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Maintaining consensus: long-term goals for the UK pensions system and options for ongoing policy review

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Introduction

Pensions policy has featured high on the political agenda since Labour came to power in 1997. Since then, the UK pensions system has undergone major reforms that have culminated in important new legislation, including the most recent Pensions Act 2007. A further Pensions Bill was introduced in December 2007, and is due for its second reading in the House of Commons in January 2008.

While there has been much debate in recent years about the details of different pensions policy proposals and the unavoidable trade-offs that must be made, there has been less debate about the long-term goals for the UK pensions system and the options for ongoing review of policy in the future.

The Pensions Commission recommended that a permanent Pensions Advisory Commission be established. They thought that ***public debate on policy changes will… be better focused and more likely to arrive at consensus if there is a permanent advisory body charged with presenting society with the unavoidable choices which need to be faced***.

However, the Government has chosen not to create a permanent advisory commission. They have proposed instead to ***periodically commission reviews drawing on a range of independent expert advice in the light of emerging evidence on demographic change.***

This paper explores the long-term goals for the pensions system and the options for monitoring key trends and reviewing policy in the future.

The analysis seeks to stimulate debate and is informed by desk-based review of national and international case studies, a small-scale survey of selected stakeholders and qualitative research conducted by the PPI with a range of experts from across the pensions sector. In particular, the PPI held a roundtable event in July 2007, which was attended by 11 sector experts, and a number of smaller group and one-to-one interviews.

This project is funded by the Nuffield Foundation, and the PPI is grateful for their support. The PPI would also like to thank all of the individuals who took time to participate in this research. The views expressed are those of the authors and not necessarily those of the Foundation or individual participants.

Summary of conclusions

Pensions policy deals with long term issues and the consequences of decisions made by today's political decision makers will have ramifications for many years to come. The nature of pensions creates a need for a long-term approach and continuity in the direction of pensions policy that can endure changes in Government and changes in political direction. But there is also a need for flexibility in the precise direction of policy, because the social and economic conditions that affect pensions policy will change over time.

While there has been much debate in recent years about the details of different policy proposals, and the unavoidable trade-offs that must be made, there has been less debate about the long-term goals for the UK pensions system and the process for review of policy in the future. This report seeks to stimulate debate about these issues.

Agreement about the overall framework, or vision for the UK pensions system, could help to achieve consistency in the direction of specific policies over time. The UK does not have an agreed, definitive vision for pensions beyond reform and this paper sets out seven potential long-term goals for the UK pensions system to be (in alphabetical order):

- Adaptable: a system that adapts to changes in the social and economic context and fits with societal values, which may change over time.
- Adequate: a system that ensures an adequate income for all, in terms of preventing poverty, meeting individuals' expectations and minimising income shocks.
- Affordable: a system that is financially viable for the state in the short term and in the long term.
- Clear: a system from which people can understand what they can expect to receive when they retire, and what actions they need to take themselves.
- Fair: a system that is fair between groups, across generations and strikes an appropriate balance of responsibility between individuals, employers and the state.
- Robust: a system that can withstand, and respond appropriately to, economic shocks and political changes.
- Trusted and builds confidence: a system that builds trust and confidence among the public and other stakeholders.

These goals are not mutually reinforcing and there will be inevitable trade-offs between them. There are no guarantees that policy decisions taken now will achieve goals in the future, as much can change in the interim.

This research suggests that the policy making process is important for enhancing trust and confidence in the pensions system. This is especially relevant because the outcomes of specific decisions may not be known for several decades. For this reason, there is a need for ongoing monitoring of key trends and analysis of the implications of changes in those trends for pensions policy.

Currently the Government monitors trends and reviews pensions policy through its own in-house analysis and ad-hoc independent reviews. This is referred to in this research as the status quo option. Two concerns have been raised about this approach: Government analysis may not be perceived to be objective; and, there is uncertainty about the timing and scope of future reviews, which could create instability in the direction of pensions policy. These concerns highlight the importance of independence from the Government in the policy analysis and review process.

There are a number of key points to consider when designing the process for monitoring and reviewing pensions policy:

1. Independence from the Government is important for building trust and confidence in the pensions system. This is true for undertaking analysis and setting the timing and scope of reviews.
2. Stakeholders see elected Ministers as the right people to take decisions about pensions policy. But, they are concerned that decisions could be, or could appear to be, driven by short-term political agenda rather than by evidence.
3. Transparency is important for building trust and confidence that policy decisions are based on evidence. Ministers may be more likely to make decisions that are evidence-based, rather than driven by short-term political agendas, if the information, analysis and trade-offs that support those decisions are publicly known and debated.
4. A comprehensive remit to explore the broad range of issues that are related to pensions policy as well as to review the pensions system as a whole is important for ensuring that policy is created with a coherent and consistent long-term view.
5. Certainty about the timing and scope of reviews needs to be balanced with the need for flexibility so that policy can be reviewed in response to emerging issues.
6. The quality of analysis will depend on the calibre and skills of the people who undertake monitoring and reviews.
7. Duplication, bureaucracy and costs should be balanced with the benefits of independence.

Two alternative options have been proposed for monitoring and ongoing review of pensions policy: the introduction of a permanent Independent Pensions Commission or periodic reviews commissioned by the Government.

There are advantages and disadvantages to both options.

- A permanent Independent Pensions Commission could offer greater independence and certainty than the status quo and than periodic reviews if commissioners have freedom to set the timing and scope of monitoring and analysis. However, a permanent Commission may be costly to administer and it could result in duplication of monitoring and analysis undertaken in-house by the Government.

- Periodic reviews could also offer greater independence and certainty than the status quo if the Government sets out in advance a framework for the timing and scope of future reviews. However, there are risks that this option will not offer sufficient flexibility to respond to emerging issues and that there may be a lack of continuity or overall strategic coherence if different people are commissioned to lead each review and if the scope of the reviews is patchy and results in gaps or overlaps.

