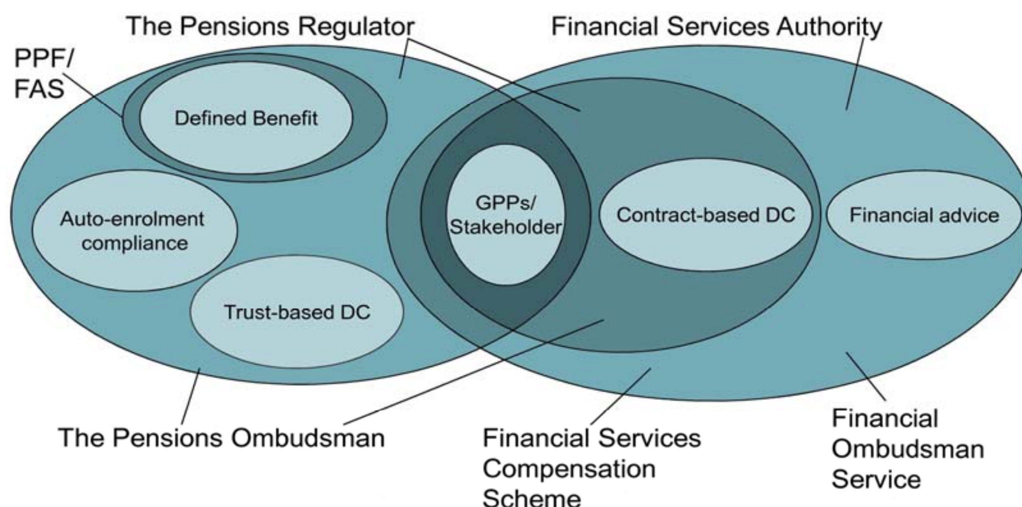
The European Union (EU) also has an impact on the operation of UK pension schemes. The Institutions for Occupational Retirement Provision directive (the main EU pensions directive), for example, sets out the principles under which defined benefit schemes must ensure they have sufficient funds to pay pensions. Examples of aspects of EU legislation and law making that impact UK pension provision are:

- the European Court of Justice has ruled that annuity rates must in future be equal for men and women;
- the EU Solvency II Directive will require annuity providers to hold more capital resulting in further reductions in annuity rates; and
- proposals to have tougher funding requirements for occupational pension schemes may significantly increase scheme running costs.

The regulatory architecture is supported by a number of institutions:

- **The Pensions Regulator:** Regulates occupational DB schemes and trust-based DC schemes. It also regulates some aspects of contract-based schemes such as the late payment of contributions. From 2012 it will also enforce compliance with the employer duty to provide and contribute to a scheme. It is paid for by a levy on schemes.
- **The Financial Services Authority:** Covers regulated firms providing group personal pensions and stakeholder pensions. May also regulate some of the activities of some DB pension funds. Regulates financial advice.
- **The Pension Protection Fund (PPF):** Covers members of DB schemes in the event of scheme and employer insolvency. It is paid for by a levy on schemes. The **Financial Assistance Scheme (FAS) provides:** Support to those who lost out from their DB schemes prior to the introduction of the PPF.
- **Financial Services Compensation Scheme: C**overs FSA regulated firms.
- **The Pensions Ombudsman:** Investigates and decides complaints about how pension schemes are run.
- **The Financial Ombudsman Service:** Settles complaints between consumers and businesses providing financial services.

Figure 10: UK pensions regulatory architecture



Fiscal support for pensions

Tax relief is granted on pension contributions made by employees and employers. This is both to ensure people do not face double taxation (where money is taxed before it is saved and again when it is drawn as income) and as a way of encouraging individuals to save into a pension.

- Employee contributions to pensions are tax free and employers receive corporation tax relief on contributions. Individuals receive tax relief at their highest marginal rate. Pension contributions are exempt from employer and employee national insurance contributions.
- There is now an annual limit of £50,000 on contributions that can be paid in tax free. And there is a lifetime allowance of £1.5 million (from 2012) that an individual can build up in their pension without incurring tax penalties.
- Investment growth is mainly tax free.
- Up to 25% of the pension pot can be taken as a tax free lump sum.
- Income from a pension is taxed at the individuals marginal rate which can be lower (or occasionally higher) than the rate at which relief was received.
- The gross cost of tax relief was £28.1bn in 2009-10. The net cost of tax relief, taking into account income tax on pensions in payment, is £19.7bn[58].

The tax treatment of pensions contrasts with ISAs where contributions are made from taxed income, but investment growth and withdrawal are tax free. IFS figures show that if an someone is a basic rate taxpayer in work and in retirement, then contributing 94p to a pension delivers the same outcome as contributing £1 to an ISA. For a higher rate taxpayer

[58] HMRC, table 7.9 cost of tax relief in registered pension schemes (updated September 2010)

in work who is a basic rate taxpayer in retirement, contributing 71p in a pension delivers the same as contributing £1 to an ISA[59].

The Pensions Commission found that while tax relief and employers' National Insurance relief significantly improved employers' incentives to provide pensions, the benefits of tax relief are poorly understood, are unevenly distributed and come at a significant cost[60]. Recent research from Aegon also suggests that the current system of savings incentives suffers from low awareness and understanding, complexity, and low trust[61].

Charges and value for money

As described earlier, the UK has a long tail of very small schemes. And for those members not in larger schemes, scheme size can have an impact. This is especially the case for DC where scale – or absence of it – can have a direct impact on the costs and charges that are deducted from members' pensions, and therefore their final retirement income. For example, for schemes with more than 50,000 members, annual costs per head tend to be between £10 and £30, while for schemes with fewer than 1,000 members, costs can often exceed £200 per member[62].

The effect of charges on the final value of the pension pot can be very substantial.

Table 7: the impact of charges on pension outcomes

Annual Management Charge	Pension pot at retirement (£)	Annual income (£)	Amount lost to charges (£)
0.5%	178,842	8,405.56	13,702
1%	160,531	7,544.97	25,469
1.5%	144,507	6,791.85	35,581

Assumptions: Average earnings of £21,024; Investment growth: 3.5% per year; Earnings growth: 2%; 40 years of saving; contribution rate: 8%; annuity rate: 4.7%

As the Pensions Regulator and DWP have pointed out, someone paying an AMC of 0.5% (a common level for very large schemes) may lose 9% of their pension pot to charges while someone paying charges at the stakeholder pension cap[63] could lose 20% of their fund to charges.

[59] Making automatic enrolment work. A review for the Department for Work and Pensions, 2010
[60] Pensions Commission, A New Pension Settlement for the Twenty-First Century, 2005
[61] Towards More effective Savings Incentives. 2011
[62] Capita Hartshead, 17th Annual Pension Scheme Administration Survey, 2010
[63] 1.5% AMC in the first ten years, 1% thereafter

Issues of scale, costs and charges are also important when it comes to turning pension saving into income.

- Larger pension pots are able to secure better annuity rates than smaller pots and hence generate higher incomes for consumers. Examples we tested using the Money Advice Service comparative tables showed that a pot of £25,000 (ie the average pension pot size) might obtain an annuity rate some 13% better than one of £5,000. Those with the smallest pots face the greatest difficulties. None of the providers participating in the Money Advice Service comparative tables were willing to offer an annuity rate to someone with just £3,000 to convert to an income.

- Almost two-thirds of savers buy their annuity from their pension provider and do not necessarily shop around for the best rate available[64]. Yet the difference between the best and worst rates can be significant. Figures produced by the Pensions Regulator include an example where the difference between the lowest rate and the highest rate available is around 25%[65]. Our own results using the FSA's comparative tables produced examples where the variation between the best and worst rates on offer ranged between 10% and 37%. And by ensuring they get an enhanced or impaired life annuity where it is appropriate, people could enhance their income still further. So by not getting the best rate, people may lose a quarter of their pension rights. For example, the best rate for a female smoker aged 65 was around 30% higher than the worst rate[66].

Pensions, investment and the wider economy

Pension funds and savings institutions play a significant role in the economy, as investors, shareholders and purchasers of government and corporate debt. Aggregate pension fund assets stand at around £1 trillion[67] at the end of 2010, invested in a wide range of assets.

It is estimated that in 2010 pension schemes held £540bn of equities and £360bn of fixed income and indexed linked bonds (government and corporate debt)[68]. As the economic climate and pensions landscape have changed, so too have schemes' asset allocations:

- the proportion of UK pension fund assets invested in UK equities fell from 48% in 2000 to 21% in 2010; and

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[64] ABI, 2008, Research paper No. 8, *Pension Annuities.* The ABI estimates that around 1/3rd of savers shop around, buying an annuity externally. 1/3rd of savers do not shop around and buy an annuity internally. 1/3rd of savers shop around and buys an annuity internally

[65] The Pensions Regulator, Making Your Retirement Choices, 2010. Example for a male smoker, aged 65 using a pension pot of £30,000 to buy a single life level annuity

[66] The Money Advice Service, annuity comparisons

[67] UBS, Pension Fund Indicators, 2011

[68] UBS, Pension Fund Indicators, 2011

- Over the same period, the proportion in UK fixed income and index-linked gilts rose from 16% to 30%[69].

There are a number of reasons for the shift in asset allocation:

- As pension schemes close to new members, and increasingly also to existing scheme members, schemes are becoming increasingly mature – in other words, they have an ageing scheme membership. Schemes are looking to more closely match their investments liabilities with their liabilities.

- Linked to this, schemes are looking to de-risk their investments, away from riskier return-seeking assets towards safer fixed interest investments.

- Regulation is also playing a part: pension fund accounting standards and scheme funding rules are also driving the shift towards risk-free assets.

The switch from equities to bonds is limited by the supply of bonds in the market. Pension funds are increasingly looking for larger numbers of long-term, index-linked bonds to match their liabilities, but there is a considerable shortage of these instruments which puts a corresponding downward pressure on yield with consequences for schemes' funding positions.

Pension funds are significant owners of UK companies, although today they own less of the UK stock market than in the past – just 13% of the index in 2010. Pension funds are closely involved in influencing and questioning company decisions on strategy, appointments and remuneration.

Public policy changes

Finally, in this section we review how public policy affecting retirement income has moved on since the time the Pensions Commission reported. The picture found by the Pensions Commission in 2004/5 was one where 10 million working age people – more than one in three of the workforce – were either not saving or not saving enough for retirement based on benchmark replacement rates. This was because of:

- growing longevity meaning that typically people would have to spread their retirement savings over a greater number of years in retirement;

[69] UBS, Pension Fund Indicators, 2010

- a decline in the numbers of people saving in pensions, together with a shift from DB provision to DC schemes with more usually a corresponding reduction in employer contributions; and

- a state pension that was falling compared to earnings, and which most women did not receive in full, supplemented by means-tested support that actually discouraged saving.

