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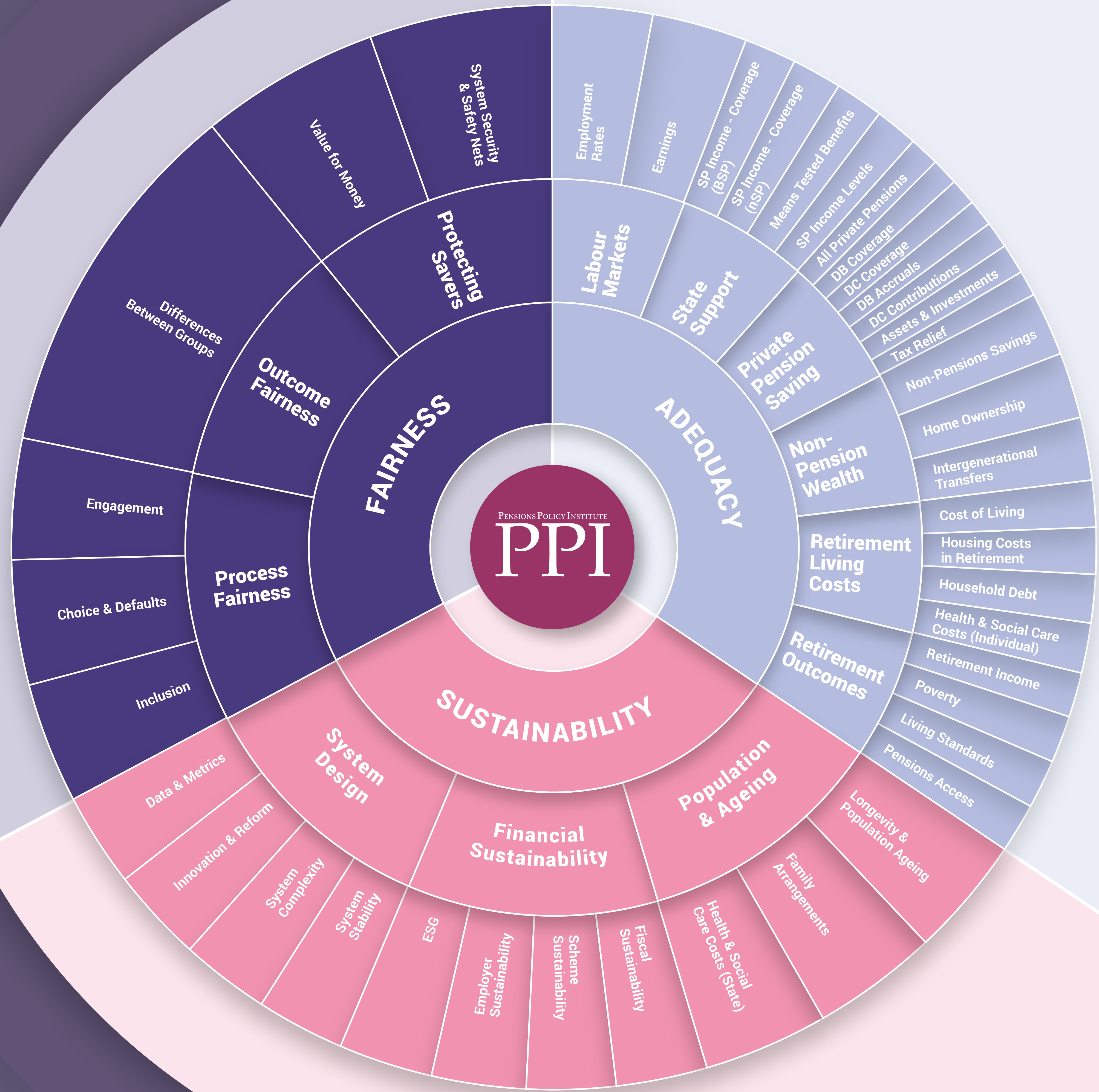

TRENDS, TRANSITIONS AND TRADE-OFFS IN THE UK PENSION SYSTEM

2022 EDITION

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About the Pensions Policy Institute

We have been at the forefront of shaping evidence-based pensions policy for over 20 years.

The PPI, established in 2001, is a not-for-profit educational research organisation. **We are devoted to improving retirement outcomes.** We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. Each research report combines experience with INDEPENDENCE to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our INDEPENDENCE sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

Our Vision

Better informed policies and decisions that improve later life outcomes.

We believe that better information and understanding will help lead to better policy framework and a better provision of retirement for all.

Our Mission

To promote, evidence-based policies and decisions for financial provision in later life through independent research and analysis.

