A Pensions Plan for the new Government

Hymans Robertson welcomes the new Government's commitment to the Pensions Schemes Bill and a pensions and retirement savings review

As set out in the new Government's "Financing for Growth" we believe there is an opportunity to ensure the current pensions framework "will deliver sustainable retirement incomes that afford individuals dignity in later life". It will also "tackle the barriers to pension schemes investing more into UK productive assets".

Together, building better futures is our purpose. It's at the heart of everything we do, and we believe that pensions policy is at the forefront of ensuring people can achieve their full potential and thrive.

We welcome the message of stability from the new Government. Stability is critical to delivering initiatives already underway, such as the pensions dashboard and auto enrolment (AE) from age 18 on the first pound of earnings. It is good to see the proposed Pensions Schemes Bill focus on finishing initiatives that have been started, with the potential to go further. This will build confidence and momentum. In particular we are encouraged to see the Government's focus on returning to a pension being a pension, not just a savings product. But in parallel, pension sustainability, adequacy and a better later life future for workers require big picture policy change. To deliver this ambition, the new Government's pensions and retirement savings review will, therefore, be essential too.

In this spirit, we have set out 'A pensions plan for the new Government'. It contains 9 key near-term pensions proposals that we believe should be considered, as part of the pensions and savings retirement review, or more widely as part of a coherent policy framework. These are designed to address shortfalls in the current UK pensions regime while also solving wider challenges that we see in front of us.

Longer-term we share one 'big idea' for discussion. It would unlock pensions capital, pay for all the proposals and supercharge 'securonomics' by making a material annual investment in the UK and our Net Zero Transition. All whilst having no impact on pension incomes or employer costs.

The near-term challenge: intergenerational sustainability

At its heart, pensions should give financial independence in later life, for as long as we live.

After decades of work and saving, it's an exchange of gifts between generations. In return for an adequate pension, older generations leave behind better opportunities and jobs. It's sustainable if we continue to grow opportunities for the young and provide decent pensions for the old.

But it's simply not sustainable right now.

Whilst AE has been a huge success in getting the employed saving for later life, the level and breadth of saving is not enough. The gift is getting smaller. Current workers are likely to be receiving inadequate pensions.

Overall, in the private sector we have an emerging pensions division with the move from Defined Benefit (DB) adequacy to Defined Contribution (DC) inadequacy for younger generations. As is, this is intergenerationally unsustainable.

The answer is to rekindle the pensions social contract, and focus on sustainably, improving pensions for today's workers.

Here's how.

Calum Cooper
Head of Pensions
Policy Innovation
calum.cooper@hymans.co.uk

1. **The Pensions Review.** The Government's staged approach to the review of pensions is brilliant. The focus on investments and doing more with what we have in stage one is sound. However, some tough choices lie ahead for the essential stage two. Beyond making our money go further, we will be a long way from an intergenerationally sustainable, inclusive and equitable pensions system. Financial independence in later life, for as long as we all live, is at risk. Meaningful change, to last a generation, will benefit from the second stage to be like the Turner Review in the 2000's, led by an independent pensions commission. There will be some hard choices near-term and huge opportunities longer-term. Cross-party consensus will give confidence and cushioning to deliver. This will give us the best chance of leaving behind better jobs and a UK pensions system to be proud of.

2. **Commit to improving pensions equity.** There is a 35% gender pensions gap to close[1]. We continue to advocate the introduction of AE credits during work absence due to carer responsibilities. Employers should also be mandated to disclose their gender pension savings gaps as employer policies have a key role in promoting equitable pension provision.

3. **Help open DB to thrive, for today's workers, with DB regulatory reform.** The Pensions Regulator's (TPR) statutory objectives prioritise security of the pensions of previous (older) generations. That job is now done. For example, the Pension Protection Fund (PPF), the pensions lifeboat, now has over £12bn of surplus capital[2]. As we stated in our evidence to the Work and Pension Committee last year, we believe it's time to set TPR a new enhanced objective of improving pensions for workers. A change in TPR's mandate would give employers, and the pension industry more generally, freedom to innovate a new generation of saving designs that would allow longer-term investment horizons. This would open the door to further UK productive assets and secure better pension incomes for millions of people.

