PENSIONS POLICY INSTITUTE

100th Briefing Note

Introduction

As the Pensions Policy Institute reaches its landmark 100th Briefing Note, it is worth reflecting on how much change there has been since it's inception in 2001, and also to look forward to the possible future of retirement policy.

Short history of the PPI

The PPI was born out of the Pension Provision Group (PPG) chaired by Tom Ross OBE. In 1997 Harriet Harman, the then Secretary of State, gave the PPG responsibility to assess the likely trends in pension provision. The group found that the issues at stake in retirement provision are often poorly understood outside the circles of experts most closely involved.

The PPG also found that the information that is needed for thorough policy analysis is often scattered, inconsistent and difficult to use and interpret.

Political decision-making is inevitably influenced by short-term considerations, but pension policy decisions can have very long-term consequences and often require a long-term view in order for results to be measured and evaluated effectively.

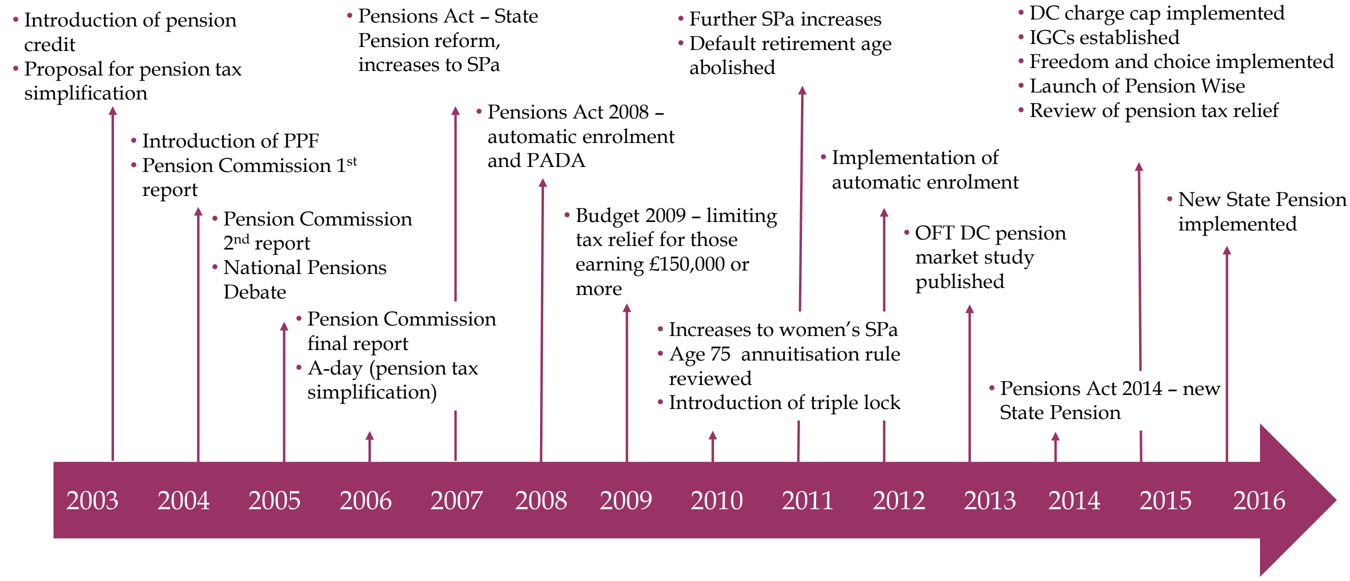
The Pensions Policy Institute was set up so that a permanent expert organisation would undertake rigorous research from an independent, long-term perspective. This would help all those involved in policy development to achieve an improved and wider understanding of retirement provision issues.

Since its inception in 2001, the Pensions Policy Institute[1] has:

- Published 98 research reports and papers and 99 Briefing Notes.
- Participated in 40 consultations, evidence sessions and responses.
- Presented at numerous conferences, meetings and roundtables, both in the UK, and in Europe.