We aim to be the authoritative voice on policy on pensions and the financial and economic provision in later life.

Est. 2001

By supporting the PPI, you are aligning yourself with our vision to **drive better informed policies and decisions that improve later life outcomes** and strengthening your commitment to better outcomes for all.

As we look forward now to the next 20 years, we will continue to be the trusted source of information, analysis, and impartial feedback to those with an interest in later life issues. The scale and scope of policy change creates even more need for objective and evidence-based analysis. There is still much to do, and we look forward to meeting the challenge head on.

FOR FURTHER INFORMATION ON SUPPORTING THE PPI

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Foreword

Doug Brown

CEO of UK Life, Aviva

At Aviva, we recognise just how much depends on the UK pensions system. It is fundamental for savers' futures and for our society, which is why we are delighted to continue to sponsor the PPI UK Pensions Framework.

Over the last year, the PPI have analysed the UK pensions system against the three key objectives of adequacy, sustainability and fairness. For the first time we now have a holistic view, and most importantly, a baseline of how it's delivering for today's savers and pensioners.

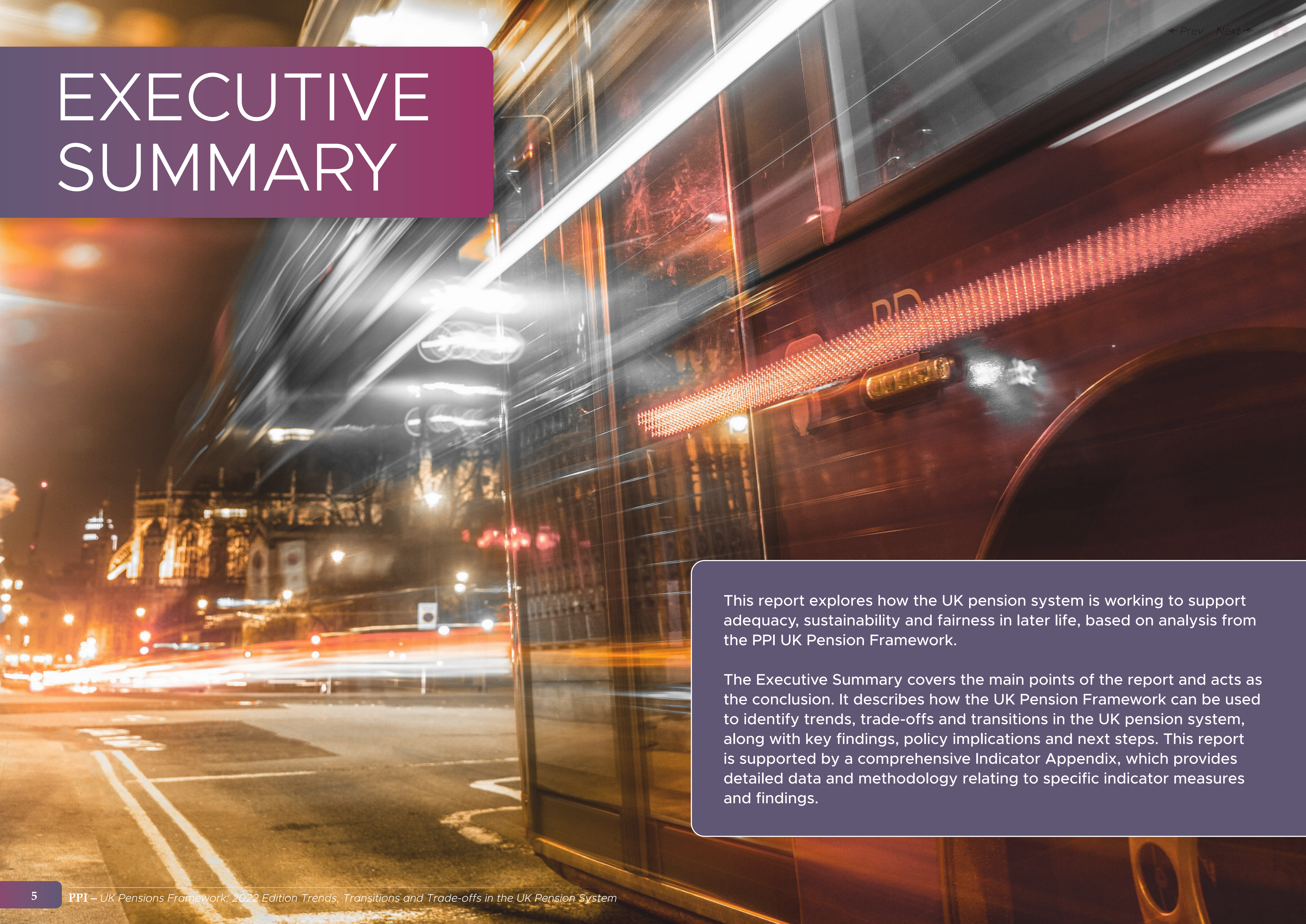
We know pensions policy is as complex as the system itself. This first Systemwide Analysis report is not only an impressive piece of work, it provides an invaluable assessment of how different parts of the system interact with each other, so we can identify and understand the trends, trade-offs and transitions to inform future policy development.