In general, both options offer greater independence and certainty than the current approach of the Government conducting in-house analysis and commissioning ad-hoc independent reviews. However, they both involve trade-offs: between independence and cost, and between certainty and flexibility in the monitoring and review process. No process or procedure for ongoing review of pensions policy can guarantee the 'right' policy outcome. Whichever option is chosen, the key points outlined in this report should be considered when designing a strong review process.

Chapter 1: Balancing continuity and flexibility in pensions policy

While there has been much debate in recent years about the details of different policy proposals, and the unavoidable trade-offs that must be made, there has been less debate about the long-term goals for the UK pensions system and the process for ongoing review of policy in the future. This report seeks to stimulate debate about these issues.

Pensions policy deals with long-term issues and the consequences of decisions made by today's political decision makers will have ramifications for many years to come. Given this long-term nature, pensions policy often involves trade-offs and decisions between different generations, for example, between today's workers and today's pensioners.

The nature of pensions creates a need for a long-term approach and continuity in the direction of pensions policy that can endure changes in Government and changes in political direction. But there is also a need for flexibility in the precise direction of policy, because the social and economic conditions that affect pensions policy will change over time.

The Pensions Commission recommended changes to the current process for reviewing pensions policy

In the past, a lack of consensus and transparency have in themselves contributed to the major problems which the UK pension system faces. In particular:

- ***Lack of consensus has driven a lack of policy continuity which has helped create the bewildering complexity of the UK pension system.***
- ***And lack of transparency… has undermined trust and understanding. People intuitively feel that the state will do less for them in the future, but do not understand how much less, nor trust that the promises made will be maintained.***[1]

The Pensions Commission was originally established in 2002 to ***keep under review the regime for UK private pensions and long-term savings, and to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach***[2] (Box 1). In the following three years, the Commission published three extensive reports that brought together evidence of key demographic, social and economic trends; highlighted the inevitable trade-offs that will result from those trends now and in the future; and, set out a way forward for reforming the state and private pensions system.

[1] Pensions Commission (2005) p 405
[2] Pensions Commission (2004) p ix

Box 1: The Pensions Commission

The Pensions Commission was an ad-hoc advisory group appointed by Government in December 2002. It had a remit to: ***keep under review the regime for UK private pensions and long-term savings, taking into account the proposals in the Green Paper, assessing the information needed to monitor progress and looking in particular at current and projected trends in:***

- ***the level of occupational pension provision:***
  - ***trends in employer and employee contributions;***
  - ***trends in coverage of occupational pension;***
- ***the level of personal pension savings, including:***
  - ***take-up of stakeholder and personal pensions;***
  - ***contributions to stakeholder and personal pensions; and***
- ***the levels of other saving:***
  - ***financial assets, for example Individual Savings Accounts,***
  - ***housing, businesses, savings, and other assets of partners.***

On the basis of this assessment of how effectively the current voluntarist approach is developing over time, to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach.[3]

The Commission concluded that ***the problems of the British pension system today reflect the cumulative impact of short-term decisions, of commitments made, and of policies rejected, sometimes under the pressure of electoral cycles, by governments over several decades.***[4] As well as proposing solutions to these problems, the Commission argued that their recommendations should be subject to extensive consultation and debate that should aim to achieve as much consensus as possible. In their view, consensus is important for ensuring continuity of the policy direction in future years and through changes of Government.

But the Commission also recognised that pensions policy is not static and that the long-term nature of pensions issues means that a lot can change in the intervening years before outcomes of policy decisions are known. They argued therefore, that ***whatever decisions are made in response to this Report, and however much desirable continuity in policy can be achieved, pension policy will and should be subject to continuing debate over time, in the light of new information becoming available.***[5]

The Commission sought to balance the tension between continuity and flexibility, saying that ***as information changes, so should the precise public policy direction, even if the overall framework of the system maintains as much continuity as possible.***[6]

[3] Department for Work and Pensions (DWP) (2002) p 31 para 68
[4] Pensions Commission (2004) p vi
[5] Pensions Commission (2005) p 406
[6] Pensions Commission (2005) p 406-407

They felt that consensus is more likely to be achieved and maintained over time if the debate is informed by independent evidence about changes in key trends and independent analysis of the implications of those changes. The Commission recommended that a permanent advisory Commission be established for this purpose.

The Government rejected the Commission's recommendation. In their view, the ***overall intention*** [of the Pensions Commission recommendation to create a permanent advisory body] ***was to provide an independent and trusted voice that would spell out 'the unavoidable trade-offs'.***[7] The Government proposed instead to ***periodically commission reviews drawing on a range of independent expert advice in the light of emerging evidence on demographic change.***[8]

This report asks what should be the long-term goals for the UK pensions system. Secondly, the report evaluates two options for monitoring and ongoing review of pensions policy: the introduction of a permanent Independent Pensions Commission and the introduction of periodic independent reviews, and compares them with the Government's current approach of conducting its analysis in-house and through ad-hoc independent reviews.

[7] Department for Work and Pensions (DWP) (2006 SR) p 98 para 2.51
[8] Department for Work and Pensions (DWP) (2006 SR) p 99 para 2.52

Chapter 2: The long-term goals for the UK pensions system

Policy making is the process by which governments translate their political vision into programmes and actions to deliver 'outcomes' - desired changes in the real world.[9]

This definition of policy making includes two elements: vision and process. This chapter deals with the first of these elements, the long-term vision for the pensions system. Agreement about the overall framework, or vision for the UK pensions system could help to achieve continuity in the direction of specific policies over time.

Although there has thus far been consensus on the main elements of the Government's current pensions reforms, the UK does not have an agreed, definitive vision for pensions policy beyond reform. This chapter sets out seven long-term goals for the UK pensions system.