Additionally, the PPI's Pension Primer and Pension Facts help those who are not familiar with the UK pension system understand its changes, intricacies and nuances.

Chart 1: Summary of main pensions policy interventions, consultations and changes between 2003 and 2016



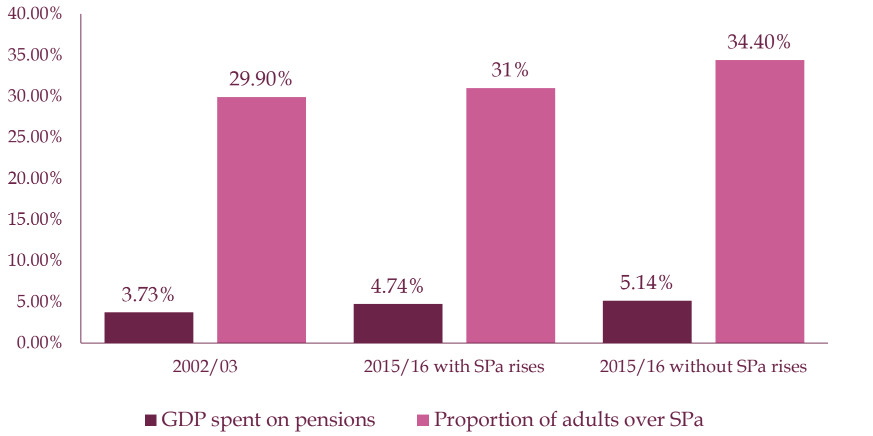
PPI Briefing Notes clarify topical issues in pensions policy.

Pensions policy reforms: 2003-2009

There have been a number of pension policy reforms since 2003 (Chart 1). These have largely been in response to rising pensioner numbers and the increasing cost of the State Pension. State Pension expenditure increased from 3.73% of GDP in 2002/03 to 4.74% in 2015/16[2] as the number of people above State Pension age (SPa) has increased from 29.9% of working age population in 2003 to 31% in 2016.[3] If SPa had remained static between 2000 and 2016, this increase would have been 3.4% larger than the 31% in 2016 with 34.4% of the working age population being above SPa (Chart 2).

Chart 2: SPa increases have reduced the amount of GDP spent on pensions had no increases occurred

Percentage of GDP spent on pensions as a function of adults over SPa



Source: Autumn Statement 2016; PPI calculations

2005 Pension Commission Recommendations include:

- The State should strongly encourage at least a minimum baseline of pension provision via automatic enrolment of individuals with a modest level of matching by employers.
- Use of National Insurance resources should be focused on ensuring that all people are kept out of poverty in retirement; making the system as non-means-tested as possible; and reducing present problems in the treatment of those with interrupted paid work records and caring responsibilities.

The reforms put in place between 2003 and 2009 were, for most of this period, delivered against a backdrop of strong economic growth and were designed to meet two core objectives:

- Encourage more savings by individuals and employers into both pensions and other vehicles and, in particular, stimulate saving among lower income groups;
- Make the State Pension system sustainable while improving the value of the basic State Pension.

Many post 2003 reforms arose from the recommendations of the Pension Commission, while others, such as the implementation of annual and lifetime allowances, and the introduction of the Pension Protection Fund (PPF) were to address perceived economic deficiencies or inequalities.

Pensions policy reforms: 2010-2016

This period of policy reforms took place at a time of uncertain economic outlook and can be summarised as falling into two distinct groupings:

- Those that continued or enhanced the policies supported or initiated by the previous government such as the rollout of automatic enrolment and the return to an earnings link for the State Pension.
- Those that reversed or conflicted with policies or principles laid down by the previous government, such as the reduction of tax allowances and the move away from viewing pensions as a vehicle for securing an income throughout retirement through the introduction of freedom and choice.
- The new State Pension was introduced for people reaching SPa on or after 6th April 2016. It

replaced the basic State Pension and additional State Pension in order to make the State Pension more streamlined, easier to understand, and to provide a higher basic level of income to pensioners above the level of means-tested benefits.