One of those trends is the major transformation underway as Defined Benefit legacy schemes are phased out and replaced with generations of new Defined Contribution savers. These savers must make active decisions about their pension savings throughout their work life and into retirement. The report highlights the shifting of responsibility from institutions and employers to the individual, and analyses the trade-offs between improving sustainability across the system and ensuring people save enough.

It is more important than ever that people are empowered to take informed decisions about their options and how to maximise their income in later life. There is an opportunity for policymakers, regulators and industry to draw on the findings in this report and work together to ensure the right help is in place for savers to navigate the system.

In developing this report, the PPI have brought together experts and policymakers from across the sector to provide their input and analysis. Having this breadth of expertise has been invaluable and has helped shape the impressive piece of work we have today. I would like to thank everyone who has given their time and support to the project so far. The PPI deserves a special thanks, for both the hard work that has gone into this first report, and the wider contribution this project will make to the UK pensions landscape for years to come.

This report is just the start. The UK Pensions Framework is a living and growing project that each year will continue to assess and benchmark the system, and provide an invaluable guide to the development of policy. We believe it can help make a real difference to the prospects of pensions savers across the UK.



EXECUTIVE SUMMARY

This report explores how the UK pension system is working to support adequacy, sustainability and fairness in later life, based on analysis from the PPI UK Pension Framework.

The Executive Summary covers the main points of the report and acts as the conclusion. It describes how the UK Pension Framework can be used to identify trends, trade-offs and transitions in the UK pension system, along with key findings, policy implications and next steps. This report is supported by a comprehensive Indicator Appendix, which provides detailed data and methodology relating to specific indicator measures and findings.

Executive Summary

Changes designed to offset the impacts of population ageing are helping to improve affordability for the State and employers in the UK pension system. However, they come at a cost to individuals, among whom retirement income inequality remains high, post-retirement choices are more complex, and among whom more people are saving, but not necessarily saving adequately for retirement.

Planning for retirement is hard at the best of times. Outcomes depend on a host of factors that build up over the course of peoples' lives, including how they work, how they save, how they access their pensions, whether they own a home, and how prepared they are for shocks to income, or unexpected expenditure needs that can arise for families at any time. But, in the midst of the most widespread changes to pensions and retirement saving for generations, the need for holistic and comprehensive understanding of how well the UK pension system is working has never been more important.

This report not only looks at how the UK pension system is supporting retirement outcomes among pensioners of today, but also at the implications of saving behaviours for pensioners of tomorrow, using the UK Pensions Framework. The UK Pensions Framework is a new, systemwide study of adequacy, sustainability and fairness which analyses forty one comprehensive, purpose-built indicators to provide a complete and compelling picture of short and long-term strengths and vulnerabilities in UK State and private pensions.[1] Results are presented on the PPI Pensions Policy Wheel, a unique visualisation tool that can help to collate outcomes from across the pension system and track how changes in one area can, through a complex web of interactions, lead to a catalogue of impacts in others over time.

The findings from this study show how the risks of population ageing to financial sustainability that once faced Government, employers and pension providers, have been largely superseded by the risk to individuals of undersaving and continuing income inequality. Using data up to and including 2021, the report also uses the PPI Pensions Policy Wheel to attribute many of these changes to trade-offs that arise from a gradual pattern of risk transfer away from institutions, such as Government and employers, that is leaving people increasingly exposed to the possibility that their savings may not adequately meet their needs in later life. As findings show, however, financial risks associated with upholding commitments to an ageing population have not disappeared, and nor have the historic inequalities that accompanied them.[2] The report includes two case studies which use Framework analysis to understand how State Pension age (SPa) increases and undersaving are impacting adequacy, sustainability and fairness outcomes in later life.

For the UK pension system to be successful, it needs to support retirement outcomes that are adequate, fair and sustainable. However, what society considers to be adequate, based upon expectations of living standards, minimum income or financial resilience, may not be financially or socially sustainable if it is not affordable. But what is considered affordable, based upon the resources available in the system and the nature of retirement, may not be considered adequate. The challenge for any pension system is to balance these objectives. The extent to which the outcomes are positive can impact differently across different groups, and how people respond can depend on two factors: whether they have confidence that the system is working, and whether they think it is fair.