These goals are not mutually reinforcing and there will be inevitable trade-offs between them. There are no guarantees that policy decisions taken now will achieve goals in the future, as much can change in intervening years.

A shared vision for pensions policy

The Pensions Commission suggested that if there was agreement as to the core principles that underlie pensions policy, this could help with maintaining consensus about trade-offs and policy adjustments. They set out two such principles for setting the State Pension Age:

- … o***ver the long run, intergenerational equity requires that pension ages rise roughly in proportion to life expectancy so as to keep stable the proportion of adult life spent paying into and receiving a state pension…***[10]
- ***…significant pre-warning of changes to SPA should be given, thus enabling people who are approaching retirement to be certain about the age from which they will be able to draw a state pension…***[11]

The PPI has identified seven potential long-term goals for the UK pensions system that underpin an overarching vision of a <u>sustainable</u> pensions system that ensures an <u>adequate</u> income for all. These goals build on the tests for reform published by the PPI in July 2003,[12] and also reflect analysis of policy statements published by the UK Government, the World Bank and the European Union[13] and stakeholders' views gathered through qualitative

[9] Prime Minister and the Minister for the Cabinet Office (1999) p 15 para 1
[10] Pensions Commission (2005) p 406
[11] Pensions Commission (2005) p 406
[12] See Pension Policy Institute (PPI) (2003)
[13] See Appendix 1 for details of the World Bank and EU goal statements.

research conducted to inform this project.[14] The seven long-term goals are for the UK pensions system to be:

- Adaptable: a system that adapts to changes in the social and economic context and fits with societal values, which may change over time. For example, changes in longevity, savings patterns, working and leisure patterns and life cycles. The Pensions Commission argued that while there is a need for continuity in the overall framework of the system, there is also a need for the policy direction to change in response to new evidence and information.[15]

- Adequate: a system that ensures an adequate income for all, in terms of preventing poverty, meeting expectations and minimising income shock. The World Bank talks about adequacy in terms of both the absolute level (preventing old-age poverty) and the relative level (replacing sufficient lifetime earnings) of retirement income that the pensions system will provide.[16] Adequacy is difficult to define, and social standards of adequacy may change over time. Stakeholders suggested that different degrees of adequacy may be addressed by different parts of the pensions system. For example, state provision may be geared to preventing poverty, while private provision may have a more generous goal of income replacement.

- Affordable: a system that is financially viable for the state in the short term and in the long term. Affordability refers to the proportion of GDP spent on state pension provision and related benefits, including means-tested benefits, as well as the costs to the state of supporting private provision. Affordability for individuals and employers is also important.

- Clear: a system from which people can understand what they can expect to receive when they retire, and what actions they need to take themselves. This does not mean, necessarily, that individuals need to be able to understand the pensions system per se, but that they are able to understand what they can expect to receive from state and private pensions when they retire and what they need to do to prepare financially for retirement.

- Fair: a system that is fair between groups, across generations and that strikes an appropriate balance of responsibility between individuals, employers and the state. Policy needs to balance individuals' different expectations of fairness, and to respond to changes in society's concept of ***fairness*** and to changes to living and working patterns.

[14] The PPI held a roundtable event in July 2007 that was attended by 11 stakeholders from across the pensions sector, a focus group with DWP officials, and 1-1 interviews with selected individuals to inform this project.
[15] Pensions Commission (2005) p 406
[16] Holzmann and Hinz (2005) p 55

- Robust: a system that can withstand, and respond appropriately to, economic shocks and political changes. The World Bank defines robustness in terms of the ***capacity of the system to withstand major shocks and to remain viable in the face of unforeseen conditions and circumstances.***[17]

- Trusted and builds confidence: a system that builds trust and confidence among the public and other stakeholders. The Pensions Commission stated that ***British pension policy for decades has been bedevilled by a lack of continuity. One consequence of this is a profound lack of trust in government pension promises, which have been changed so many times that few people understand what is now planned, and few trust that what is planned will be delivered.***[18] Themes that emerged in the research suggest that the policy making process is important for enhancing trust and confidence in the pensions system. This is especially relevant because the outcomes of specific decisions may not be known for several decades.

The long-term goals for pensions policy are not all mutually reinforcing. It is inevitable that there will be some trade-offs between different goals; between pensions goals and goals in other policy areas; and also between achieving goals in the short term and in the long term. For example, there will inevitably be a trade-off in the state pensions system between affordability and adequacy.

Gaining political consensus as to the long-term goals for the UK pensions system will be a challenging task. And, even if political consensus is gained, there are no guarantees that it will be maintained over time. In New Zealand and Ireland stakeholder and public engagement with pensions issues have been used to maximise the chances of consensus being maintained through changes in political leadership (Box 2, over page).

Even if consensus regarding the vision and goals for the UK pensions system is gained and maintained, there are no guarantees that policy decisions taken today will actually achieve those goals in the long term. The social and economic conditions that affect pensions policy will change over time, and there will be a need for flexibility in the precise direction of policy. How trade-offs are analysed, decided and communicated is important for ensuring that any changes to policy direction are driven by evidence rather than by short-term political agendas. This will help to build public trust in the pensions system.

The following chapters set out the options for monitoring trends and for the ongoing review of pensions policy. They explore the features that are important for enabling a strong review process, and the advantages and disadvantages for two alternative options that have been proposed: the introduction of a permanent Independent Pensions Commission or periodic independent reviews.

[17] Holzmann and Hinz (2005) p 57
[18] Pensions Commission (2006) p 42

Box 2: Gaining and maintaining consensus

Ireland

The OECD has commented that ***Ireland has developed a very effective and open procedure of involving social partners in developing a basic framework for national economic and social decisions. The Irish government brings together representatives of diverse groups in Irish society for an informed and structured debate, with the express purpose of working together to produce a national framework statement... This approach has also been applied to a national ageing strategy through the National Pensions Policy Initiative. As part of this initiative, representatives of employers' organisations and trade unions have worked together as members of the Pensions Board***.[19]

New Zealand

In New Zealand, efforts have been made to formalise agreement between political parties to the fundamental long-term structure of the state pension. These efforts have taken the form of a political Accord (signed in 1993 by the three major political parties, and subsequently by one other), and acknowledgement in legislation that the parties have signed up to the basic structure of the state pension and are required to consult those parties ahead of policy changes. Although the Accord later broke down, there is still a transparent formal sign up to the eligibility age and level of NZ Super (the New Zealand equivalent of the UK's Basic State Pension).