4. **Empower £100s of billions of surplus DB capital to be shared productively.** There is £225bn of surplus capital in private sector DB pensions schemes, and growing[3]. Making it as easy as possible for larger schemes to 'run on' and share surplus capital with companies and pensioners is key to releasing this capital productively, and helping deliver higher pensions, for example to manage the cost of living. In our DB Options Consultation response we stated how investment incentives such as targeted tax relief may be required if the goal is for capital released to employers to be invested in UK productive finance rather than simply distributed to shareholders.

5. **Make Productive Finance work.** Stimulating UK economic opportunity supports the sustainable exchange of gifts between generations. Productive pension investment can help. In practice, the pensions industry needs a practical road map and attractive opportunities to do so at scale. Targeted government incentives and underwriting of the risk may be required. The new Government should identify where investment is most needed and make it attractive to provide the most meaningful stimulus to UK productivity. Practical and tangible targets and goals will be vital to engaging and attracting investors. The pensions and financial services industries will then mobilise attention where it will have impact aligned with their long-term goals.

---

[1] https://www.gov.uk/government/statistics/gender-pensions-gap-in-private-pensions/the-gender-pensions-gap-in-private-pensions
[2] https://committees.parliament.uk/publications/44037/documents/218270/default/
[3] https://www.gov.uk/government/consultations/options-for-defined-benefit-schemes/options-for-defined-benefit-schemes

6 Stimulate Collective Defined Contribution (CDC) and broader innovation in DC.

Risk sharing options like CDC can increase someone's expected pension by over 20% for the same cost (source: Hymans Robertson). CDC regulations should stimulate a range of design options, covering DC, CDC and pooling of longevity risk solutions. All can create a larger pool of assets which can be used to increase retirement incomes and invest productively over longer time horizons. Hymans Robertson, along other industry participants, stands ready to support the Government to design CDC regulations that encourage market-led design and let innovation thrive.

7 Build on the success of auto enrolment.

a. Increase AE default contributions to 12%. An average earner paying the AE minimum 8% has only a 1 in 3 chance of Pensions and Lifetime Savings Association (PLSA)'s moderate standard of living (source: Hymans Robertson). We'd like to see an increase in employers' contributions to take the AE minimum from 8% to 12%. The cost could be phased in from 2026, with auto escalation of 0.5% p.a. This allows people and employers a decade to adjust. The impact on Treasury can be neutral (see long-term solution).

b. Expand AE to self-employed. Only 1 in 7 self-employed save into a pension. The Government should find a way to auto enrol self-employed people into pensions e.g. via His Majesty's Revenue and Customs (HMRC). We must not leave vast swathes of the population behind, especially gig economy workers.

8 Preserve confidence in the State Pension.

To plan for what they need to save for retirement, workers need confidence that the State pension will exist at that point. We remain supportive of the Triple Lock for now to combat pensioner poverty. But we are aware that it isn't sustainable forever. A 21 year old today would expect to receive a state pension of £100k per year when they retire with the triple lock (source: Hymans Robertson). To maintain the State Pension the Government must set a clear and sustainable target level for it and look at new mechanisms to keep it there.

9 Introduce decumulation defaults.

The industry needs to 'solve the DC decumulation puzzle'. The retirement options and decision-making support people face at retirement result in poor outcomes in too many cases. Action needs to be taken to help savers navigate from work into retirement safely and successfully. Research shows people want a guaranteed income for life[4]. It's good to see the Government pressing ahead with legislation requiring all schemes to offer savers a comprehensive decumulation strategy comprising appropriate product options, a default retirement path suitable for the majority, alongside signposting / guidance services.

---

[4]https://www.scottishwidows.co.uk/about-us/media-centre/press-releases/new-retirement-matrix.html

A longer term solution: unlock hundreds of billions from pensions for UK growth

By changing when pension saving is tax incentivised, the Government can increase public money invested in the UK by over £20 billion a year. This can be done with no expected impact on how much pensions tax relief is provided over time nor changing the level of income received by pension scheme members when they retire.

Recap: how does tax incentivise pension saving today?

Currently the Government provides tax relief on pension contributions as an incentive to save in pensions. For example, take a typical worker paying basic rate tax. For every pound they save, 20p is tax relief. Put another way, when a typical worker gives up £800 of take home pay to save into a pension, the Government effectively tops it up by £200. This is an incentive to save.

This pension money, including the £200 incentive, is then, mostly, invested overseas.

When workers retire, the majority of the tax relief is expected to be clawed back by the Government as most workplace pension income is taxed in payment. In fact, the typical worker who paid £800 into their pension will return £150 of their £200 'incentive' to the Government through tax* (page 6). This leaves them with only £50 of extra money in their final pension pot.