[1] For full background on the design of the UK Pensions Framework, see The UK Pensions Framework Design Series 2021
[2] UK Pensions Framework Indicator Appendix (2022). Indicators S2.1, S2.2, A6.3

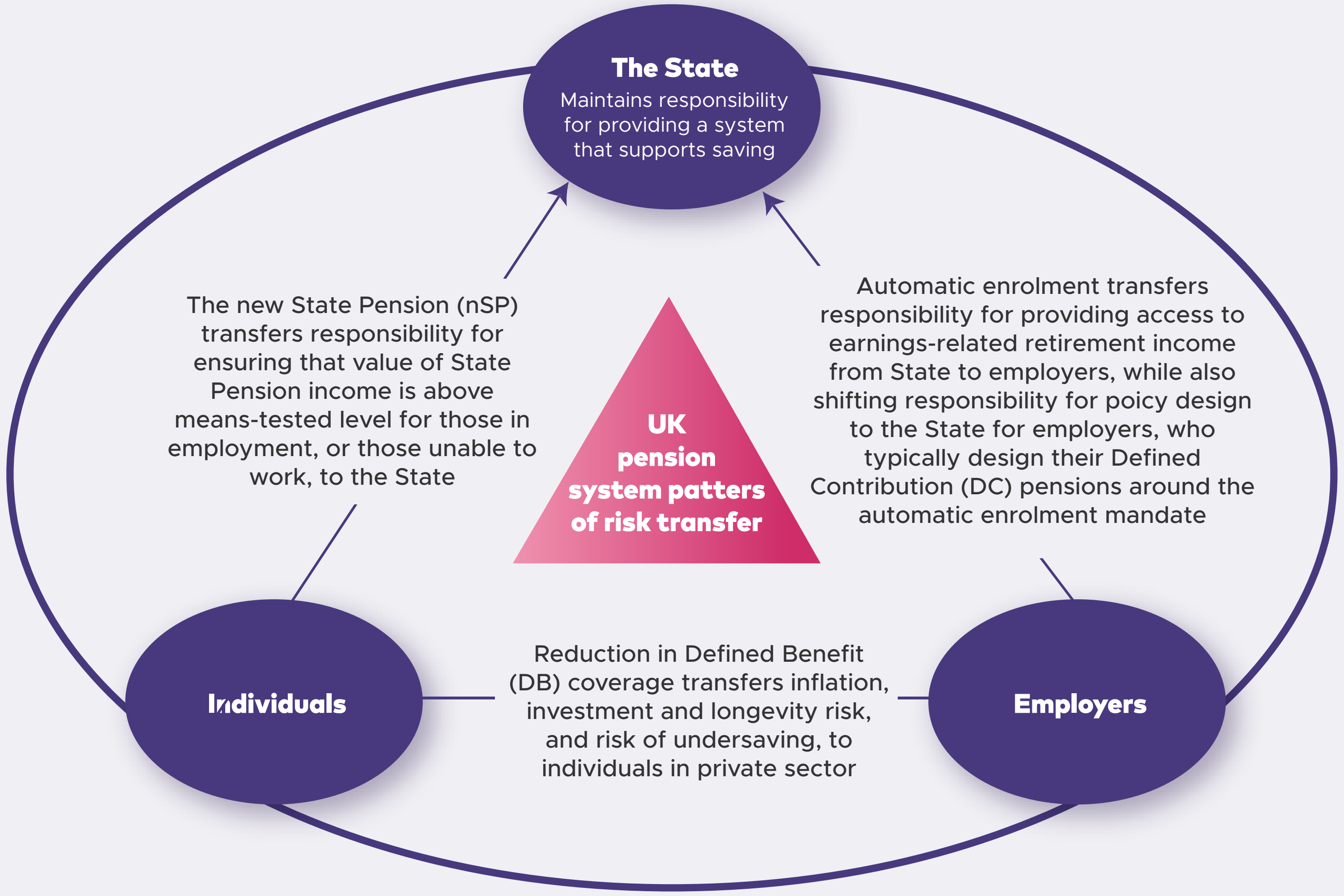
Key Findings

Changes in the UK pension system, including State Pension reforms and the shift from Defined Benefit (DB) to Defined Contribution (DC), are having a net positive impact on sustainability. Improved financial sustainability for the State, employers and pension providers has a strong influence on overall sustainability in the UK pension system, but it remains sensitive to ongoing risks associated with population ageing, economic factors and economic inactivity, as well as system design issues relating to complexity and data.