Furthermore, in New Zealand, there is a high level of voter engagement with pension policy. For example, in a 1997 referendum there was 80% voter response in a postal ballot with around 90% 'no' vote against replacing New Zealand Super with a compulsory private savings system, an unprecedented turnout and majority vote. It is likely that the New Zealand Government would seek to gain support from the public to change any significant aspects of the pensions system.[20]

[19] OECD (undated) p 20-21 para 74. See also the Pensions Board (2004) for more on its role and functions.

[20] See Pensions Policy Institute (PPI) (2004) and also Retirement Commission (2007) for more on roles and responsibilities in New Zealand.

Chapter 3: Designing a strong review process

Even if consensus is gained regarding the vision and goals for the UK pensions system, there will need to be flexibility in the precise direction of policy over time. This is because the social and economic conditions that affect pensions policy will change.

Currently the Government monitors trends and reviews pensions policy through its own in-house analysis and ad-hoc independent reviews. Two concerns have been raised by organisations outside of Government about this approach: government analysis may not be perceived to be objective; and, there is uncertainty about the timing and scope of future reviews. These concerns highlight the importance of independence from the Government in the policy analysis and review process.

There are a number of key points to consider when designing the process for monitoring and reviewing pensions policy:

1. Independence from the Government is important for building trust and confidence in the pensions system. This is true for undertaking analysis and setting the timing and scope of reviews.
2. Stakeholders see elected Ministers as the right people to take decisions about pensions policy. But, they are concerned that decisions could be, or could appear to be, driven by short-term political agenda rather than by evidence.
3. Transparency is important for building trust and confidence that policy decisions are based on evidence. Ministers may be more likely to make decisions that are evidence-based, rather than driven by short-term political agendas, if the information, analysis and trade-offs that support those decisions are publicly known and debated.
4. A comprehensive remit to explore the broad range of issues that are related to pensions policy as well as to review the pensions system as a whole is important for ensuring that policy is created with a coherent and consistent long-term view.
5. Certainty about the timing and scope of reviews needs to be balanced with the need for flexibility to do that policy can be reviewed in response to emerging issues.
6. The quality of analysis will depend on the calibre and skills of the people who undertake monitoring and reviews.
7. Duplication, bureaucracy and costs should be balanced with the benefits of independence.

What are the features of a strong review process?
Currently the Government undertakes ongoing monitoring of key trends and reviews pensions policy as and when it sees fit, mostly through the Department for Work and Pensions and the Office for National Statistics. Information is collected and analysed in-house, by civil servants, and independently when ad-hoc reviews are commissioned. Policy decisions are taken by elected politicians on the basis of advice from civil servants and evidence presented to Ministers by external stakeholders.

Stakeholders who took part in the qualitative research[21] that informed this project identified two key concerns with the status quo: Government analysis may not be perceived to be objective; and, there is uncertainty about the timing and scope of future reviews, which could create instability in the direction of pensions policy.

There is concern that Government in-house analysis may not always present an unbiased view, or may be perceived not to. For example, changes in the official definition of unemployment during the 1980s and 1990s led to a lack of trust in unemployment statistics.[22] A similar issue could arise in pensions policy if the definition of 'adequate saving' was frequently changed, for example. This risk may be mitigated by the increasing independence of the Office for National Statistics.

Within the current system, the Government chooses whether to commission independent reviews on an ad-hoc basis. This means that there is a lack of certainty about the scope and nature of future reviews, which could result in uncertainty for the pensions sector. Stakeholders voiced concern that because reviews are not set out in advance, the timing and scope could be driven by political agendas rather than by the latest evidence. While the current approach does allow Government flexibility, several stakeholders commented that in practice ad-hoc reviews are often commissioned later than is ideal because they are responding to, rather than pre-empting, critical issues.

These concerns highlight the importance of independence from the Government in the monitoring and review process. There are also several other key points to consider when deciding how pensions policy will be reviewed in the future. The following key points emerged from analysis of a stakeholder discussion at a PPI roundtable event, analysis of political debate surrounding the Pensions Bill 2007 and case study analysis.

[21] The PPI held a roundtable event in July 2007 that was attended by 11 stakeholders from across the pensions sector, a focus group with DWP officials, and 1-to-1 interviews with selected individuals to inform this project.
[22] See Yorgos Vournas (1999) for a discussion of the changes and the impact of these.

1. Independence from Government is important for building trust and confidence in the pensions system.

Stakeholders' concerns about the current approach for monitoring and reviewing pensions policy highlight the need for independence from Government, both in undertaking analysis and setting the timing and scope of reviews.

2. Stakeholders see elected Ministers as the right people to take decisions about pensions policy. But, they are concerned that decisions could be driven, or could appear to be driven, by short-term political agendas rather than by evidence.

Stakeholders generally agreed that due to the fiscal and political implications of pensions policy it was very unlikely, and undesirable, for Government to grant an independent body executive decision-making powers regarding the ***entire*** pensions system.

Stakeholders also discussed the relative risks and merits of Government devolving responsibility for ***some elements*** of pensions policy to an independent body, in the way that the Monetary Policy Committee sets interest rates, for example (Box 3).