A better way?

Instead of providing this £200 incentive and then clawing £150 back in retirement, the Government could simply give the net £50 incentive that the worker retains as an up-front top-up payment (through tax relief or another mechanism). Thereafter, pension savings could be completely tax free. This can be designed so that the expected pensions cash and income received is unchanged** (page 6).

The £150 of upfront tax adds up to more than £20bn p.a. of extra income to the Government now, rather than decades in the future. Provided this is invested in the UK and for growth there is alignment with the interests of future generations too.

This could materially accelerate much needed investment in the UK, and could keep expected pension income at retirement and take home pay unchanged without costing anything more for employers. And, because future pensions would be tax free, it would make it simpler and more certain for people to plan for later life.

Why?

Overall, this approach brings forward more than £20 billion a year that the Government can invest, for example in the National Wealth Fund (NWF) and Net Zero-aligned sectors, and UK communities and growth. If three times as much private sector capital is crowded in to the NWF per Rachel Reeves' current plans, this would lead to £80bn NWF investment a year. **After a decade we could have a NWF of more than £1 trillion***.**

We imagine this would positively impact the Government's debt-to-GDP position over the critical 5 year time horizon, reflecting that a material state asset is being built up that was otherwise invested globally.

We recognise the scale of this long-term ambition***. The communication and oversight of this would need a great deal of care. But we do not have decades to find the money to meet the UK's investment and productivity needs, including the commitment to Net Zero. The dividend to the next generation from sustainably investing in the UK, done well, would be huge. This scale of change would need time to get operationally ready, and independent oversight and governance would be essential to ensure that value accretes fairly to the next generation. But all of this gives the NWF time to get to scale too.

** For simplicity this does not include growth or relief on investment returns (which does not affect the impact or rationale). It reflects the expectation that 25% of pension can be taken tax-free for most people. The remaining 75% is taxed at marginal rates on pension in payment, assumed to be the basic rate here. The same outcomes can be achieved for higher rate taxpayers in employment and/or retirement. However, other design considerations will become important for higher rate taxpayers, like whether to continue to incentivise them by more than lower-rate taxpayers to save into pension: this is a political question. Here we assume a design that sustains current incentives and so pension outcomes for each individual.*

*** For higher rate tax payers in employment, if the goal is to expect to be tax- and pensions-outcomes neutral through time, the top up would need to be higher, reflecting the current tax system design. Clearly it could also be designed to redistribute incentives to the lower paid e.g. via flat-rate relief. However, here we have focused only on stimulating UK investment to achieve growth and Net Zero.*

**** As an extension of this idea, the Government could go further and underwrite and direct how circa £500bn of pensions savings, that is effectively deferred tax receipts, is invested. That is, c£500bn of the current £2.5trn of pensions wealth is expected to be paid to Government via tax on pensions in payment. It could be deemed reasonable that the Government has a say on how this money, that is due to them in time, is invested. However, this is an even bolder and more politically ambitious suggestion, and we suspect it is further than is needed or desirable.*

Summary

With the right policies and long-term mindset, as set out here today, **we could improve pensioner financial security, equity and adequacy whilst reducing debt as a proportion of GDP through a five year view.**

At Hymans Robertson we are working across a variety of stakeholders to find the best solutions to ensure the success of the pensions framework.

We would welcome the opportunity to speak to you about our **'Pensions plan for the new Government'** in more detail and share insights and findings from our in-house expertise and from our work across the pensions industry.

About Hymans Robertson

Hymans Robertson is an independent partnership helping to build better financial futures for millions of people across the UK. We provide services to organisations and individuals across pensions, investments and insurance.

We're proud to be B Corp certified. That means we're one of thousands of other purpose-led organisations who champion business as a force for good.

We make a significant contribution to the UK economy in our own right, employing over 1,400 people in four UK offices, with 90+ Partners and over 100 years of financial services experience.

Contact

Calum Cooper
Head of Pensions Policy Innovation
calum.cooper@hymans.co.uk

Contributors

Laura McLaren
Head of DB Actuarial Consulting

Paul Waters
Head of DC Markets

Leonard Bowman
Head of Corporate Consulting

Jon Hatchett
Senior Partner

Elaine Torry
Head of Trustee DB Investment

Kathryn Fleming
Head of DC At-Retirement Services

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global.
© Hymans Robertson LLP. Hymans Robertson uses FSC approved paper.