The picture for adequacy is mixed, but the overall outlook is somewhat negative. Retirement income rose slightly faster than inflation and earnings in the years to 2021, pensions coverage and employment are high, and the new State Pension (nSP) is helping to improve income in the lowest income households. However, low levels of DC contributions among those who need more than the State Pension in retirement, slow earnings growth, low financial resilience and limited support for decision-making, as well as the relatively low level of the State Pension and benefits for those who depend on them for the majority of their income continue to present risks to adequacy and financial security in later life.

Variation in the level of financial security people have in retirement is improving, but persistent differences in retirement outcomes have a net negative impact on fairness. Several issues continue to underpin differences between groups and outcomes in the UK pension system. They include the access that people have to different forms of retirement saving, the extent to which they are connected with their pensions and able or supported to make optimal decisions, the protection they have from risks in retirement, and widespread resulting income inequality in later life. Although defaults such as automatic enrolment are helping to narrow saving divides in working life, lack of infrastructure to help people manage DC pensions through retirement may compound challenges around financial capability.

Figure Ex.1 People are taking on greater responsibility for financial wellbeing in retirement than ever before, as risks associated with how much to save, how to invest and how to access pensions are transferred towards individuals, and away from institutions, including the State and employers



Across the Framework, findings highlight a pattern of transition towards increased personal responsibility for retirement outcomes in the UK pension system, driven and characterised by rising life expectancy and population ageing, a prolonged period of low-interest rate economies, changing financial regulation and advances in technology (Figure Ex.1).

At first glance, findings show that many of the changes brought about by the transition are positive. Financial sustainability is improving, workplace pension coverage is rising, employment at older ages is growing, and the new State Pension is helping to provide a more simple and improved safety net that can reduce State Pension income inequality, lower dependency on means-tested benefits, and narrow gender pension gaps in years to come.

On further examination, however, it is evident that changes also bring about a series of interactions and trade-offs between policies and policy outcomes, that together present a challenge to achieving adequacy and fairness in the pension system. They relate to:

- **Widespread undersaving and low engagement among DC savers,** which can jeopardise adequacy, increase the risk that people lose track of their pension savings. They also make it hard for people to decide how best to access their pension in later life, due to the complexity of post-retirement choices, relatively underdeveloped solutions, and limited support for decision-making.
- **Persistent inequality in retirement income,** which is driven by the relatively low value of the State Pension (particularly for those who retired under the old system), poor inclusion of low-income, self-employed and non-standard workers in private pension coverage, low earnings growth and differences in contributions and the type

or quality of pension offered by employers.

- **High levels of dependency on State benefits in later life,** which, despite increases over the past decade, continue to produce comparatively high rates of poverty against international peers and poor outcomes against retirement living standard targets.
- **The increased risk of poverty, decline in living standards or savings leakage** among people who make an unplanned exit from the labour market before reaching SPa.

Policy Insights

The potential impact of findings from the UK Pensions Framework on pensions policy are documented throughout the report. Overall, they highlight that although individuals are bearing greater responsibility for financial security in retirement than ever before, the State and other key stakeholders still have an important role to play in risk sharing and supporting fairness by creating the long-term conditions, incentives and support necessary for people to achieve adequacy in later life.

Findings show that changes and outcomes have considerable implications for policy makers seeking to ensure the provision and stability of these conditions. They include the following:

- Changes have created **a more straightforward State pension system, but a more complex private pension system** that requires people to keep track of their pensions and make difficult decisions around how much to save, as well as how to access their savings in later life.
- As higher coverage becomes embedded in the private pension system, **there is a growing need for policy reforms to tackle pension adequacy**, without compromising affordability and **participation.**
- Shifts in what constitutes a pension, from a guaranteed income in retirement to a pot of savings, mean that **system design has an increasingly important role to play** in mitigating against the erosion of savings. Erosion can be brought about by undersaving, high charges, low performance, leakage, poor decision making, the proliferation of small pots and cost of consolidation, and poor selection of investment strategies or assets.
- **DC savers have greater flexibility than those in DB schemes, but at the expense of fewer guarantees.** With the exception of the option to buy an annuity and safety nets provided by the State Pension, DC savers do not share longevity, inflation or investment risks with institutions in retirement. Although CDC schemes could offer a way to moderate these risks, development and legislation are still in very early stages. Among those retiring with DB, risks (within the constraints of inflation caps) are largely borne by institutions.
- **Inconsistencies in system design** are producing tensions between the need for engagement and the need for defaults that can protect people from risks that might arise from low engagement. While the DC system relies on inertia to encourage participation through defaults, for example, managing risk relies on engagement and more active decision making from savers, many of whom may be unprepared or unequipped to make complex choices.
- Where defaults are used to mitigate risks for those who do not (or are unable to) engage with their pension, there is a high risk that **people may be unaware that outcomes may not meet their needs or expectations in later life** and a lack of support available to them which, in turn, risks undermining the confidence people have in the system.
- There is continued need for practical **solutions that can help people to manage complexity**, in order that they do not make decisions that could disadvantage them, as well as to mitigate the risk of poor outcomes for those who do not engage with the system.
- The **pension system interacts heavily with other policy systems** and outcomes are dependent on individual circumstances. Recognising the impact of differences in health, caregiving, working patterns, and home and family arrangements through coordinated policy design can help to support adequacy, sustainability and fairness by reflecting the experiences that people have in later life.
- Although average statistics paint a relatively stable picture of adequacy for pensioners, they mask considerable **variation in characteristics and inequalities among the older population**. As the transition from DB to DC progresses, more effort will be needed to tackle increasing income inequality with a particular focus on middle income households.