Box 3: Monetary Policy Committee (MPC)

The Bank of England's monetary policy objective is to deliver price stability – low inflation – and, subject to that, to support the Government's economic objectives including those for growth and employment. Price stability is defined by the Government's inflation target of 2%.[23]

The Bank seeks to meet the inflation target by setting an interest rate. The level of interest rates is decided by a special committee – the Monetary Policy Committee (MPC). The MPC consists of nine members – five from the Bank of England and four external members appointed by the Chancellor. It is chaired by the Governor of the Bank of England. The MPC meets monthly for a two-day meeting, usually on the Wednesday and Thursday after the first Monday of each month. Decisions are made by a vote of the Committee on a one-person one-vote basis.[24]

The objective of delegating responsibility for interest rates setting to the MPC is to remove any suggestion that the interest rate could be influenced by short term political priorities. However, by setting an inflation target, the Government maintains control of the goal for UK monetary policy.

Some stakeholders have suggested that Government might delegate responsibility for setting the State Pensions Age (SPA) to an independent body and that the MPC might provide a useful model. For example, the British Chambers of Commerce (BCC) has stated it would ***support the establishment of an independent pensions commission that acted much in the way of the Bank of England in***

[23] Bank of England (2007) website http://www.bankofengland.co.uk/ accessed September 2007
[24] Bank of England (2007) website http://www.bankofengland.co.uk/ accessed September 2007

guiding interest rate policy for inflation targets, for State Pensions age changes, contracting out rebates levels as contracting out is wound down, and the appointment of Directors or Governors for the [Personal Accounts Scheme]. [25]

In this scenario, an independent body of experts could decide the SPA and the Government could set a target proportion of life in retirement, for example.

However, stakeholders commented that decisions to change the SPA are likely to be taken less frequently than decisions to change interest rates and therefore may not warrant a permanent commission. Furthermore, there is now very little room for periodic adjustments to the SPA given the Government's decision to set out future increases in the SPA until 2046 in the Pensions Act 2007 (an alternative approach could have been to set in statute the principle's by which the SPA would be increased).

While stakeholders acknowledged that devolving executive decision making powers for the SPA to an independent body could increase independence, they felt that, on balance, given the complexity and interrelated nature of the pensions system, it may not be feasible, or desirable, for decisions regarding one element of the system to be taken in isolation.

So, stakeholders <u>do</u> see elected Ministers as the right people to take decisions in pensions policy. However, they are concerned that decisions about important trade-offs may be driven, or could appear to be driven, by short-term political agenda rather than by evidence. And for this reason they support greater independence and transparency in the monitoring and review of pensions policy.

3. Transparency is important for building trust and confidence that policy decisions are based on evidence.

The Pensions Commission argued that if future debates are informed by independent evidence and analysis of the inherent trade-offs, this ought to increase the likelihood of consensus and continuity in the overall framework for the pensions system and in the transparency of the debate.

Ministers may be more likely to make decisions that are evidence-based, rather than driven by short-term political agendas, if the information, analysis and trade-offs that support those decisions are publicly known and debated. In particular, if Ministers choose to not take forward policy options or recommendations made by independent experts, this will be transparent.

4. A comprehensive remit to explore the broad range of issues that are related to pensions policy as well as to review the pensions system as a whole is important for ensuring that policy is created with a coherent and consistent long-term view.

[25] The British Chambers of Commerce (BCC) (2006) p 7

Pensions policy deals with long-term and complex issues that require a coherent and strategic long-term view that balances consistency and flexibility over time. A comprehensive remit is important for ensuring that any policy decisions are informed by the full picture of implications about trade-offs. This means that reviewers or commissioners need to be able to explore any and all issue related to pensions, such as demographic, social and economic trends, non-pension retirement provision, and employment rates among older workers, for example. They also need to be able to review the pensions system as a whole, including state and private elements of the system, in addition to any reviews of individual policy elements, such as review of the State Pension Age, for example. This is to avoid any gaps or overlaps in the review of pensions policy.

5. Certainty about the timing and scope of reviews needs to be balanced with the need for flexibility so that policy can be reviewed in response to emerging issues.

Setting out the timing and scope of reviews in advance could insulate reviews from political influence and could increase stability in pensions policy. This is because stakeholders will know in advance what issues will be explored and when, and there will be less risk that the scope and timing of reviews is influenced by political agenda. However, the preset framework could also reduce the flexibility of Government to respond to issues or review evidence that arise in the short term. There is therefore a trade-off between certainty and flexibility that will need to be managed in setting the scope and timing for the monitoring and reviews.

6. The quality of analysis will depend on the calibre of the people who undertake monitoring and reviews.

Stakeholders stressed that regardless of what process is chosen for monitoring and review of pensions policy, the calibre of the people who undertake the work will be critical for ensuring high quality analysis is produced.

7. Duplication, bureaucracy and costs should be balanced with the benefits of independence.

It is likely that there will be some degree of overlap between analysis and research that is undertaken by government departments and which would be within the remit of an Independent Pensions Commission or periodic independent review. Some degree of overlap may be tolerated; however stakeholders are not eager to see a new body created, or review commissioned, if it will largely duplicate operations undertaken elsewhere. The benefits of greater independence will need to be weighed up in relation to the additional costs and duplication that could result from an independent pensions commission.

There are a number of options for monitoring and ongoing review of pensions policy that could be more independent and offer greater certainty than the current approach. The following chapter describes two alternative options that have been proposed: the introduction of a permanent Independent Pensions Commission or periodic independent reviews. The paper finishes by exploring the advantages and disadvantages of these two options compared to the Government's current approach.

Chapter 4: What options are being proposed?

There are a number of options for monitoring and ongoing review of pensions policy that could be more independent and offer greater certainty than the current system where the Government conducts in-house analysis and commissions independent reviews on an ad-hoc basis (referred to as the status quo option in the rest of this chapter). This chapter discusses two alternative options that have been proposed for monitoring trends and review of pensions policy: a permanent Independent Pensions Commission and periodic independent reviews commissioned by Government.

There are advantages and disadvantages to both options.