The Pensions Commission concluded that inertia was a primary barrier to saving for retirement. It also concluded that the state's role should be to provide a basic level of pension income and to encourage strongly and help people to save for themselves through a work-based pension. Previous attempts at the state providing earning-related pensions had proved unsustainable.

They also questioned continued adherence to the voluntarist approach where employers could choose whether to operate a scheme and whether to contribute to it and employees were under no obligation to join. The Pensions Commission concluded that this approach had been a failure, with too many people saving too little for old age.

They recommended:

- a state pension linked to earnings with a gradually rising pension age;

- moving to a soft compulsion system under which employees would be automatically enrolled into pension schemes with employers required to contribute a minimum of 3%; and

- the creation of a new low cost national pensions savings scheme (now established as NEST) to serve those parts of the market deemed uneconomic by the existing pensions industry.

These policy changes when taken together would deliver to someone on median earnings a pension income (from the state and their DC pension) of around 45% of their gross final earnings. They emphasised that voluntary contributions to reach a higher figure should be strongly encouraged.

The Pensions Commission's recommendations commanded a broad consensus and are in their final stages of implementation.

- From 2012 employees aged 22 or more and earning over £7,475 a year will be automatically enrolled in a workplace pension with a minimum contribution of 4% of

qualifying earnings from the employee and 3% from the employer. A further 1% in tax relief brings the total to 8%. The scheme will be phased in between 2012 and 2016. Employees will have the right to opt out.

- The National Employment Savings Trust (NEST) has been established to provide a low-cost pension scheme particularly for those employers who do not have access to a suitable pension scheme for auto-enrolment.

- The State Second pension is gradually changing so that a flat rate amount of £1.60 is awarded for each year a person spends in qualifying work or caring activity. The state pension age is being raised in stages to 68.

The result of these reforms is to extend pension saving to 5-8 million people. However, it is predicted that at any one time 6-9 million will either not be eligible, primarily on age grounds (4-5 million) or will opt out (2-4 million)[70]. It is the number of opt outs that is perhaps the most uncertain number. The auto-enrolment concept was created in 2005 an era of high employment, higher interest rate, positive equity market returns and when real wages were not flat. As has been outlined in the earlier parts of this chapter, the current post-crisis environment is not the most auspicious time in which to be starting auto-enrolment.

Clearly some of those who do not participate will be people for whom saving in a pension is not the best course. However, the Government's analysis does not enable us to predict what outcomes these 6-9 million people might expect in retirement and thus how many are on course to achieve the replacement rates suggested by the Pensions Commission.

A number of changes to other elements of the pensions system have also been introduced recently:

- The basic state pension is being up-rated in line with the higher of earnings, the Consumer Price Index or 2.5%. The State Second Pension is being up-rated in line with the Consumer Price Index (CPI) rather than the retail price index (RPI).

- Changes to the state pension age are being accelerated so that by 2020 the state pension age for women and men will be 66. Further increases have been legislated for. Under current proposals, 30,000 women will see their state pension age increase by 2 years. Around 5 million of working age people in total will be affected by the accelerated increase[71].

[70] DWP, Pensions Bill 2011 Impact Assessment, January 2011
[71] Sustainable state pension: when the state pension age will increase to 66 – impact assessment, DWP, 2010

- The annual tax relief allowance for pension contributions has been reduced from £255,000 to £50,000 a year and the lifetime allowance is bring reduced to £1.5m from £1.8m from 2012. This will affect an estimated 100,000 people of whom 70,000 are earning more than £130,000. Around 15% of those affected will be women and more than 90% are 40 or older[72].

- The requirement to buy an annuity by age 75 has been removed and there is now increased flexibility as to how people can take their pension income. The changes allowing people to have more freedom in accessing their pension benefits will mainly benefit those with large pension pots[73].

- The Government is proposing significant changes to the pensions of public sector workers following the Public Service Pension Commission Report undertaken by Lord Hutton of Furness. (His report showed that the median pension received by public sector workers is £5,600.) Lord Hutton was clear that there should not be a "race to the bottom" in terms of reforming public sector pensions, but recognised that action needed to be taken to ensure the schemes' sustainability. He proposed, and the government has accepted, that a new career average scheme should be implemented for the UK's 5.5 million public sector workers along with linking retirement age to state pension age. Whilst the impacts will differ by scheme, it is generally accepted that a career average scheme better protects the low paid whilst continuing to link pension to salary. The Government is expected to come forward with proposals in the Autumn. These changes are not the concern of the WRIC, but they cannot be ignored in terms of their overall impact.

The Government is continuing to seek to reform the pensions system. Most radically, it is proposing simplification of the State Pension. One option under consideration is to replace the current system for new retirees with a flat-rate pension combining the basic state pension and the state second pension, paid at around £140 a week in today's money. A second option would speed up the flat-rating of the State Second Pension but retain a more complex two-tier system. In its summary of responses to the consultation exercise, the DWP reported majority support for a flat-rate pension[74].

[72] Options to meet high annual allowance charges from pension benefits: a discussion document, HMT, 2010
[73] Pensions Policy Institute, Retirement income and assets: the implications of ending the effective requirement to annuitise at by age 75 , 2011
[74] A state pension for the 21st century – summary of responses, DWP, 2011

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Chapter 2: What the Commission has learned

Key points are:

- **Auto-enrolment and the 2012 reforms:** There was general support for auto-enrolment, mandatory contributions and NEST. Most saw the reforms as being an important step towards reviving the pensions habit in the UK, but most also recognised that it was not journey's end. Refinements to the 2012 settlement were suggested.
- **Need to save more:** There is general agreement that the 8% statutory minimum from 2012 is unlikely to generate an adequate pension. But there was little clarity on who should meet the costs of increased contributions, and over what time scale.
- **Trust and confidence:** The lack of trust and confidence in the UK pension system, not just by employees but also by employers, was seen as a major obstacle to improving savings levels. Past scandals and the financial crisis had played a part.
- **Continuing role for pensions:** there was a strong – and perhaps given the nature of most respondents – not unsurprising view that there was a clear and on-going need for pensions. And there was a strong feeling that the workplace was the right place to provide pensions. A key point to come through from the evidence was that the future was largely DC, and therefore it was important to get DC right. This had a number of facets including choice, consumer understanding, costs and charges and structural issues.
- **Consumer engagement and understanding:** There was a strong feeling that consumers needed to be better educated and equipped to understand the choices they would need to make and the risks they faced. But others felt there were limitations to the extent to which consumers could be reasonably expected to tackle these difficult issues.
- **Risk:** Whilst there was a view that consumers needed to be better equipped to take on DC risk, there was some pessimism that this was a realistic objective.

Introduction

Since its launch in February, the Commission has been gathering evidence on the state of pensions today and the challenges ahead. We have:

- Received over 80 responses to our Call for Evidence. (Annex C lists respondents.)
- Held 7 'round table' events around the country talking to employers, scheme managers, trade unions and trustees to ensure we understand the issues from a range of perspectives. (A list of round table events is at Annex D.)
- Held 16 Select Committee-style evidence sessions and saw 27 separate witnesses to gain a more in-depth understanding of the issues.

- Commissioned IpsosMORI to undertake focus groups with members of the public to hear their views on pensions and retirement saving. Their full findings will be published separately.

This chapter summarises what we have learned during this evidence gathering phase of the Commission's work.

Assessment of the overall state of retirement saving

Question 1: Is this the right assessment of the state of retirement saving provided through the workplace and elsewhere today – and likely future trends?

There was broad agreement that the Commission's assessment of the state of retirement saving was correct. A number of additional themes came through strongly.

First, there was strong agreement that debate over the future of pensions must be seen in the wider context of the changing nature of workplace reward packages and the retirement income choices people will make. The IMA told us that *"it is clear that there will in future be very heterogeneous sources of retirement income".* One employer on a regional visit told us *"non-pension elements of our rewards package are much more attractive to younger workers, but as a good employer we think it is important to promote the pension".*

Some said property, including equity release, would feature more prominently as a way of generating retirement income – a view that also came through strongly from the focus groups. Other industry groups suggested that ISA-style arrangements could be an alternative to pensions. However, for participants in our focus groups, there was a strong feeling that ISAs were just for short term saving.

For others, the wider context included wider economic pressures. The TUC said: *"Looking at pension provision in isolation without looking at broader changes in wages and conditions does not make sense... when wages are under pressure pension contributions are likely to suffer".* We were also told that the current review of long term care and increases in university tuition fees would affect people's ability to save.

A second key theme to emerge was risk – both for employees and employers. There was a strong consensus that individuals were now being required to take on risks that they did not understand. PICA told us: *"Too few individuals are aware of the increased responsibility the shift from DB to DC places on them".* Whilst for many, helping consumers to manage risk was a matter of better information and engagement, for others it was a more fundamental issue

of changing that market, and market interest, to fit the consumer. Russell Investments said: *"One of the challenges we face in developing an adequate level of retirement security in the UK is dealing with the powerful vested interests, both political and commercial, that present severe obstacles to an equitable and efficient occupational pension system. If we are to succeed in this challenge we need the emergence of a strong and informed consumer perspective."*

Most were pessimistic about the prospect of employers returning to a position of taking on pensions risks. The IoD told us *"DB has gone and it's not coming back".*

Barriers to retirement saving

Question 2: What are the barriers to getting people to save – and to save more – for their retirement? What further actions might overcome some of these barriers?

For many of the industry representatives, ensuring consumers were better informed and better engaged was the key to getting people to save and save more, rather than the need for any fundamental changes in the products on offer to consumers. On a similar theme Michael Johnson for the CPS said: *"There is no point seeking the perfect design of a savings product if people do not recognise a need to save".* But there was a view that the financial services industry does not communicate well. One small business organisation told us: "*The financial services industry has obfuscated this whole issue…Industry has a huge role in helping to get the message out… They need to work hard on how they communicate".*

Some suggested the process of ensuring people were more financially aware should start in schools and some said employers had an important role to play. Others were more sceptical about the role of information and education. The TUC told us that: *"perfect information was not necessarily the way to improve saving – most people do not want to make choices about their pensions, they just want to know they are being looked after".*

Harnessing the power of behavioural economics (eg using methods like auto-enrolment) were highlighted as ways of overcoming consumer inertia. A simplified advice process sitting between the Money Advice service and full financial advice was proposed to us by the ABI.