Next Steps

The UK Pensions Framework is a strategic, multi-year project that aims to support and inform long-term policy making in the UK pension system.

This year's report is predominantly based upon analysis of data relating to 2020-21, or most recently available information. As well as providing a comprehensive picture of the UK pension system that can help to inform where policy response and action may be needed, it will also provide a valuable baseline against which the rapidly evolving macroeconomic and political events of 2022 and future years can be compared.

In the year ahead, the UK Pensions Framework will examine the extent to which acute economic pressures of 2022 signal a departure from recent indicator trends to understand risks they present to saving in working life, adequacy in later life, the sustainability of public finances, stability of pension schemes, and living standards across the population. It will also examine the potential impact of decisions over future increases in State Pension age, the uprating of benefits and the triple lock, the role of pensions tax relief and the long-term implications of challenges in health and social care for population health and spending.

Findings will be published in the 2023 edition of the Framework, the next in a series of annual reports. The Framework will also be used to support future policy research by simulating the potential impacts of policy proposals, interventions or economic scenarios on retirement saving.

Introduction

The UK Pensions Framework is a long-term instrument, which brings together analysis of three strategic objectives in the UK State and private pension systems that overall determine the financial security that people have in later life – adequacy, sustainability and fairness.

Together, these objectives reflect the notion that the security of pension provision is determined across several different dimensions and over long periods of time. This report highlights key findings from both quantitative and qualitative analysis of over forty different indicators relating to:

ADEQUACY: Labour Markets, State Support, Private Pension Saving, Non-pension Wealth, Retirement Living Costs, Retirement Outcomes

SUSTAINABILITY: Population and Ageing, Financial Sustainability, System Design

FAIRNESS: Process Fairness, Outcome Fairness, Protecting Savers

The UK Pensions Framework is the product of a robust, two-year development process, with input from over seventy stakeholders and experts in national and international pension systems.

This report presents the very first overview of trends, trade-offs and transitions in the UK pensions landscape. It highlights differences in outcomes between key actors including the State, employers, the pensions industry and population groups, as well as insights and implications for future pensions policy. It also examines how variation in characteristics, including age, gender and household composition, can produce differences in how people prepare for and live through retirement. The report is not intended to provide an exhaustive account of the Framework's findings, nor to make specific policy recommendations. Where interactions or trade-offs between factors are identified that can help to explain specific outcomes, analysis is descriptive only. This means that the relationship between indicators is analysed, but the degree to which change in one or more indicators causes or affects the value of another is not isolated or quantified. Further detail can be found in the 2021 UK Pensions Framework Design Series.

A comprehensive Indicator Appendix accompanies this report and provides detailed information relating to specific indicator measures and findings.

This information is used to assign a score out of six to each indicator that classifies the extent to which outcomes are providing support for their relevant system objective. The classification score is calculated by reviewing findings from underlying indicator measures against a standardised set of principles for either adequacy, sustainability or fairness. These scores are a useful way to develop an overall picture of where elements of the pension system are working well, and where there may be risks or opportunities to improve outcomes that could benefit overall levels of adequacy, sustainability and fairness in the future. The classification outcomes are:

L6	Strong support for system objective
L5	Good support for system objective
L4	Some support for system objective
L3	Somewhat fails to support system objective
L2	Poor support for system objective
L1	Fails to support system objective

A colour scale from red (negative) to blue (positive) is used to present indicator outcomes. The PPI is committed to inclusivity and the decision not to use traditional Red/Amber/Green visualisation was purposefully made to enhance accessibility of the report and its findings.