- A permanent Independent Pensions Commission could offer greater independence and certainty than the status quo and than periodic reviews if commissioners have freedom to set the timing and scope of monitoring and analysis. However, a permanent Commission may be costly to administer and it could result in duplication of monitoring and analysis undertaken in-house by Government.
- Periodic reviews could also offer greater independence and certainty than the status quo if Government sets out in advance a framework for the timing and scope of future reviews. However, there are risks that this option will not offer sufficient flexibility to respond to emerging issues and that there may be a lack of continuity or overall strategic coherence if different people are commissioned to lead each review and if the scope of the reviews is patchy and results in gaps or overlaps.

In general, both options offer greater independence and certainty than the status quo of Government in-house analysis and ad-hoc reviews. However, they both involve trade-offs: between independence and cost and between certainty and flexibility in the monitoring and review process. No process or procedure for ongoing review of pensions policy can guarantee the 'right' policy outcome. Whichever option is chosen, the key points discussed in chapter three should be considered when designing a strong review process.

A permanent Independent Pensions Commission

Who proposed it?

This option was initially proposed by the Pensions Commission.[26] They recommend that ***a permanent Pensions Advisory Commission should be created, charged with continually assessing developments and laying before Parliament every three to four years a report describing key trends in demography, pension provision, employment and retirement patterns, and spelling out the unavoidable trade-offs which result.***[27]

[26] Pensions Commission (2005)
[27] Pensions Commission (2005) p 407

In their view, a permanent advisory Commission would help to better focus the ongoing pension debate and would increase the likelihood of arriving at consensus.[28] As proposed by the Pensions Commission, a permanent advisory Commission would have two key roles:

- information and monitoring: in particular, producing latest best estimates of future life expectancy, private pension provision, and average retirement ages and employment rates among older people, and analysis of trends overall and within specific groups
- analysis of the implications for policy and trade-offs inherent in changing trends: for example, ***The Commission should… be the source of authoritative and independent estimates of what public expenditure consequences would result from a variety of different future SPA scenarios, and should illustrate what future rises in SPA might be implied by the principle of pension ages rising in proportion with life expectancy increases, given latest life expectancy forecasts.***[29]

The Government rejected the Pensions Commission's recommendation, saying ***we do not agree that a standing commission to monitor developments in demographic and other relevant trends and reporting to Parliament every three to four years is the right way to proceed. A standing commission might create policy instability by creating a vehicle for permanent re-examination of the pension reform framework and policy.***[30]

A number of other organisations have shown support for the idea of a permanent Independent Pensions Commission, although they have differing views about the shape and remit of such a body.

The NAPF has proposed one option - a Pensions Monitoring Board. They say that this body would not be a policy making body but would be charged with monitoring the ***adequacy and sustainability of the UK pension system, and provid[ing] a triennial report to Government on developments, and any implications for pensions policy… its remit would be to help government ensure that the pensions system remains on the course set by the reforms.***[31] The NAPF identify the Low Pay Commission (LPC) as a model for the Pensions Monitoring Board (Box 4).

[28] Pensions Commission (2005) p 407
[29] Pensions Commission (2005) p 407
[30] Department for Work and Pensions (DWP) (2006 SR SOR) ***Security in retirement: towards a new pensions system – summary of responses to consultation*** p 55, para 33
[31] NAPF (2007) p 4-5 paras 4.1 – 4.2

Box 4: Low Pay Commission (LPC)

The Low Pay Commission (LPC) is an independent statutory non departmental public body set up under the National Minimum Wage Act 1998 to advise the Government about the National Minimum Wage. Our permanent status was confirmed by Government in 2001 and we were given a Terms of Reference for a programme of longer-term research.[32]

Government sets the Terms of Reference for the LPC on an annual basis. In 2007 t***he Low Pay Commission is asked to:***

- ***Monitor, evaluate and review the National Minimum Wage and its impact, with particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers; the effect on pay structures; and taking into account any forthcoming changes to the statutory annual leave entitlement.***
- ***Review the levels of each of the different minimum wage rates and make recommendations for October 2008.***
- ***Contribute to Government consultations and reviews on major policy issues impacting the national minimum wage.***
- ***Report to the Prime Minister and Secretary of State for Trade and Industry by the end of February 2008.***[33]

The PPI conducted a survey of selected stakeholders in the pensions sector in July 2007. We asked respondents if they supported the creation of an Independent Pensions Commission, and, if so, what remit it should have. Of the 28 organisations that responded, 19 supported this option. These respondents generally suggested a remit that included monitoring and analysis of key trends in demography, work and retirement patterns and financial literacy, and review of all elements of the pensions system (including state, occupational and personal pensions and State Pensions Age, for example). Stakeholders who took part in the qualitative research for this project also supported a broad remit for an Independent Pensions Commission if the Government were to establish one.

[32] Low Pay Commission (LPC) (2007) website http://www.lowpay.gov.uk/lowpay/whatwedo_pfv.html accessed September 2007

[33] Low Pay Commission (LPC) (2007) website http://www.lowpay.gov.uk/lowpay/whatwedo_pfv.html accessed September 2007

What could a permanent Independent Pensions Commission look like?

The following description draws from survey responses, stakeholder discussion at a PPI roundtable event and case study analysis.

Table 1: Independent Pensions Commission (IPC)

Description:	Government establishes a permanent independent body to undertake research and reviews of pensions policy. The IPC could be made up of a small number of Commissioners, supported by a small secretariat of research and policy experts.
Role:	To: • monitor key social, demographic and economic trends, • analyse the implications of those trends for pensions policy, • stimulate and facilitate public debate about the trade-offs inherent in pensions policy, and • keep under review current pensions policy.
Remit and responsibilities:	The IPC could have a remit to undertake research and analysis related to all elements of pension and retirement policy and retirement provision. It could be required to periodically lay before Parliament, perhaps every 5-7 years, a report monitoring key social, economic and demographic trends and analysing their implications for the UK pensions systems (state and private). The IPC could have the flexibility to monitor and report on any other elements of pensions provision and pensions policy on its own initiative, or at the request of the Secretary of State on an ad-hoc basis.
Powers:	The IPC could have advisory powers only. All decisions could remain with the Secretary of State / Parliament.
Accountability:	Commissioners could be accountable to the Secretary of State / Parliament.
Appointments:	Commissioners could be appointed by the Secretary of State / Parliament for a term longer than the electoral cycle, perhaps 7 years, with the opportunity to renew once.