For consumers the barriers to pension saving were more fundamental. Not being able to afford to save was a theme that emerged time and again. Younger focus group participants said that they had more immediate priorities for their money. One focus group member captured the mood saying "*When I get paid, I have my rent, my bills and I want to go out and see my friends, there isn't much left to save after that".* Our focus groups found "*most*

participants thought you didn't need to think about a pension until your thirties", and the employers we spoke to confirmed that this was when employees started to show interest. However, our focus groups revealed that the more people thought about pensions the more negative they were. Older participants – those in their 40s and 50s – tended to be the most negative about retirement, and the majority believed the only way they would be able to make ends meet would be by continuing to work.

And for those who did save, there was a feeling of being duped, having done the right thing. One individual told us: *"I feel it is totally unfair for people to be advised to put a little each week into planning for their future if the only outcome is disappointment".*

Lack of trust remains a barrier to saving. Individual respondents who had recently lost their company pensions felt the Government had not delivered on its promises that pensions were safe and contrasted this to the experience of banking, where the Government has guaranteed deposits. Our focus groups highlighted the fear that their money could just disappear. One participant said "*You don't know where it's going, it was never explained properly. For all you know they're taking money and you are never going to see it".*

Auto-enrolment

Question 3: How far will auto-enrolment address these barriers? How do you think employees and employers will respond to auto-enrolment?

There was general support for the 2012 reform package – auto-enrolment, mandatory contributions and NEST. The ABI summed up the views of many: "*The 2012 reforms are the first step on a long journey".* Most believed that auto-enrolment would increase the number of savers. Hargreaves Lansdowne said: *"It will not only nudge investors to start saving, it will also promote a cultural shift which will extend beyond getting members into a pension in the first place".* But support for the reforms carried a number of caveats.

First, there was concern about the additional cost and complexity employers – especially small employers – would face. The FSB told us that the cost of auto-enrolment comes on top of other increasing costs. And the BCC said "*Sole traders report that auto-enrolment is a key barrier to them taking on more staff".*

Second, there was a concern that whilst auto-enrolment may increase the number of savers, it may not increase the overall amount of saving. There was real concern about levelling down. A CIPD survey showed that most of their members did not intend to change their pension schemes following auto-enrolment, but of those that did 23% would increase, and

11% reduce contributions. The TUC believed the risk of levelling down to be overstated: *"We think this impact has been exaggerated by those hostile to auto-enrolment".*

Third, there was a general recognition that auto-enrolment needs to be accompanied by a government-led mass communication campaign. The Money Advice Service said: *"Both employees and small employers will need education and advice to help them understand the impact of auto-enrolment on their financial circumstances, and this creates a significant need for free and impartial unregulated financial advice".*

Participants in our focus groups were more sceptical about auto-enrolment, though this may reflect the fact that most had not heard about the reforms. Whilst most believed that auto-enrolment would be helpful in forcing people to think about retirement, the most common thought was that government was forcing people to pay for their pension twice and that it could be a way for them to reduce the state pension. Others saw the potential benefits of auto-enrolment, particularly once it had been explained: *"I think it's a good idea. I wish someone did this when I was 21"* (Female, non-saver, BC1C2). And there was recognition that it would increase general awareness about pensions: *"I think it puts pensions out there you know, it makes people start to think about their pension at an earlier age…"* (Male, non-saver, ABC1)

Employers' engagement in pensions and workplace savings

Question 4: Why do employers provide pensions? What is the role of the employer in providing retirement income, and where does this responsibility end? Does this vary by size of employer?

Most responses highlighted recruitment and retention, a sense of paternalism, and tax efficiency as the primary reasons for employers providing pensions. The CBI said their survey showed 83% of company directors surveyed agreed that there was a good business case for offering a pension and 43% felt they had paternalistic obligations to contribute. There was general agreement that employer motivations for providing pensions varied by size of firm. The CIPD told us that SMEs tend to see retirement planning as the responsibility of the employee, whereas the largest firms have more of a duty of care philosophy. However, there was recognition that, regardless of size of company, these motivations were waning.

Nonetheless, there was a strong feeling that the workplace was still the best place to provide pensions. JLT Benefit Solutions said: *"The workplace is ideal for the provision of pensions to employees and the best member outcomes will be delivered through engaged employers"*. The CBI said: *"Pensions are a far more effective savings vehicle – through economies of scale, higher contributions and a stronger framework to get people into*

membership – when the employer is involved". The NAPF put it succinctly: *"Pensions work best when they work though the workplace".*

However, there was a feeling that the company pension was not always valued by employees, in turn diminishing the incentive for employers to provide one. Hargreaves Lansdowne referred to: *"Expenditure on pensions that isn't reflected in employee appreciation…".* A participant in our regional events said "*we want to be able to tell recruits we have a good pension but few show much interest in the details."* We also heard examples of paternalism such as "*We hope to raise our DC contribution even though we know most staff would rather just have the cash."*

Many argued that if employers are to have a role in providing pensions they need to be incentivised to do so, whilst others thought that there needed to be more stick than carrot. The TUC said: *"An effective pensions system that has workplace pensions as one of its pillars cannot rely on either duty or market forces to get employers to provide decent pensions any longer. This is why we need the employer duty and auto-enrolment as a minimum"*.

Question 5: What priority will employers give to pensions compared to other workplace benefits – including other saving vehicles – in their remuneration policy post 2012?

Some, such as the ACA and CIPD, suggested that the 2012 reforms might prompt employers to look more closely at their pensions and place a higher priority on the company scheme. However, Aviva cautioned that whilst pensions were the dominant workplace benefit today, we could expect a wide range of opinions and actions from employers. Others suggested that a scrutiny of pensions would also necessitate a wider review of reward. A common message was that pensions are only one part of the wider employer reward package. The CBI said*: "workplace pensions need to be seen as part of a more tailored employee benefit package".*

Flexible benefits packages are being developed in response to the reluctance of many employees to tie up savings for the long term. Some were optimistic that corporate ISAs and other more flexible savings vehicles could provide a route into long term saving, particularly for young people.

Coverage of retirement saving

Question 6: Where are the remaining gaps in coverage both in terms of types of worker who will be at risk of undersaving for retirement and sectors of the labour market? What are the potential solutions?

Two main 'at risk' groups were identified:

- People with multiple low paid jobs, frequent job changers, the unemployed. The self employed were also identified as those who may lose out due to labour market factors.
- Those who make poor pensions decisions – people who opt out and those who assume that an 8% contribution will be enough.

To help people with multiple short employments it was suggested that transfers should be allowed into NEST. There were also strong views from some that the rules should be amended to ensure that workers could be auto-enrolled into a pension from their first day of employment. The GMB said: *"Transient and low paid workers need to be aided to save through the removal of the waiting period and earnings threshold for auto-enrolment and NEST participation"*. However others felt that removing the earnings threshold would damage affordability, and the FSB argued for a longer waiting period to reduce costs for those employing short term workers. There was also a strong feeling from some that the self-employed (currently excluded from the state second pension and any requirement to auto-enrolment from 2012) should be forced to save in a pension.

A number of people suggested that the only way to crack the pensions crisis was a move to full blown compulsion. Others argued that it may be right that those who have debts are not paying into pensions. However, there was a strong view, expressed by industry representatives and commercial pension providers, that auto-enrolment should be allowed to settle before new measures are considered; any changes should follow the already – scheduled 2017 review of auto-enrolment and NEST.

Adequacy of retirement saving

Question 7: What level of income should individuals be targeting in retirement?

There was agreement that it was difficult to set a single target level of retirement income that would fit all circumstances as it would depend to a large degree on individual aspirations and initial income levels. There was also agreement that the Pensions Commission's analysis – a 66% replacement rate for someone on median earnings, but closer to 100% for a low earner, was broadly correct. However, the GMB said: *"Even the adequacy levels set out by the Turner Commission as an absolute minimum can now be viewed as insufficient due to the changing burden of funding former public services and the economic experience of inflation and earnings in the time since publication".* It was also suggested that housing costs should be taken into account. SHIP said: *"Future generations are increasingly unlikely to enter retirement without any mortgage liabilities".*

Whilst many felt that there was a need to educate people to ensure they reached their desired target income, others felt it was beyond most people to determine what they would need in retirement. The TUC said *"It is not up to individuals to target the level of income in retirement. The pensions system should ensure that inertia is likely to deliver a reasonable retirement income".* Others felt that this should be further supported by offering guarantees to people to help them reach a decent level of retirement income – especially those in DC schemes. Unison said: *"there must be some form of underpinning guarantee for benefits and the contributions".*

Question 8: Is an 8% total contribution enough to achieve the desired outcomes? If not, what are the potential policy responses and how might these be delivered?

There was general agreement that the 8% mandatory minimum contribution would not be enough to generate adequate retirement incomes for most. The TUC, NAPF and ABI argued that the contribution floor would need to increase to avoid future generations having inadequate incomes. However, the CBI said that the levels set for auto-enrolment were "reasonable" and gave employers flexibility to build reward solutions around the legal minimum.

Evidence submitted by the PPI showed that contributions of 16% were required to reach a 67% replacement rate, ie the 2/3rds final pension targeted by most final salary schemes. A number of policy responses were suggested as to how contributions could be increased and who should bear that increase. A system of 'auto-escalation' of employee contributions (as in the "Save More Tomorrow" scheme[75]) was suggested by some. Some suggested that if employees were offered a choice of contributions at 4,6,or 8% most would be 'nudged' into paying 6%.

Unions and individual respondents said that future contribution increases were necessary and should be borne by employers. The TUC said*: "We would therefore support over the longer term from 2020 a phased increase in contributions to 12 per cent of earnings… with a 2:1 employer/ employee split".* Reducing costs and charges would be an effective way of ensuring that more of the saver's contributions worked for them, others said.

Trust and confidence

Question 9: What effect has the financial crisis had on confidence in saving for retirement?

[75] Save More Tomorrow, or SMarT, is an idea propounded by Richard Thaler of the University of Chicago and Shlomo Benartzi of the University of California, Los Angeles where employees elect in advance to forgo a proportion of future pay increases and for those increases to be directed to their pension scheme

There were mixed views on this question. Some felt it had accentuated lack of trust, others felt that the damage had already been done and so the financial crisis made little difference.

Many felt that the crisis had made people question the merits of saving. On a perhaps optimistic note, the TUC suggested that because workplace savings were seen as "*a workplace benefit, rather than speculating in the financial sector"* people were less likely to be put off saving in a pension. ABI research also showed current savers were resilient and Aviva research suggested the decline in trust has been arrested. TPAS report that the crisis had caused people to put off retiring and to continue working instead.