Chapter One – Trends

Describes findings from the 2022 UK Pensions Framework analysis and PPI Pensions Policy Wheel to outline high level trends in, and impact on, outcomes for adequacy, sustainability and fairness in the UK pension system

Chapter Two – Trade-Offs

Examines how outcomes in the UK pension system can be derived from the changing nature of relationships between policy functions and objectives. Considers the potential implications of interactions and trade-offs for future pensions policy using two case studies: State Pension age (SPa) Reform and Undersaving for Retirement

Chapter Three – Transitions

Uses the PPI Pensions Policy Wheel to discuss interactions between indicators that show how the UK pension system is evolving in response to socioeconomic factors which underpinned the transition to Defined Contribution (DC), where reforms are taking place, the extent to which they are achieving their objectives, and where gaps exist as a result of legacy system design

CHAPTER ONE:

TRENDS

This chapter describes findings from the 2022 UK Pensions Frameworks Analysis, outlines trends, and provides an overview of how policy and system interactions are leading to differences in outcomes between population groups.

The main aims of this chapter are to:

- Introduce the Pensions Policy Wheel as a tool to bring together findings from analysis across the UK Pension system
- Outline key trends and outcomes in the UK pension system based on the most recent data, much of which relates to 2021, or the 2020-21 financial year
- Describe strengths and vulnerabilities in the UK pension system which together highlight the extent to which it is supporting overall strategic objectives of adequacy, sustainability and fairness

This chapter discusses the findings from analysis of indicators in the UK Pensions Framework that together help to develop a picture of how the UK pension system is working in respect of three key objectives:

- **Adequacy –** Defined in the Framework as a clear system that enables people to plan reliably for a retirement that provides protection against poverty, financial resilience, and the ability to maintain living standards from working into later life.
- **Sustainability –** Defined in the Framework as a stable, secure and affordable system which allows the needs of the present to be met, without compromising the ability of others to meet their own needs.
- **Fairness –** Defined in the Framework as an inclusive system which engenders trust, provides fair benefits for all, protects people equally from risk in retirement, and upholds the commitments that are made within and between generations

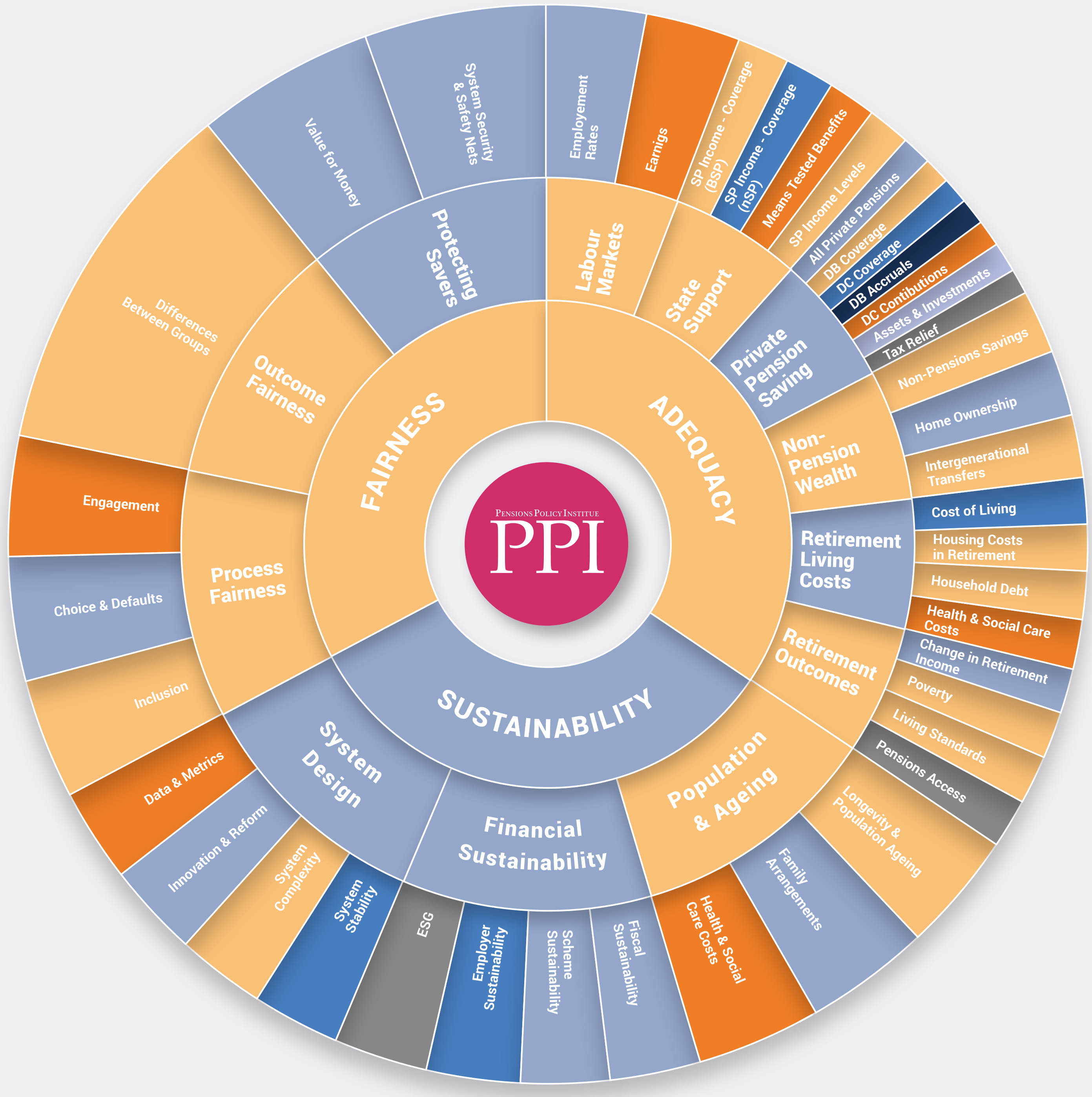
What is the PPI Pensions Policy Wheel and how does it work?