Periodic review

Who proposed it?

Periodic reviews have been proposed by the Government**.** The Government proposes ***to maintain [consensus] by carrying out periodic reviews of the available evidence to confirm the effectiveness of these simple and sustainable reforms. These reviews will provide an opportunity for the Government to seek independent advice on the impact of the pension reforms, maintaining the consensus around the main elements of reform…***

The Government recognises the importance of carrying out reviews to ensure that our proposals continue to meet the challenge of increasing longevity. The remit and timing of future reviews depend both on the timetable for changes to the State Pension Age and on when the relevant demographic analysis is available – much of which is drawn from census data.

It is also important for successive Governments to retain the flexibility to include within the remit of future reviews other areas where independent advice would be beneficial.[34]

There is currently a lack of certainty about the nature and frequency of the periodic reviews proposed by the Government. The Government is already committed to undertake a post legislative review of the Pensions Act 2007 by the end of 2014, and some other reviews of discrete parts of the pensions system, such as the contracting-out review undertaken by the Government Actuary.

Stakeholders felt that if periodic reviews were to be used, the timing and scope of future reviews should be set out in advance. This should include a ***comprehensive*** review of the pensions system as a whole, and any smaller reviews of discrete parts of the system.

Experience has shown that it can be difficult to determine how frequently reviews should be undertaken. This could mean that if the timing and scope are set out in advance, the Government of the day may be required to commission reviews at inopportune times or on issues that are no-longer as relevant, or could use the framework as an excuse for not reviewing pressing issues in between times.

For example, the Government Actuary is required to review and report on the assumptions he proposes for calculating contracted-out rebates for members of contracted-out pension arrangements at intervals of not more than five years (Box 5). The Secretary of State for Work and Pensions publishes his own report to Parliament, alongside that of the Government Actuary. In his report on rebate and rate levels laid before Parliament in 2006, the Secretary of State stated that …***the Government will be bringing forward its proposals [regarding the future of contracting out] in a White Paper in the Spring. Subject to that response, a***

[34] Department for Work and Pensions (DWP) (2006 SR SOR) p 55-56, para 34-37

further review of the reduced rates and rebates of National Insurance contributions may be conducted earlier than would otherwise be necessary.[35]

Box 5: Government Actuary's Department (GAD) – periodic review of rate and rebates of National Insurance (NI) for individuals contracting out of state second tier pensions (contracting out rebate review)

Although constituted as a government department, GAD operates as a consultancy firm within the public sector, offering independent actuarial advice to clients and charging fees for its services. GAD is required to charge to recover its costs but does not seek to make a profit.[36]

Under the Pension Schemes Act 1993, the Government Actuary is required to report on the assumptions he proposes for calculating contracted-out rebates for members of contracted-out pension arrangements [at intervals of not more than five years]. ***The Secretary of State for Work and Pensions publishes his own report to Parliament, alongside that of the Government Actuary. The Secretary of State's report sets out his decision on the appropriate level of rebates after consideration of the report of the Government Actuary, together with Orders setting the rebates.***[37]

It has become established practice for the Government Actuary to consult with the pensions industry before reporting on the assumptions for calculating contracted-out rebates.[38]

This problem is not unique to the UK. In New Zealand, legislation required the New Zealand Government to commission a Periodic Report Group (PRG) to review pensions policy every six years. The report from the most recent PRG, in 2003, stated that ***we think policy reviews occurring only once every six years are too far apart to adequately inform retirement income policy.*** They recommended instead that an ongoing work programme replace the six-yearly reviews.[39]

Stakeholders have different views about how frequently a periodic review of the entire pensions system ought to be conducted. Suggestions at the roundtable event and interviews undertaken for this research ranged from 3 yearly or 5 yearly to 'not less frequently than every ten years'. Another suggestion was for the timing of reviews to be tied to a policy change of some kind, such as increases in State Pension Age.

[35] Government Actuary and Secretary of State for Work and Pensions (2006) p 24
[36] Government Actuary Department (GAD) (2007) website http://www.gad.gov.uk/Corporate_Information/Our_aims_and_objectives.htm accessed September 2007
[37] Government Actuary Department (GAD) (2005) p 1
[38] Government Actuary Department (GAD) (2005) p 1
[39] Periodic Report Group (PRG) (2003) p 12

What could periodic reviews look like?

The following description draws from Parliamentary debates, Government statements, stakeholder discussion at a PPI roundtable event and case study analysis.

Table 2: Periodic reviews

Description:	Government could set out in advance the timing and scope of reviews of the pensions system. A small number of commissioners could undertake each review, supported by a small secretariat of civil servants.
Role:	To: • monitor key social, demographic and economic trends, • analyse the implications of those trends for pensions policy, • stimulate and facilitate public debate about the trade-offs inherent in pensions policy, and • keep under review current pensions policy.
Remit and responsibilities:	The timing and scope of the reviews could be called the review framework. The review framework could be developed in consultation with political parties and sector stakeholders. The framework could include a: • Requirement to commission a comprehensive review of the whole pensions system, perhaps every 5-7 years, preferably not coinciding with the political cycle. • Review of discrete parts of the pensions system, for example review of the policy to restrict transfers into and out of Personal Accounts.
Powers:	Reviewers could have advisory powers only. All decisions could remain with the Secretary of State / Parliament.
Accountability:	Reviewers could be accountable to the Secretary of State.
Appointments:	Reviewers could be appointed by the Secretary of State for the duration of the review. Alternatively, the Government could commission an independent organisation / agency to undertake reviews periodically (eg GAD reviews above).