Policy changes seen as consequential to the financial crisis (notably the change from RPI to CPI for inflation-proofing state and some occupational pension schemes) had also damaged trust and confidence we were told. The media was particularly singled out for negatively impacting trust and confidence in the industry. The CIPD said: *"Journalists have damaged the public perception of retirement savings far more than any other group"*.

Our focus groups showed that past scandals still affect trust today: *"The Mirror Group, Robert Maxwell completely obliterated all their pensions, billions…" (female, non-saver, ABC1).*

Question 10: What can be done to improve trust and confidence in pensions?

Most felt the introduction of auto enrolment, NEST and the proposed flat rate state pension would go a long way to improving trust and confidence.

Whilst some said clear communication was the key to restoring confidence, for others more fundamental industry market failures needed to be tackled. This included pushing down costs and charges and ensuring people were clear about what they were paying for. Reinvigorating the trust model was also seen as important to ensure schemes operated in the interests of members. Russell Investment said: *"An important ingredient in rebuilding that confidence will be an understanding that there are structures, mechanisms and organisations that stand with the individual savers and assert their interests against the powerful communities of service providers".*

Some highlighted the need for simplicity and deregulation to help improve employer confidence in pensions. Suggestions (from the NAPF) included a single pensions regulator and renewed rules on disclosure documents highlighting inconsistencies between DWP and FSA. By contrast others, including unions and pensioners who had lost their occupational pensions, argued for more regulation of the industry. One member of the Pensioners' Action Group said: *"To put things right for the future start with the wrongs of the past".*

Many respondents felt there should be a period of stability in pensions policy and law. This was a view highlighted by the FSB: *"The best way to achieve near universal take up of 2012 reforms is to inject stability".* Many argued for an independent pensions commission to oversee policy to take the politics out of pensions and help generate a more stable system.

Understanding and Engagement

Question 11: What are the respective roles of government, employers, individuals, employees and other groups (eg trade unions) in helping to improve understanding about the need to save for retirement?

Almost all respondents saw a key role for government, particularly in providing information and advice, educating consumers. There was also a view that government should be honest about how modest the state pension will be. The TUC said: "*Government needs to have a role in ensuring that people have access to non sales oriented advice through financial literacy initiatives"*.

Unions and employers were also seen as having an important role in helping to improve understanding. JLT Benefit Solutions said: *"Employers are often more trusted than Government and therefore for the restoration of trust and confidence it is vital that employers remain engaged".* Respondents highlighted the unique opportunity employers have to talk to people about their income as they earn it.

For participants in our focus groups the issue was simple. Whilst they were not clear on what a target level of income should be, they were clear that it was Government's job to help them reach it: *"Most people, and those in their 40s and 50s in particular, believed that responsibility for ensuring everyone has a level of income which enables them to have a good standard of living should lie solely with the government"*[76].

Question 12: Are there barriers that prevent or discourage employers from providing support to their employees when it comes to saving for their retirement?

At our regional round table events we found that many larger employers were keen to give guidance and encouragement to their employees but were concerned about regulatory comeback. This view was backed up by many of the responses to our Call for Evidence. Many urged the Government to clarify what guidance could be offered by employers without falling foul of regulation.

[76] *The future of pension provision – qualitative research on behalf of the WRIC* IpsosMORI, June 2011 (forthcoming)

Some smaller employers would be willing to pay for an IFA but many thought this was not a role for them. The Money Advice Service highlighted their research which showed the key barriers for employers providing support and financial education were cost, time, lack of confidence and lack of interest. This view was supported by TPAS. We were told that employers would be more inclined to fund financial advice if it were tax free up to £500. The ABI argue that small employers afraid of being perceived to give financial advice would benefit from ABI's proposed simplified advice service.

The balance of risk between employer and employee

Question 13: In saving for retirement, how much risk is it appropriate for the employee to bear, and how much is appropriate for the employer to bear? Could risks be shared differently or more equitably? Does the capacity for risk alter with firm size?

Many felt that employers were better placed than employees to bear and manage risk. However, there was recognition that there was a limit to the amount of risk and volatility employers were prepared to accept. On our company visits and at round tables many employers were uncomfortable about the DC risk their workers faced but said "*never again"* to DB schemes. Even closed DB schemes consumed so much management time and energy there was often little time to focus on the open DC schemes which had replaced them.

There was consensus that individuals in DC schemes do not understand the risk that they are taking on and are ill-equipped to manage their risks. Aviva said: "*the issue is not whether risk sharing is right or wrong but rather whether the employee can understand the level of risk they are now accepting".*

Risk sharing was discussed by many. Some felt career average DB schemes and other new options might help some employers retain an element of DB provision. The NAPF said: "*If you want certainty, you could do something with benefits between DB and DC, but the regulatory environment is not aligned to this…we need more flexibility".*

Others said there were limitations to risk-sharing saying that risk could only be shared between generations of employees in DC schemes if there were compulsory contributions and long lived tightly controlled schemes – features not present in the UK DC market. Some argued that smaller businesses were less well equipped to share risk, but others said company culture was a more important determinant of capacity to take on risk than size.

Witnesses from the financial services industry thought the capital markets could do little useful to reduce the volatility risk. We were told the cost of guarantees would be high and volatility was best addressed through the investment mix.

Question 14: To what extent does the regulatory system push risk disproportionately to the employer or disproportionately to the scheme member? If this is a problem, what are the solutions?

Some argued that regulation had been a key factor in the decline of DB schemes. Tesco said: "*We believe that a key factor in causing this decline is the disproportionate level of regulation and the lack of flexibility to spread the cost of increasing pension provision fairly between different generations within defined benefit schemes."* The CBI said *"The main driver on DB is less about cost today; it's more about costs tomorrow – it is not that it costs 20% today, but that it might cost a lot more tomorrow".* However other respondents pointed out that the shift from DB to DC was not necessarily a result of regulation, but more a response to cost and other factors. The Public Service Pensioners' Council said: *"The PSPC acknowledges that it would be appropriate for employers to re-examine their pensions provision faced with escalating costs. We believe, however, that too many employers have used these pressures as an excuse to retreat from pension provision".*

The changing labour market and how people save for retirement

Question 15: Will additional flexibility lead to an increase in saving? What would it mean for the balance between long-term and short-term saving? What issues might any additional flexibility raise for employees and employers?

The majority of respondents felt that flexibility in the form of early access carried risks – principally that people who accessed funds early could be left with too little income at retirement. Many also pointed to a lack of evidence that early access would increase saving: an Aviva survey showed that those with incomes under £14,000 a year were more likely to say they would not want early access. Some also felt that introducing flexibility could undermine what was being achieved through auto-enrolment. On one of our company visits the HR director said "*I'm happy for us to pay towards pensions for our staff, but not if they can get it out and blow it on other things."* Russell Investment said: *"It would be better to keep the funds 'clean' and wholly for pensions".*

Among those who favoured early access some wanted to see it available for a limited set of reasons only – eg house purchase. Several suggested limiting early access to 25% of fund, and some wanted this offset against the tax free lump sum usually available at retirement.

Hymans Robertson said: *"[flexibility] is a key area where the biggest inroads can be made to employees' savings behaviour".* Focus group members also wanted to feel they could get their hands on their money: "*What if I lose everything and need to start again? I want to be able to get to all my money, I don't want someone holding it back when I can use it to start a business or save my house".* However, there was also recognition that they may lose their money and have nothing left for retirement.

Some suggested other ways to make pensions more flexible, for example abolishing requirement to annuitise at 75. Alternative workplace products such as corporate ISAs were discussed positively. The CBI said *"We will increasingly see savings packages tailored to the workforce perhaps with more workplace ISAs for those with younger workforce".* It was suggested that the tax regime should be adapted to encourage provision of corporate ISAs.

***Question 16: Are there additional issues that need to be addressed in the 'at retirement market' that have not been addressed so far in the Government's legislative programme*?**

Whilst there were some who suggested that ending the compulsion to annuitise was important, many others argued that annuities provided a secure income for life. It was said that the more important issue was accessibility for people with small pots and a lack of innovation in the market.

There was a strong view that customers should be better supported to shop through the Open Market Option (OMO). We heard that a number of industry-proposed solutions to reform the OMO were under consideration. Some argued that trivial commutation rules should be amended and others that the limit per pension pot should be around £5,000 as annuities are hard to buy below this amount. More radically, it was suggested that NEST should, in time, be allowed to become an aggregator of small pots to help consumers get a good deal.

We were reminded that a more holistic approach should be adopted which looked at the retirement process in the round, including long term care. In this context, we were told that: *"equity release is becoming a viable option for more people…"*

Question 17: What impact will the increase in the State Pension Age and the abolition of the default retirement age have on a) employee behaviour and b) employer behaviour?

Most respondents welcomed the abolition of the default retirement age, and accepted the need to increase the State Pension Age. Most believed that these policy changes would lead to people working longer. This could help some people manage risk. One witness told us: *"working longer now gives people a way of coping with the volatility of DC schemes".*

However some respondents – particularly unions – pointed out inequalities in life expectancy, and said that some lower paid workers would be pushed into poverty by these measures. And by making retirement an even more remote prospect, some could be put off saving. Unison said: "*Increasing Normal Retirement and State Pension Ages will to some extent act as disincentive to save…and consider pensions a very distinct concern".*

For members of our focus groups, increasing retirement ages compounded the view that saving in a pension was a waste of money because they would die before it came into payment. Others were sceptical there would be jobs for older people.

Supply side issues

Question 18: What are the pros and cons of having a long tail of small schemes? Are any new policy initiatives needed? What lessons can be learned from abroad?

The high costs of small schemes were recognised as an issue. RPMI proposed a *"PPF style centralised administration of such funds"* to minimise costs. However, whilst acknowledging the diseconomies of scale of small schemes, one respondent pointed out small employers tend to have a strong relationship with their employees.

Several respondents supported moves to bring together small schemes into larger trusts to gain the benefits of scale and risk pooling. The NAPF told the Commission: *"We've got too many funds at the moment. We need to keep [pensions] out of the retail sector and get some really big schemes that are well governed. We need to find ways of consolidating what we've got and keeping this out of retail and in wholesale".* This view was endorsed by Russell Investments who said: *"A rejuvenated occupational system with large well resourced funds could provide the basis for a revival of confidence and indeed a revival of financial strength and success in pensions".* The TUC also said *"We would urge the Commission to investigate whether regulation can be used to drive the creation of large multi-employer super trusts that can levy low charges, deliver good governance and achieve the scale needed to share risks among members".*

However some opposed this move. The ABI said: *"any initiative seeking to drive small schemes to large scale provision would be inappropriate.... as it is unclear whether these other schemes will indeed provide improved outcomes for members".*

NEST was seen a having a potential role in acting as a home for combining small pots. However, others saw this as an inappropriate extension of NEST's role.