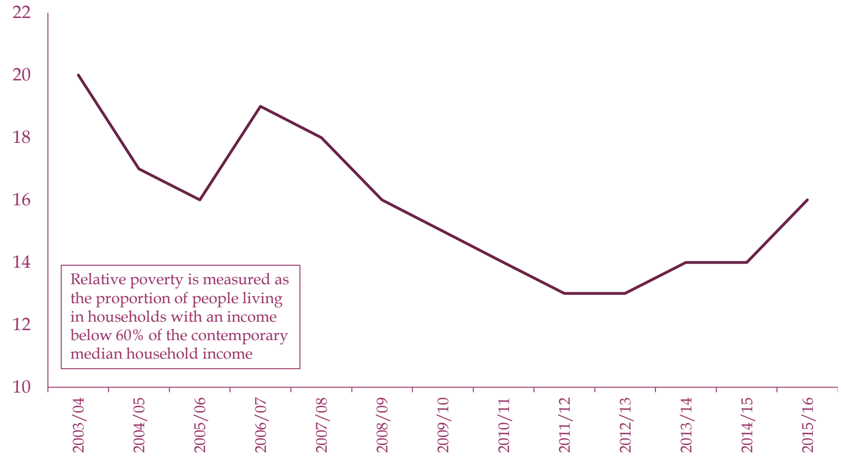
Since 2003 pensioner incomes have risen and the proportion of pensioners in relative poverty has decreased

Between 2003 and 2016, average pensioner unit incomes after housing costs rose by 33% in real terms. This is largely due to increases in incomes from private pensions and employment. Increases in income from these sources is associated with younger pensioners as they reach State Pension age. Older pensioners are less likely to work or see private pension income increase in real terms. Income growth has not been spread evenly across all pensioners.[4]

As well as an increase in pensioner incomes, there has been a decrease in pensioner poverty. In 2003, a fifth of pensioners were in relative poverty with this proportion decreasing to a low of 13% in 2011/12 and 2012/13, before increasing again to 16% by 2015/16 (Chart 3), a net decrease in poverty from 2003/04 of 4 percentage points. In 2015/16, 1.6 million pensioners were estimated to be living in relative poverty with 8% suffering material deprivation. Again, the increasing importance of earnings and private pension income suggests that older pensioners may be more likely to be at risk of being in poverty.[5]

Chart 3: The proportion of pensioners in relative poverty has reduced from 20% in 2003/4 to 16% in 2015/16

Proportion of pensioners living in relative poverty over time after housing costs



Source: Households Below Average Income (HBAI), United Kingdom, DWP, 2017

Pensioners are also much more likely (relative to the rest of the population) to receive income from disability benefits. These benefits are intended to compensate individuals for the extra costs of disability. While the income is taken into account in measuring poverty, the extra costs are not, so poverty estimates may underestimate the proportion of pensioners with incomes (after disability costs) below poverty levels.

The introduction of automatic enrolment has increased workplace pension coverage and shifted the workplace pension landscape

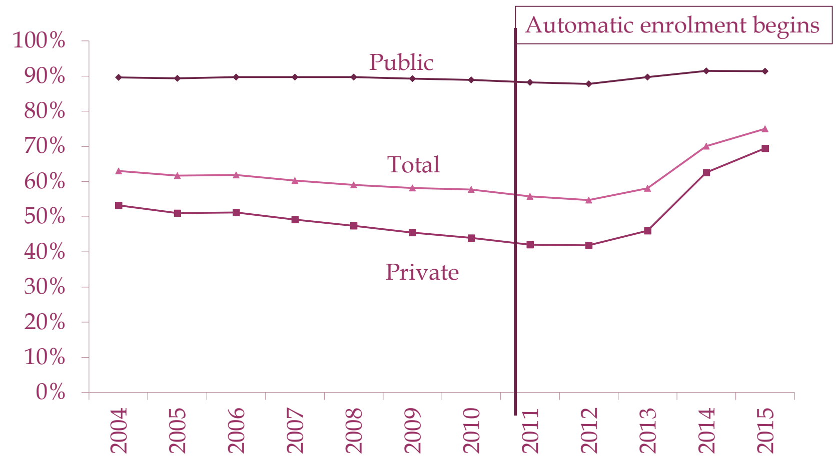
Since the introduction of automatic enrolment in 2011, participation in workplace pensions has increased significantly (Chart 4). Automatic enrolment has resulted in 59% of all employees becoming active members of pension schemes by March 2015.