Each approach has advantages and disadvantages

- Independence

Both options offer greater independence than the status quo, because monitoring and analysis would be undertaken by independent experts. However, a permanent Independent Pensions Commission would be the most independent because it would be able to set the timing and scope of its research and reviews independently of the Government.

- Powers

In both options, the reviewers would have advisory powers only, and could not take policy decisions. This means that decisions and accountability for pensions policy would remain with elected Ministers. However, there is a question as to whether independent experts ought to ***make recommendations*** or ***present policy options***. It may be easier for Ministers to take unpopular decisions that are for the benefit of long-term goals if those decisions are ***recommended*** by independent experts.

- Balancing certainty with flexibility

Both options assume that a framework for monitoring and reviews is set out in advance, and that it includes commitment to a comprehensive review of the pensions system to be undertaken every 5-7 years. This means both options would offer greater certainty than the status quo. However, a permanent Independent Pensions Commission would also be able to respond to emerging issues, allowing it to better balance certainty with flexibility. If periodic reviews are used, this would not prevent Government from commissioning additional reviews to respond to emerging issues in between times, but there would be no guarantee that the Government of the day would do this.

- Permanent or time-limited

As a permanent body, an Independent Pensions Commission has the advantage of being able to plan ahead and take a coherent and strategic long-term view beyond the parliamentary cycle. It may also be able to build up a stock of knowledge and expertise among staff, and to respond quickly to issues that emerge in the shorter term. However, a permanent body could become institutionalised and may be tempted to continually make adjustments to policy.

Periodic reviews or ad-hoc reviews may attract individuals with issue-specific skills and expertise, because they are time-limited. If different people are commissioned to undertake each periodic review, this could result in ‘fresh thinking’ in pensions policy, but may come at the cost of losing some overall continuity in the direction of monitoring and policy analysis.

Regardless of what process is chosen for monitoring and review of pensions policy, the calibre and skills of the people who undertake the work will be critical for ensuring high quality analysis is produced.

- Cost

It is likely that there will be some degree of overlap between analysis and research that is undertaken by an independent body and analysis and research undertaken in-house by government departments. Some degree of overlap may be tolerated; however, stakeholders are not eager to see a new body created that will largely duplicate operations undertaken elsewhere. The benefits of independence will need to be weighed up in relation to the additional costs that are associated with establishing a permanent body if an Independent Pensions Commission is adopted. While periodic reviews could be less costly, there are hidden costs involved in setting-up and winding-down time-limited bodies that should not be forgotten.

A permanent Independent Pensions Commission or periodic independent reviews?

There are advantages and disadvantages to both options.

- A permanent Independent Pensions Commission could offer greater independence and certainty than the status quo and than periodic reviews if commissioners have freedom to set the timing and scope of monitoring and analysis. However, a permanent Commission may be costly to administer and it could result in duplication of monitoring and analysis undertaken in-house by Government.
- Periodic reviews could also offer greater independence and certainty than the status quo if Government sets out in advance a framework for the timing and scope of future reviews. However, there are risks that this option will not offer sufficient flexibility to respond to emerging issues and that there may be a lack of continuity or overall strategic coherence if different people are commissioned to lead each review and if the scope of the reviews is patchy and results in gaps or overlaps.

In general, both options offer greater independence and certainty than the status quo of Government in-house analysis and ad-hoc reviews. However, they both involve trade-offs: between independence and cost and between certainty and flexibility in the monitoring and review process. No process or procedure for ongoing review of pensions policy can guarantee the 'right' policy outcome. Whichever option is chosen, the key points outlined above should be considered when designing a strong review process.

Appendix: Long-term goals for pensions systems

The World Bank: ***Old Age Income Support in the 21st Century***, 2005[40]

First Order

- Adequate: both the absolute level (preventing old-age poverty) as well as the relative level (replacing sufficient lifetime earnings) of retirement income that the pensions system will provide.
- Affordable: the financing capacity of individuals and society
- Sustainable: the financial soundness of the scheme, now and in the future
- Robust: the capacity of the system to withstand major shocks and to remain viable in the face of unforeseen conditions and circumstances

Second Order

- Contribution to economic development: create developmental effects, either by minimizing negative impacts or by leveraging positive impacts, especially by increasing saving and promoting financial market development

European Union: ***Working together, working better:*** 2005[41]

The overarching objectives of the Open Method of Communication for social protection and social inclusion are to:

a) Promote social cohesion and equal opportunities for all through adequate, accessible, financially sustainable, adaptable and efficient social protection systems and social inclusion policies.

b) Interact closely with the Lisbon objectives on achieving greater economic growth and more and better jobs and with the EU's Sustainable Development Strategy.

c) Strengthen governance, transparency and the involvement of stakeholders in the design, implementation and monitoring of policy.

And specifically related to providing adequate and sustainable pensions:

- ***In the spirit of solidarity and fairness between and within generations, guarantee adequate retirement incomes for all and access to pensions which allow people to maintain, to a reasonable degree, their living standard after retirement.***
- ***In the context of sound public finances, ensure the financial sustainability of public and private pension schemes, notably by: supporting longer working lives and active ageing; ensuring an appropriate and fair balance of contributions and benefits; and promoting the affordability and ensuring the security of funded and private schemes.***
- ***Ensure that pension systems are transparent, well adapted to the needs and aspirations of women and men and the requirements of modern societies, demographic ageing and structural change; that people receive the information they need to plan their retirement and that reforms are conducted on the basis of the broadest possible consensus.***

[40] See Holzmann and Hinz (2005)
[41] See European Union (2005) and (2007) and European Commission (2003)

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