Question 19: Are pensions in the UK too expensive to the consumer? Is this perception or reality?

Industry respondents tended to say that costs were reasonable, and that the focus should be on what is delivered for a price. The ABI told us that there is a competitive market and most annual management charges are now under 1% and that auto-enrolment may well push costs down further. The IMA also said that "*fund managers do not make excessive charges".* The ABI did not see it as a problem that some employers would auto-enrol their employees into schemes with charges higher that those of NEST: *"…this may be appropriate for some employers and employees…"*

Others did not see costs and charges as a barrier to saving. The ACA said: *"we do not feel that cost alone is a particular barrier to long term saving – lack of trust and inflexibility are much greater reasons".*

However, this view was not universally accepted. ATP told us that two things were clear about pensions in the UK *"[people] are sick and tired of choices and they are paying too much to their providers"*, and of the industry they said *"there are a lot of people taking basis point costs from the savings [of people]".* Others also saw costs and charges as a significant problem. The NAPF agreed that costs, including the costs for fund management services to occupational pension schemes, were too high. And employer groups told us that the financial services industry levies high charges for pensions – not just to scheme members but also to employers for advice.

Fiscal incentives to save for retirement

Question 20: Does the current structure of tax relief incentivise the right people? If not, what would a more effective structure look like?

Most respondents acknowledged that the current pensions tax relief regime – providing £28.1bn of relief in 2009/10 – meant the majority of tax relief went to higher earners. Most felt that this was probably not the group who most needed to be incentivised to save. However, several respondents pointed out that pension decision-makers in firms tend to be higher rate tax payers. Reducing their tax incentives to save in pensions may therefore reduce their motivation to provide pensions to the wider workforce. There was also widespread agreement that tax relief is not well understood and some felt this limited its ability to act as an incentive.

A number of proposals were put forward to address these concerns. Some suggested harmonising tax relief at 30% for all savers; limiting tax relief to basic rate tax; replacing tax relief with a system of matching contributions; or abolishing tax relief altogether and investing in the basic state pension; or abolishing tax relief but making pensions in payment tax free. Calls for changes in tax relief came from across the spectrum of respondents. There was also a call for the pensions tax regime to be replaced with the tax regime for ISAs. Some argued for additional tax incentives for employers to incentivise them to provide contributions above the statutory 8% minimum required from 2012.

Question 21: Should pensions be more (or less) tax favoured than other forms of saving?

Most respondents believed pensions should be more tax favoured than other forms of saving. Respondents argued that pensions fulfilled a particular social policy objective and needed to be treated differently and others argued special incentives were needed to persuade people to lock away savings for the long term. The ABI said: *"It is appropriate and necessary for pensions to be more tax favoured than other forms of saving… it is also the fairest way of taxing income that is deferred and fair compensation for those who make responsible sacrifices to save and ensure they are not a burden on the State and taxpayers when they retire".*

However a minority strongly opposed this and argued for a harmonised tax treatment of a suite of savings products including ISAs and pensions in a lifetime savings regime.

Governance and Regulation

Question 22: Do we have the right balance of risk and regulation in UK pensions and the right regulatory architecture? If not, what policy solution would deliver the right mix? Is there a case for an alternative, principles-based, approach?

On our regional visits we heard the frustration of many employers with DB schemes. One comment summed it up: "*At one review my scheme is in surplus, at the next it has a huge deficit even though nothing has changed in the real world. It's all based on assumptions. We go through months of agony for everyone in the firm then the assumptions change back again."* Employers with foreign owners told us of the incredulity they faced when explaining the volatile figures to the owners.

Many respondents highlighted the role that over-regulation had played in the decline of DB. Tesco said: *"Over the last few decades, mandatory requirements have increased costs by more than 50%, as well as adding significant complexity. This has come at a time when*

employers are also seeing increased costs due to improvements in life expectancy". To address this problem some called for more discretion to be available for DB schemes. For example there were calls to allow retirement age to be linked to a longevity index as the Government has done for the State Pension, and to remove mandatory pension increases and allow them to be discretionary instead.

However, others pointed out that other factors had probably had greater impact and regulation should not be made a scapegoat. Unions and pensioners tended to argue that there is a need for tighter regulation in some areas – particularly on DC schemes.

Views on the right regulatory regime for pensions differed sharply. However, there was common support for a streamlined and harmonised regime supported by an efficient and effective enforcement of the regulatory regime. A number of respondents commented on the role of the Pensions Regulator itself and we heard concerns about inconsistency in the application of regulation. One employer said "*We run two DB schemes in almost identical positions: on one the Regulator was happy with our recovery plan, on the other we were sent back to the drawing board."*

Question 23: Does the way in which pensions are currently regulated act as a barrier to employer-provided pension provision or determine the form of that provision, and to what extent is it a barrier to innovation?

There was agreement that regulation impacted the type of pension provided. CIPD said: *"regulation impacts on the type of pension provided rather than the decision to provide a pension per se".* Many felt that the regulatory regime made contract based DC schemes the easiest option for employers. Others felt that risk sharing models were not well supported by the current regulatory regime, which tends to polarise provision. One manager of a cash balance scheme told us his type of scheme "*is not well liked by the regulator or by HMRC*". The CBI said: *"…ideas like conditional indexation, cash balance, collective DC and Super Trusts might interest a few firms. There is little reason for regulation to stop them offering such schemes".*

Others supported regulatory change to encourage smaller schemes to band together. The TUC said: *"We think the intellectual case for such [super] trusts is strong but it is hard to see why employers should adopt these…unless there is some form of public policy encouragement". The NAPF said "Strong encouragement should be given to creating large, low-cost, Super Trusts which would offer benefits to savers and employers…Super Trusts could add around 30% to the eventual size of someone's pension"* . The EEF said *"we are excited by the idea of Super Trusts".*

Many felt deregulation could support innovation. The CBI was typical of this view: *"CBI members would encourage the Government and the Pensions Regulator to work to deliver the permissive savings environment that allows new ideas to develop at workplace level"*. And Michael Johnson for the CPS said: *"Over the last 20 years the pensions and savings industry has surrendered initiative to the regulator…It also needs to come up with its own plans to create a forum for self-regulation that set standards and policies for good practice".*

Question 24: What is the optimal form of governance for pension schemes, whether DB or DC?

Many respondents favoured trust based arrangements while some argued that good governance could be equally well delivered under either model. Usdaw said: *"We strongly believe that only trust based governance can ensure high levels of employee confidence in workplace pensions and deliver straightforward and easily-understood communications tailored to meet the needs of a particular workforce".* There was recognition that more needed to be done to secure the good governance of DC schemes. Unison said: *"There is much work to be done with regard to sufficient governance arrangements for defined contribution pension schemes in particular".*

Retirement savings and the economy

Question 25: What are the trends in the role that pensions and savings institutions play in the wider economy? How might this change in the future?

A consistent theme was the continuing decline in the proportion of assets held by DB schemes in UK equity over the last 20 years. It was pointed out that long term investors such as pension funds and insurance companies own around 13% of UK companies – the lowest level since 1975. Notwithstanding that, we were told that pension funds were active and engaged shareholders, though the diminution of UK equity holdings could dampen activity.

Thinking more broadly, it was suggested by the TUC that government should make gilts more attractive to pension funds by allowing them to be used as a hedge for longevity and inflation. This income could be used to invest in capital projects when demand is low. Russell Investments speculated that the financial crisis could lead to a resurgence of mutuals.

Conclusion

Question 26: What steps need to be taken to meet the Government's Coalition Agreement commitment to "reinvigorate occupational pensions"?

A range of policy suggestions were put forward – some specific "tweaks", others full scale root and branch reforms. Suggestions included:

- Regulatory reform – The ACA said: *"the first and essential point is to accept the need to "simplify rules and regulation"*
- A meaningful debate about how to make DC better, including consolidation of DC.
- More, and more innovative, approaches to consumer financial education.

Amongst the calls for more radical reform were:

- The suggestion for a Lifetime Savings Account combining ISAs and pensions, allowing money to be transferred between the two. Initial measures proposed included a single annual limit for contributions to ISAs and pensions and a harmonised tax regime.
- Pensions start up loans to help young people start saving.

Unison summed up the views of many when it said: *"The Commission needs to take the opportunity to look to halt the seeming race to the bottom in pension provision…and make recommendations that will help to maximise pensions coverage."*

Workplace Retirement Income Commission

Chapter 3: Our recommendations

As noted in Chapter 2 our evidence gathering has shown strong support for the 2012 reforms. But there is recognition too that this was a half-way point, not the end point. We agree. In some areas, there was broad agreement that further, urgent, action was required and the Commission has been able to put down specific recommendations. On other areas there was no clear consensus on the specific course to be taken, but a pressing need for further investigation by Government and co-operation by industry. Our recommendations for Government, the industry, employers and individuals are set out below.

Risk and adequacy

State Pensions

1. The Commission welcomes the proposals for a simpler, single-tier pension, which will give individuals a solid floor on which to build workplace pensions retirement savings. The Government should move ahead quickly to put in place these new arrangements.

Adequacy

2. For many, an 8% minimum contribution will not be sufficient to meet expectations in retirement. This must be reviewed as part of the 2017 review of auto-enrolment, and a clear way must be sought to increase contributions gradually over time.

3. But ahead of any decisions in 2017, the Government should begin actively to lead work with employers and industry to develop and encourage approaches such as 'auto-escalation' that make it easier for people to save more.

Risk Management

4. Greater innovation is still needed to develop approaches that can allow risk and volatility to be managed to ensure good consumer outcomes. The Government must show leadership in encouraging and creating an environment in which employers can feel confident and rewarded for taking on risk. And the financial services industry and Pensions Regulator should jointly develop approaches that help to smooth investment volatility for savers.

Value for money, costs and charges

The 'At Retirement Market' and Annuities

5. Given the detrimental impact on the consumer, further work must be done to understand the causes of significant variation in outcomes when people buy the same type of annuity, and whether these differences can be justified.

6. More could be done to ensure that shopping around really is the default, and that all consumers are getting the best deal. Serious consideration should be given to requiring schemes and providers to direct their members and consumers to an annuity 'price comparison site'.

7. Greater innovation in the annuity market is required to ensure that income meets spending patterns in later life. Particular consideration should be given to encouraging annuities to be flexible enough to account for unplanned events such as an unexpected increase in income from inheritance, or the need to draw down income for healthcare costs during retirement.