Since 2003, there has been a marked change in the supply of workplace pensions. This includes a decline in the number and proportion of open Defined Benefit (DB) schemes in the private sector, from 43% of private sector schemes being open to new members and future accruals in 2006, to just 13% in 2015.[6] This occurred largely as DB schemes became more expensive for scheme sponsors and the more certain (for the employer) Defined Contribution (DC) model became more attractive. Along with automatic enrolment, this has resulted in a rapid increase of active savers in DC schemes and has overtaken the number of active DB savers. In 2016, there were around 12.3 million active members in DC schemes compared to 1.5 million active members in private sector DB schemes[7], compared to 1.18 million active members of DC schemes and 8.63 million active members in DB schemes in 2004.[8]

The decline in DB schemes has been offset by the introduction of automatic enrolment and overall there has been a small increase in total employer pension contributions. However, average employer pension contributions have, for the short-term at least, fallen as large numbers of new savers attracting minimum levels of DC contributions bring down the average.

Chart 4: Automatic enrolment boosts participation in workplace pensions

Percentage of eligible employees participating 2004-2015 (ASHE)



The cost of the State Pension is projected to continue to rise

The Government expects the cost of the State Pension to increase from 5.5% of GDP in 2014/2015 to around 7.3% of GDP in 2065/2066 (Chart 5).[9]

Current legislation states that SPa will continue to rise in line with life expectancy to help manage costs. However, the rate at which these increases occur remains uncertain as the Government is yet to respond to the recommendations of the Cridland Review of SPa.

For every year of SPa rises, yearly costs are reduced by 0.1% to 0.3% of GDP.

Automatic enrolment will continue to increase workplace pension coverage

Workplace pension coverage is expected to continue to increase until 2018 when the staging process is complete. In 2015, 47,000 large and medium sized employers had completed the process of automatically enrolling their employees with focus now having shifted to the 1.3 million small and micro firms who have now begun the process of automatic enrolment. Opt out rates have been far lower than expected at 9%, although this is expected to increase as minimum contributions are increased over the coming years.[10]

Automatic enrolment still poses many future challenges with initial staging being only the first step in a long-term process of increasing minimum contributions and focussing on specific areas such as the self-employed, all topics that will be covered in the upcoming automatic enrolment review.

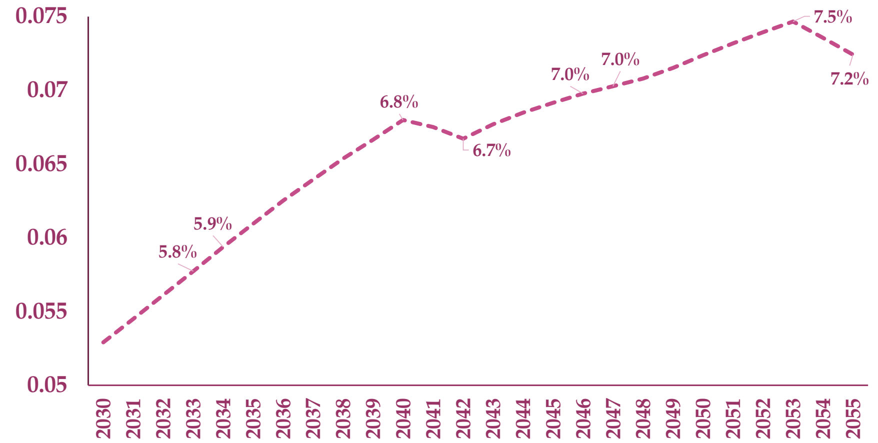
There is likely to be further change in 2017, with a number of reviews and initiatives for both state and private pensions under way

These include:

- **State Pension age review:** This has considered changes in life expectancy along with wider changes in society to work towards ensuring that the State Pension is affordable, fair, and enables individuals to have fuller working lives.[11]
- **Lifetime Individual Savings Account (LISA):** A new tax-advantaged savings account, available to individuals aged under 40, which can be used to save for a house purchase, for retirement or both was introduced in April 2017.