Charges

8. The Commission does not think a 'wait and see' approach on charges is sufficient, given the impact of high charges on pension outcomes. We recommend the Government uses its regulatory powers to apply stakeholder charge caps to schemes that will be eligible for auto-enrolment.

9. Disclosure around costs and charges remains inconsistent across schemes and providers. What is consistent, though, is the opacity of that disclosure. All schemes should be required to disclose costs and charges in a way that is transparent for consumers and which shows the cash impact of charges on the pension pot. The industry should develop a code of good practice on this issue and the government should monitor this and consider taking regulatory action if standards are not improved.

Small Pots

10. Whilst the main restrictions on auto-enrolment and NEST will not be reviewed until 2017, there is a case for lifting the restriction on transfers in to NEST before this date for those with small pension pots below a de minimis amount.

11. Longer term, consideration may need to be given to whether small pots should be defaulted into schemes where they can be managed efficiently, including NEST, which is currently banned from taking them.

Scale

12. Government and the Pensions Regulator should develop a package of measures that would encourage the consolidation of small schemes into larger, better value, schemes to drive down costs and improve outcomes. With many employers actively considering their pension provision in light of auto-enrolment, this is a matter that must be tackled urgently.

Cultural change

Consumer confidence

13. 2012 presents a one-off opportunity to change the way the nation thinks about saving for retirement, and to shift from a society that spends today and pays tomorrow to one where it is in the nation's DNA to save, and save for the long term. Whilst there will always be limits to the role of consumer empowerment, the overarching message that saving is a good thing needs to be actively promoted by government, employers, the pensions and savings industry and consumer groups. And the communication strategy that accompanies auto-enrolment must be a powerful one.

Trustworthiness

14. For consumers to have more trust in the pensions system, the industry needs to show it can reform itself to be trustworthy. An industry-led drive around disclosure, transparency, clear communication, and driving down costs and charges will help to achieve this. But we have also heard that employers are most trusted when it comes to pensions, and are well positioned to act as an intermediary on behalf of the consumer. To hold the industry's feet to the fire, the Government and the Pensions Regulator should make it a priority to promote strong and consistent governance and employer engagement with workplace pension schemes, whether trust or contract-based.

Rebuilding employer confidence

15. Employers should be encouraged to confidently engage with their workforce on pensions, including through tax incentives to encourage provision of independent advice, and 'safe-harbours' for discussions about pensions. And employers are well placed to encourage other forms of saving, for example workplace ISAs and feeder funds into pensions, if changes to the tax regime can be made that support these approaches without undermining retirement saving.

Stability

16. The Commission recommends that, in line with the Government's proposal to establish a standing advisory body on longevity and state pension ages, and the original recommendation of the Pensions Commission, an independent standing commission on pensions should be established that can take the politics out of pensions.

Introduction

This final chapter brings together what we have learned from the analysis and the evidence we have received and draws out a set of recommendations for individuals, industry, government and employers.

During the course of the Commission's work, we have been struck by the high degree of consensus on key issues from across the board. We are extremely encouraged that there is a high level of agreement that progress is being made, in particular in regards to the 2012 reforms.

There is almost universal agreement that the 2012 reforms lay the foundations for a better pensions system for the future, and there is agreement that the combination of auto-enrolment, mandatory contributions and NEST will make a difference. However, there is also recognition that the environment has changed significantly – the Pensions Commission foresaw introducing auto-enrolment into a world of low inflation, positive real interest rates and booming equity markets. That world has been turned on its head, with the result that the positive effects of the reforms could be muted.

We see automatic enrolment as a positive step to get more people saving for their retirement. It is one that must be built on.

But there remain areas where further changes have the potential to deliver a stronger appetite for saving for retirement, better value for money for the consumer, greater confidence in the system both for employers and their workforces, and a more sustainable landscape for workplace pensions going forward. Our recommendations to achieve this impact on the Government, regulators, industry, employers and individuals alike, and fall into four overarching themes:

- adequacy and risk;
- value for money, costs and charges;
- cultural change; and
- stability.

These recommendations are set out below.

Adequacy and Risk

Adequacy of future retirement incomes

There is agreement that it is hard to define what an "adequate" income is – there can be no universal answer to this question. For each individual it will depend on the lifestyle they hope to achieve, financial commitments they carry into retirement and their ability to save during their working life. However, the Pensions Commission benchmarks (66% replacement rate for someone on median earnings, nearer 100% for lower earners and around half for higher earners) remain relevant as a broad guide. Whilst they may benefit from some

refinement, we think it would be helpful to develop a clear 'rule of thumb' that people can use as an easy to understand way point to assess their own retirement savings levels.

Individuals need to have a clear starting point for their retirement planning: they need to know what they can expect from the state once they reach retirement age. The Coalition Government's proposal to reform the state pension into a single-tier pension above means-tested benefit levels is addressing this issue. Throughout our work we have found widespread support for simplifying the state pension system.

Recommendation 1: The Commission welcomes the proposals for a simpler, single-tier pension, which will give individuals a solid floor on which to build workplace pensions retirement savings. The Government should move ahead quickly to put in place these new arrangements.

However, there is agreement that the 8% statutory minimum required from 2012, which will generate a 15% replacement rate[77] (excluding state pension income) for someone on median earnings, will not generate a reasonable standard of living in retirement for most. This view is compounded by the fact that the financial crisis and lack of discretionary spend will make it more difficult for people to put aside additional income for the long term. And there are now new pressures not envisaged by the Pensions Commission, including student debt and meeting the costs of long term care, making it tougher for people to save for old age. Compounding this further still, up to 9 million people could fall outside the scope of auto-enrolment (at least for some portion of their working life). Millions could still be heading for a poor and uncertain old age.

What is abundantly clear, and echoed in all the evidence we have received, is that more needs to be done to encourage higher levels of saving and participation. Whilst it is plain that the new 8% contribution level needs to be given time to bed in it is also clear that we need to start to consider now how we increase contribution levels, over what time frame, through which method, and from whom.

We received a large number of suggestions about how to do this.

- **Using inertia to increase contributions over time:** Ideas include automatically increasing the contribution rate when an individual's salary rises or when they reach certain age thresholds. This approach, known as 'save more tomorrow', has been adopted by some companies in the USA and has succeeded in raising contribution

[77] Pensions Commission, "A New Pensions Settlement for the Twenty First Century: The Second Report of the Pensions Commission," 2005

levels. Research conducted by the Employee Benefits Research Institute (EBRI) in the US shows that this 'auto-escalation' can increase low income people's income in retirement by between 11% to 28%.[1] Some schemes in the UK are already using these tools to increase both member participation and saving rates. The Government could start to actively work with those schemes now to develop and share tools and systems and encourage innovation ahead of 2017. We are also interested to explore how employer inertia might be utilised, making it easier for them to do the right thing.

- **Increase the minimum contributions for auto-enrolment:** This could apply to either employee or employer contributions or to both. Alternatively, the lower threshold for contributions could be reduced so that contributions cover a bigger proportion of pay. There is clearly a risk that this could be counter-productive by making saving appear unaffordable or by discouraging employers from promoting scheme membership. However it has been put to us that a very gradual increase in minimum contribution levels over several years from 2017 could make a real difference.

- **Improving incentives to contribute:** Proposals include clearer and more focused incentives for employees and/or employers to contribute. They could be focussed on encouraging contributions above the statutory minimum or on encouraging retirement income saving more broadly. We are very conscious of the financial constraints the government faces but we think this is not an issue that should be ignored. Getting the best value from tax relief and ensuring that it visibly acts as an incentive to save is essential.

- **Financial education and awareness initiatives:** This could include making it easier for employers to promote retirement saving and changing the language of pensions which can be a turn off for many people. We comment on this further later in this chapter.

- **Using 'decision framing' techniques to encourage higher contributions:** For example giving individuals a choice of paying contributions at 4, 6 or 8%. The idea is that people are most likely to choose the middle option. There is however a risk that the need to make choices acts as a deterrent to save and the individual ends up opting out altogether. ***We think such techniques, whilst potentially helpful, may have a limited impact.***

- **Making it compulsory to contribute:** We accept that this might ultimately have to be considered. But our initial view is that the focus over the next few years should be on making auto-enrolment work. A variant would be to require the self-employed to contribute as they currently do not contribute to the state second pension nor will they be auto-enrolled like employees. We note however that the Government's idea of a single-tier state pension could boost the state pension incomes of the self-employed in some circumstances. Further consideration of the self-employed should await a decision on state pension reform.

- **Integrating pension and other forms of saving:** It has been suggested that people may be more attracted to saving if they could use their pension 'pot' to fund other key life changes (eg a house purchase) or that feeder funds could be developed, eg through workplace ISAs. Views were sharply divided on this issue. Some said it would kick-start the savings habit, whilst others doubted it would motivate non-savers and worried that early withdrawal would reduce already limited retirement income. Some employers we spoke to were less enthusiastic about contributing to such arrangements as opposed to pensions. However, there are smaller, but nonetheless powerful, steps that could be taken to improve flexibility in the pension system that would require changes to existing rules and fiscal incentives. These should be explored, and the Commission welcomes the announcement by the Financial Secretary in April that the Government will work with industry to develop other forms of workplace saving to supplement pension savings, and to make the tax rules simpler and more flexible.

We think the ideas that are most promising, and which will have the most impact, are increasing minimum contribution levels and using inertia to increase contributions over time.

Recommendation 2: For many, an 8% minimum contribution will not be sufficient to meet expectations in retirement. This must be reviewed as part of the 2017 review of auto-enrolment, and a clear way must be sought to increase contributions gradually over time.

Recommendation 3: But ahead of any decisions in 2017, the Government should begin actively to lead work with employers and industry to develop and encourage approaches such as 'auto-escalation' that make it easier for people to save more.

Helping individuals manage risk

There was universal agreement that people face more risks in planning and saving for retirement in DC schemes, and that the vast majority of people were ill equipped to handle

that risk. Put simply, they do not know how much they will get out for every pound they have put in. Whilst insurers and employers can bear some investment downside, people often with very modest savings are less well placed to do so.

Some argue that DC pensions are simply less attractive to people and therefore it is harder to get employees to join. Others argue that they match today's labour market well and offer individuals greater freedom and choice. However, there was a common call that if the future is DC, we need to get DC right. This is not simply about ensuring adequate contributions are paid in. It is also about risk, and risk mitigation, for scheme members. We agree. There is no inherent reason why DC schemes cannot deliver good outcomes.

We have heard from both investment experts and trade unions that risk-sharing schemes are inherently more efficient than individualised pure DC provision. At its heart the argument is simple: just as with insurance, risks that can be pooled across many parties are cheaper to cover than if each party has to cover the risk alone.

While we recognise that a large scale revival of traditional final salary schemes is very unlikely, we do see a strong case for exploring how the risk-sharing principle could be developed both to help individuals mitigate their risks and to improve the overall efficiency of the pension system. A wider use of risk sharing schemes could make it easier for employers to offer schemes with some sort of 'guarantee' underpin and which would also help employees manage and mitigate risk. The Government should take forward a programme of work to understand, and address, the barriers and disincentives to risk-sharing approaches that remain. In particular, the following issues should be explored:

- If, as some say, risk sharing is already possible, why is it so little used?
- Is it a question of communicating the availability of risk sharing better, or is it a matter of regulatory blockages?
- If it is the latter, what is it that needs to change? What does a regulatory environment which encourages risk-sharing look like?
- What are the risks and opportunities to members and employers of a more pluralist approach?

Recommendation 4: Greater innovation is still needed to develop approaches that can allow risk and volatility to be managed to ensure good consumer outcomes. The Government must show leadership in encouraging and creating an environment in which employers can feel confident and rewarded for taking on risk. And the financial services industry and Pensions Regulator should jointly develop approaches that help to smooth investment volatility for savers.

Value for Money, Costs and Charges

The importance of the supply side

Whilst consumer engagement, addressed later in this chapter, is important, it is not a substitute for simple and appropriate products. And based on what we have heard, calls for a more informed consumer base are often a smokescreen for deeper and more fundamental supply side problems. For example, we have heard that too few consumers use the Open Market Option (OMO) to shop around for the best annuity price, and that more needs to be done to promote or develop the OMO. But this ignores the much more fundamental question in our view – why is it that there is such variation in prices for the same annuity type in the first place?

We believe the priority lies in tackling these supply-side issues.

Many people and organisations representing employees and consumers have expressed concern about whether the financial services industry is providing value for money. Some in the industry itself agree with these concerns. One told us *"powerful vested interests, both commercial and political, present severe obstacles to an equitable and efficient occupational pension system"*. On the other hand we heard from organisations such as the ABI and IMA that charges are not excessive and that value for money is not a major issue. We have been alarmed by this complacency.

In an area as important as long-term savings and pensions we are not looking for providers to cut corners or do things 'on the cheap'. And of course the industry is entitled to make a return on its capital. But we think the weight of the evidence we have at this stage points heavily towards the need for improved value for money. We question whether, in a world of largely disempowered customers, the institutional frameworks are currently strong enough to look after the interests of those customers.

We have identified four main areas of concern, where a lack of clarity and consensus still threatens the success of well-intentioned pension reforms, and where we believe further changes to the system could get many consumers a better deal. They include the 'at retirement' market, charges, issues of small pots, and issues of scale.

The 'at retirement' market

It is clear that people can make very substantial improvements in their retirement income by shopping around for an annuity. Despite this up to two-thirds of people stay with their provider and one-third of people do not shop around at all. We have heard that there are a number of industry-led initiatives aimed at making shopping around easier. However, it is

also unclear to us why the same type of annuity can have such radically different prices – with such differing and lasting outcomes for consumers; it is not just their income at retirement that will be affected, but throughout their retirement which could be 20 years or more. It is essential that these supply-side issues are tackled. Once they are, it may be possible to harness the power of inertia to point people to the right annuity. The Financial Secretary to the Treasury has asked a government-industry working group to develop proposals for strengthening the OMO process so that more people engage with the annuity buying process and 'shop around' for the best deal.

One way of addressing this problem would be to 'default' people through to 'price comparison' websites, where they would see the rates their provider offers alongside others. Information about the process of buying an annuity could be sent out several times before retirement, as suggested in the Best Practice Guide for Retirement published by the ABI. A way forward must be found that makes it likely that people always end up with a best value annuity.

Recommendation 5: Given the detrimental impact on the consumer, further work must be done to understand the causes of significant variation in outcomes when people buy the same type of annuity, and whether these differences can be justified.

Recommendation 6: More could be done to ensure that shopping around really is the default, and that all consumers are getting the best deal. Serious consideration should be given to requiring schemes and providers to direct their members and consumers to an annuity 'price comparison site'.

A linked issue is whether annuities adequately meet the shape of pensioner expenditure and need today. We know that people tend to spend more money in the early years of retirement when they are more active, spend less money when they get older, but then later often need resources to fund social care. More could be done to ensure that annuities reflect this spending pattern and that income streams can better adjust to unanticipated events (eg inheritances or unexpected expenditures) that could incentivise saving and make purchasing an annuity more attractive.

Recommendation 7: Greater innovation in the annuity market is required to ensure that income meets spending patterns in later life. Particular consideration should be given to encouraging annuities to be flexible enough to account for unexpected events such as an increase in income from inheritance, or the need to draw down income for healthcare costs during retirement.

Workplace Retirement Income Commission

Charges

We also are struck that employers are free, under auto-enrolment to select a pension scheme with charges at any level, even though it will usually be the employee who ends up paying those charges. We are sure the vast majority of employers will want to get a good deal for their workers. But some employers may have little time and expertise in this field. There is a danger that their employees may end up in a scheme where charges are higher than they need to be.

We note that Parliament has given ministers a power to cap charges but at present the Government is holding that power in reserve. We are concerned that the Government has not taken the opportunity to extend the stakeholder charge caps to schemes that qualify for auto-enrolment. And we have reservations about the Government's plan to use the capping power only if charges are seen to be too high when auto-enrolment gets underway.

Recommendation 8: The Commission does not think a 'wait and see' approach on charges is sufficient, given the impact of high charges on pension outcomes. We recommend the Government uses its regulatory powers to apply stakeholder charge caps to schemes that will be eligible for auto-enrolment.

Recommendation 9: Disclosure around costs and charges remains inconsistent across schemes and providers. What is consistent, though, is the opacity of that disclosure. All schemes should be required to disclose costs and charges in a way that is transparent for consumers and which shows the cash impact of charges on the pension pot. The industry should develop a code of good practice on this issue

People with more than one small DC pension pot

People whose pensions savings are spread across several small pension pots may suffer two disadvantages.

- First, they are unlikely to obtain the best annuity rates and people with very small pots may not be able to find an annuity at all.

- Second, they may be penalised through higher charges. We have noted the industry practice of so-called active member discounts. Looked another way, these might be deemed deferred member surcharges.

The problem with small dormant pots is not because individuals cannot transfer them, but with inertia and complexity. While it is possible for individuals to transfer dormant pension savings to their current pension the process is complex, costly and off putting. The Making

Automatic Enrolment Work review[78] saw the ability to transfer pots as critical to the success of the 2012 reforms, and called for more wholesale consideration of how transfers in general, as well as in particular regards to NEST, could be made easier. Taking inertia into account, automated transfers could be introduced for transferring small pots.

Recommendation 10: Whilst the main restrictions on auto-enrolment and NEST will not be reviewed until 2017, there is a case for lifting the restriction on transfers in to NEST before this date for those with small pension pots below de minimis amount.

Recommendation 11: Longer term, consideration may need to be given to whether small pots should be defaulted into schemes where they can be managed efficiently, including NEST, which is currently banned from taking them.

Scale of DC pension schemes

During our visits and round tables we spoke with representatives of both large and small schemes. We have no doubt that many small schemes are well run and some have negotiated very good charging levels with their providers. But on average, the charges in smaller schemes do appear to be around 50% higher than in large schemes (while the largest schemes can offer better value still). This matters in a world that is increasingly DC when it is important that more of the consumer's money is driving value in their pension.

We have been told that the UK pension system is peculiar in having a long tail of very small schemes, and that the average size of pension schemes in the UK is significantly smaller than in other comparable countries. We have heard from some organisations, such as the ABI, who oppose any drive to consolidate schemes and believe it should be left to market forces to determine the right charging levels. Others have told us that consolidation is the way forward, to improve value for money and governance to ensure good member outcomes.
The issue of scale prompts at least three questions that we believe need to be addressed:

- Should action be taken (and if so what?) to make it more likely that larger-scale schemes with greater economies of scale develop in the future?

- Should action be taken to promote the consolidation of existing smaller schemes?

- How can smaller schemes achieve lower costs and charges, similar to those of bigger schemes, through more pooling or outsourcing of functions?

[78] DWP, 'Making automatic enrolment work – a review for the Department for Work and Pensions', October 2010

Recommendation 12: Government and the Pensions Regulator should develop a package of measures that would encourage the consolidation of small schemes into larger, better value schemes to drive down costs and improve outcomes. With many employers actively considering their pension provision in light of auto-enrolment, this is a matter that must be tackled urgently.

Cultural Change

The Coalition Government's commitment to reinvigorate occupational pension provision is a commendable one. But it has yet to find its teeth. The evidence has shown that the habit of saving for retirement continues to wane ahead of auto-enrolment. There are economic and social challenges that will create more financial barriers for younger workers to look to the future and save for retirement. And employers continue to disengage from workplace pension provision anxious about the burdens of governance, regulation, and liability. How do we change a nation of spenders into a nation of savers? How can the current system be transformed into one that is fit for purpose and trustworthy? And with the introduction of auto-enrolment, how do we encourage employers to talk about pensions with their workforces and make the workplace the default place to plan for retirement?

If these issues are to be addressed, cultural change is needed on three levels: the industry needs to focus more on the consumer and communicate in a language consumers understand; individuals need to overcome habits of overspending, and start saving instead; and Government and regulators need to make it easier for employers to run pension schemes effectively.

Consumer confidence

In the current DC world, the decision-making process is too complex for individuals to make on their own. The array of decisions is not trivial and include decisions about whether to contribute, how much to contribute, how and where to invest, and how to turn a pension into income on retirement.

A common theme at every round table, in our evidence sessions and from the focus groups, has been the need for more and better financial education and guidance. We are well aware that the principle of auto-enrolment is to harness inertia and so it might be thought that education and guidance are no longer needed in the new world. Everything we have heard suggests this could not be further from the truth. There should be a shared interest in getting this right.

We have received a range of suggested actions to tackle this issue amongst savers, including:

- **Financial education in schools:** Many who responded to our call for evidence argued that financial education should begin in schools. ***Whilst there may be benefits in this approach, given the timing issue and the many pressures on schools at present our initial view is that this is to be encouraged but could not be relied on as the primary solution.***

- **Advice services:** A case has been made to us that financial services providers should be able to offer 'simplified advice' subject to less onerous regulation. The argument is that this would cut costs and improve accessibility. Others have argued that people need access to non-sales oriented advice.