Chart 5: SPa rises decrease the costs of State Pension, but the overall costs are projected to continue rising

Cost of State Pension as a percentage of GDP under SPa rises based on 2014-based projections of life expectancy



Source: PPI Aggregate Model

- **Automatic enrolment review:** The scope looks at coverage, consumer engagement and contributions.[12] A report of the recommendations is due by the end of 2017.
- **Charge cap review:** This considers whether the charge cap should be lowered from 0.75% and how transaction costs should be evaluated.[13]
- **Potential changes to reporting of transaction costs:** This considers transaction cost disclosures that would place a duty on asset managers to disclose such costs in aggregate to pension schemes that invest in their funds. In addition, this proposes that asset managers provide a breakdown of transaction costs on request.[14]
- **Pensions dashboard:** This would enable individuals to see all of their pension pots in one place, with a prototype being planned for 2017.
- **Master trust regulation:** The Pensions Bill stated it would give The Pensions Regulator new powers to regulate Master Trust schemes. This Bill also commits to cap early exit fees charged by trust-based schemes.
- **DB pension green paper:** This considers various aspects of the DB pension system and whether there are any modifications required.
- **Replacing the triple lock with a double lock:** This was in the Conservative Party manifesto and would be implemented at the end of 2020. Subsequent to the 2017 General Election and the Conservative deal with the DUP, the triple lock has been guaranteed for the duration of this Parliament.
- **Social care green paper:** Announced in the 2017 Spring Budget as being imminent.

The recent election seems to have deferred the timetables of some of the above policy development and implementation, and others may or may not progress. Other perennial areas of potential reform such as pensions tax relief could also be resurrected. What is clear is that there does not appear to be an end to change in the pensions policy landscape any time soon as existing policies to continue to bed down and new reforms are developed.

Conclusion

It is clear that since the PPI was formed in 2001 that the reforms put in place have improved outcomes for the majority of pensioners, although the outcomes for future pensioners remain less certain. As ever, the trade-off between affordability and adequacy of retirement income remains, as well as questions concerning the role of defaults, nudges, incentives, engagement and product design in private pensions.

The PPI will continue to research all of these topics and more (including the role of working longer, and investment and governance issues), and continue to contribute an independent evidence base to ongoing discussions with the aim of improving policy development.

[1] All PPI publications, Briefing Notes, responses and presentations are available on our website.
[2] Autumn Statement 2016; ONS; PPI calculations
[3] PPI Pension Facts
[4] PPI BN88 – Have pensioner's incomes grown in this period of austerity
[5] Household Below Average Income (HBAI), United Kingdom, DWP (2017)
[6] The Pensions Regulator and Pension Protection fund (2015)
[7] Occupational Pension Schemes Survey (2014)
[8] Occupational Pension Schemes Survey (2004)
[9] OBR Fiscal Sustainability Report 2017 supplementary tables 1.1 and 1.5
[10] DWP (2015) Millions more to be automatically enrolled into workplace pensions
[11] https://www.ageing-better.org.uk/wp-content/uploads/2016/08/02-08-2016-Briefing-on-the-Independent-Review-of-State-Pension-Age.pdf
[12] DWP (2016)
[13] https://www.fca.org.uk/news/press-releases/fca-publishes-proposals-transactions-cost-disclosure
[14] https://www.fca.org.uk/news/press-releases/fca-publishes-proposals-transactions-cost-disclosure

For more information on this topic, please contact
Sarah Luheshi, Deputy Director
020 7848 3751 sarah@pensionspolicyinstitute.org.uk
www.pensionspolicyinstitute.org.uk