We address the issue of advice services further when we talk about employer engagement below. We believe that the workplace is the best place for most people to access information and advice about private pensions. But there will always be limits to consumer engagement on issues such as pensions where planning is both complex and for the longer term and the UK is starting from a poor position. The 2012 reforms are a huge opportunity to engage large sections of the workforce in thinking about retirement, many for the first time, and the communication and information strategy that supports the reforms should be suitably ambitious.

Recommendation 13: 2012 presents a one-off opportunity to change the way the nation thinks about saving for retirement, and to shift from a society that spends today and pays tomorrow to one where it is in the nation's DNA to save, and save for the long term. Whilst there will always be limits to the role of consumer empowerment, the overarching message that saving is a good thing needs to be actively promoted by government, employers, the pensions and savings industry and consumer groups. And the communication strategy that accompanies auto-enrolment must be a powerful one.

Trustworthiness

We have heard a great deal about the need to build more trust and confidence in pensions. The fall out from the Maxwell affair and later from schemes collapsing when their employer was insolvent has been substantial and continues to resonate. This is despite the fact that through the creation of the Pensions Regulator and the Pension Protection Fund pension scheme members are now better protected than they have ever been.

As well as asking "*how consumers can have more trust in the* pensions *system?"* the more sensible question, in our view, is "*how can we make the* system *more trustworthy?".*

From what we have heard, our sense is that the balance of power lies primarily with the supply side rather than with consumers, be they individuals or employers trying to do the best for their employees.

For consumers to have more trust in the pensions system, the industry needs to show it can reform itself to be trustworthy. An industry-led drive around disclosure, transparency, clear communication, and driving down costs and charges will help to achieve this. But we have also heard that employers are most trusted when it comes to pensions, and are well positioned to act as an intermediary on behalf of the consumer.

In a world where individuals lack the time and expertise to drive a good deal with service providers it must be clear who is standing up for their interests and driving the best deal with suppliers. In trust-based schemes the trustees can play this role but the extent to which they do so seems variable. For contract-based schemes it is usually only the employer who could do this and the extent to which they do so is variable.

We are aware that the Pensions Regulator is currently examining this issue. But if the challenge is to ensure that DC is fit for purpose, this governance vacuum – this lack of grit in the system working for the consumer – cannot be ignored.

Recommendation 14: For consumers to have more trust in the pensions system, the industry needs to show it can reform itself to be trustworthy. An industry-led drive around disclosure, transparency, clear communication, and driving down costs and charges will help to achieve this. But we have also heard that employers are most trusted when it comes to pensions, and are well positioned to act as an intermediary on behalf of the consumer. To hold the industry's feet to the fire, the Government and the Pensions Regulator should make it a priority to promote strong and consistent governance and employer engagement with workplace pension schemes, whether trust or contract-based.

Employer Engagement

Regulation is an area where we have found opinions to be sharply divided. We have heard a good deal about how the regulatory system can inhibit innovation, create unnecessary cost and complexity, and drive good employers away from doing their best

Whilst many say they trust their employer most on pensions, employers can still be reluctant about engaging with their workforces on the topic – in particular if they risk being seen as giving guarantees or advice. Two specific ideas have been put to us that would encourage employers in this area.

- First, that those employers who are providing financial education and guidance should be given a clear 'safe harbour' where they can be free of concerns about regulatory or legal comeback so long as they act in good faith. Safe harbours are particularly useful where legislation or regulation can be interpreted in a variety of ways and would provide people with more certainty about what is and what is not acceptable. For employers to use a safe harbour under this circumstance, they would have to meet more stringent requirements around the provision of financial education and guidance. But once the requirements have been met, they would be sure that they have fulfilled their duties and would be protected under law. This would give employers the confidence to talk about saving for retirement in the workplace without fear.

- Second, that employers should be free to offer, as part of their benefits package, independent financial advice worth up to £500 free of tax. We believe there is merit in helping employers to promote pensions as we have heard that employers are trusted when it comes to pensions.

As discussed above in approaches to improve adequacy, we think employers can take a broader role to encourage a savings habit in the workplace, including the provision of workplace ISAs and feeder funds into pensions. We look forward to seeing developments in this area.

Recommendation 15: Employers should be encouraged to confidently engage with their workforce on pensions, including through tax incentives to encourage provision of independent advice, and 'safe-harbours' for discussions about pensions. And employers are well placed to encourage other forms of saving, for example workplace ISAs and feeder funds into pensions, if changes to the tax regime can be made that support these approaches without undermining retirement saving.

Stability

It is very clear from all that we have heard that employers and employees are deterred by the constant chopping and changing in our pensions system. For employers, the problem is one of continuing changes and policy shifts which layer upon previous changes which, whilst small at an individual level, add up to a much bigger picture of constant change and a feeling of 'death by a thousand cuts'. For individuals, there is a belief that the goal posts will have changed so much by the time they retire there is no point in saving: constant policy change becomes another reason to put off saving.

It is clearly not possible to re-write history or wipe from people's minds the mistakes of the past. However, we do think that the lack of stability in the system does need addressing. It is clear to us that the clash between the 4-5 year political cycle and the 45 years over which people need to plan for their retirement do not fit well together.

Conscious of the potential clash of time horizons, and the instability it creates, the Pensions Commission recommended that there should be a standing Independent Pensions Commission. The government of the day did not take forward that recommendation. However, we have continued to hear arguments that such a body could help to inject greater stability into the pension system. The current Government has just consulted on how best to determine future increases in state pensions ages, and the response has shown there is still broad support for having a body for independent advice and information on issues of longevity and broader retirement and pensions issues – whether through a periodic review or standing commission or committee.

We would argue that any standing review needs to be broadened to provide independent advice and rigorous analysis on demographic trends, labour market developments, and to assess the strengths and weaknesses of the system and the adequacy of pension provision in the UK. Such an independent commission could report to the Secretary of State for Work and Pensions on a regular basis, and would provide a stable source of independent scruitiny and challenge across the political cycle.

Recommendation 16: The Commission recommends that, in line with the Government's proposal to establish a standing advisory body on longevity and state pension ages, and the original recommendation of the Pensions Commission, an independent standing commission on pensions should be established that can take the politics out of pensions.

Closing Remarks

The recommendations above demand action now, to enable these gaps in public policy to be tackled, and a roadmap for action to be agreed and embarked on. If followed through, we believe these recommendations as a package will create a more stable, stronger, and more transparent pensions system in which consumers can have more confidence, and in which employers will be motivated to contribute to, and – most importantly – will provide better outcomes for our citizens.

Workplace Retirement Income Commission

Annex A – WRIC Commissioners

Rt Hon John McFall, Lord McFall of Alcluith
Chairman, Workplace Retirement Income Commission

John McFall was MP for Dumbarton and later West Dunbartonshire for 23 years. He was Chairman of the Treasury Select Committee and was made a Life Peer in 2010.

Graham Cole CBE

Graham Cole is currently the Chairman of AgustaWestland Group.

John Hannett

John Hannett is the General Secretary of the Union of Shop, Distributive and Allied Workers (USDAW).

Chris Hitchen

Chris Hitchen is the Chief Executive of the Railways Pension Trustee Co Ltd and a former chairman of the NAPF.

Paul Johnson

Paul Johnson is the Director of the Institute for Fiscal Studies.

Imelda Walsh

Imelda Walsh is the former Group HR Director for J Sainsbury PLC.

Further details about the WRIC Commissioners can be found at www.wricommission.org.uk

Annex B – Terms of Reference

To undertake a review of pensions as well as other forms of saving, principally but not exclusively delivered through the workplace, to evaluate current public policy and industry/employer practice, and to make recommendations to ensure that all UK citizens can retire in security and dignity.

In reaching its recommendations the Commission will examine:

- The barriers to workplace retirement saving for both employees and their employers and how these can be overcome. It will pay particular attention to the barriers faced by small and medium sized enterprises and the self-employed.
- The most efficient ways of providing retirement income that meet the needs and demands of today's workforce and employers, that optimise opportunity, efficiency and adequacy, in which employees have confidence and which employers are encouraged to run.
- The role of retirement savings in the wider economy.

The Commission will seek evidence from a wide range of stakeholders and individuals and aim to build a consensus around solutions for strengthening workplace retirement saving. In doing so, the Commission aims to raise knowledge and awareness of the importance of providing for old age.

The Commission will build on the recommendations of the Pensions Commission chaired by Lord Turner, including auto-enrolment and the introduction of NEST.

The Commission's role does not extend to a consideration of public sector pensions reform, which is being considered by the Independent Public Sector Pensions Commission under the Chairmanship of Lord Hutton of Furness. However, the Commission will consider how Lord Hutton's recommendations may affect private sector schemes.

The Commission will report in October 2011 at the NAPF Annual Conference and Exhibition. Its report will set out a series of recommendations around which consensus can be built and which can be used by government, regulators, other policymakers, employers and the industry and which will help meet the Government's commitment to "reinvigorate occupational pensions".

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Annex C – List of respondents to Call for Evidence

Organisations

Association of British Insurers (ABI)
Association of Consulting Actuaries (ACA)
Actuarial Profession
Association of Members of IBM UK Pensions Plans
AVIVA
Barnett Waddingham
Confederation of British Industry (CBI)
CFA Society for the UK
Chartered Institute of Personnel and Development (CIPD)
Devon Pensioners' Action Forum
Fidelity International
Federation of Small Businesses (FSB)
GMB
Hargreaves Lansdown
Hymans Robertson
Investment Management Association (IMA)
Independent Trustee Services
Investment and Life Assurance Group
JLT Benefit Solutions
Lapinskas
Money Advice Service
More to SIPPS
National Association of Pension Funds (NAPF)
National Federation of Occupational Pensioners
Pension Income Choice Association
Pensions Action Group (PAG)
Pensions Policy Institute (PPI)
Public Service Pensioners' Council
Reckitt Benckiser
The Pensions Advisory Service (TPAS)
Trade Unions Congress (TUC)
Unison
USDAW
Visteon Pensions Action Group

Individuals

We also received responses from 40 individuals.

Annex D – Regional events and evidence sessions

Regional events

7th March 2011	Glasgow
21st March 2011	Birmingham
4th April 2011	Bristol
5th April 2011	Cardiff
21st April 2011	Glasgow
5th May 2011	Manchester
16th May 2011	Norwich

Evidence sessions

WRIC held 16 evidence sessions over 5 days in June 2011. The Commission saw 27 separate witnesses.

Workplace Retirement Income Commission

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