The PPI Pensions Policy Wheel is a visualisation tool that summarises and aggregates findings from forty-one system indicators in the UK Pensions Framework, in a single chart (Figure 1.1). Its aim is to illustrate trends, strengths, vulnerabilities and risks in the pension system, how they relate to each other, and how they impact adequacy, sustainability and fairness as pension system objectives that shape the overall financial security people have in later life.

The PPI Pensions Policy Wheel is organised around the three system objectives, and three levels of analysis. The outer ring shows results from individual indicators. Each indicator comprises detailed, in-depth analysis of data selected by the PPI, and is scored and validated against a set of PPI principles to classify the extent to which it supports its relevant system objective. Classifications take account of both point-in-time outcomes such as poverty rates, as well as longer-term trends in factors such as earnings or population ageing, to develop a picture of how the system is working for pensioners of today, and those of tomorrow. The middle ring then groups and aggregates indicator findings into twelve core components of the pension system, before matching system components to their relevant objective in the inside ring. The inside ring contains the three system objectives of adequacy, sustainability and fairness, and their classification provides a high-level, aggregate overview of how the system is performing in relation to each. For example, Employment Rates and Earnings indicators relate to changes in Labour Market conditions which, in turn, relate to Adequacy because they can affect how much people save in working life. In some cases, it was not possible to classify indicator outcomes due to gaps in data and metrics which could potentially compromise the validity of results.

The size of each Framework component is not intended to reflect the relative importance or weight of its content because the pension system is recognised to have multiple ongoing objectives, not all of which can be fully achieved at the same time. The weight given to each objective will change over time according to socioeconomic circumstances, as well as societal norms. Full details on the design of the Framework can be found in the UK Pensions Framework Design Series.

Figure 1.1 Changes designed to offset social and economic impacts of population ageing are helping to improve sustainability for the State and employers in the UK pension system. However, they come at a cost to individuals, among whom retirement income inequality remains high, and among whom more people are saving, but not necessarily saving adequately for retirement



L6	Strong support for system objective
L5	Good support for system objective
L4	Some support for system objective
L3	Somewhat fails to support system objective
L2	Poor support for system objective
L1	Fails to support system objective
	Unrated in 2022 Edition due to quality of data

Source data relates to financial year 2020-21 or most recently available data.

Key Findings

Of forty-one indicators analysed in the 2022 edition of the UK Pensions Framework, one provided strong support for system objectives, five provided good support, and thirteen somewhat supported their respective objective of adequacy, sustainability or fairness. Twelve indicators somewhat failed to support objectives and seven provided poor support, but no indicators were deemed to have failed to support respective goals. **Most data in this report relates to financial year 2020-21, or calendar year 2021.** The PPI elected to postpone analysis of three indicators due to issues with quality or availability of data or metrics which preclude the ability to draw robust conclusions from findings.

SUSTAINABILITY

Overall, the UK pension system was most likely to be meeting objectives that relate to sustainability. Sustainability refers to risks that could compromise affordability, efficiency, and integrity in the UK pension system. The outcome is heavily influenced by positive trajectories in financial sustainability for the State, employers and providers. Reforms aimed at lowering the cost of pension contributions and benefits are partially offsetting the impact of population ageing and economic change, despite the growing cost of meeting regulatory requirements, and persistent system design issues relating to complexity and data.

ADEQUACY

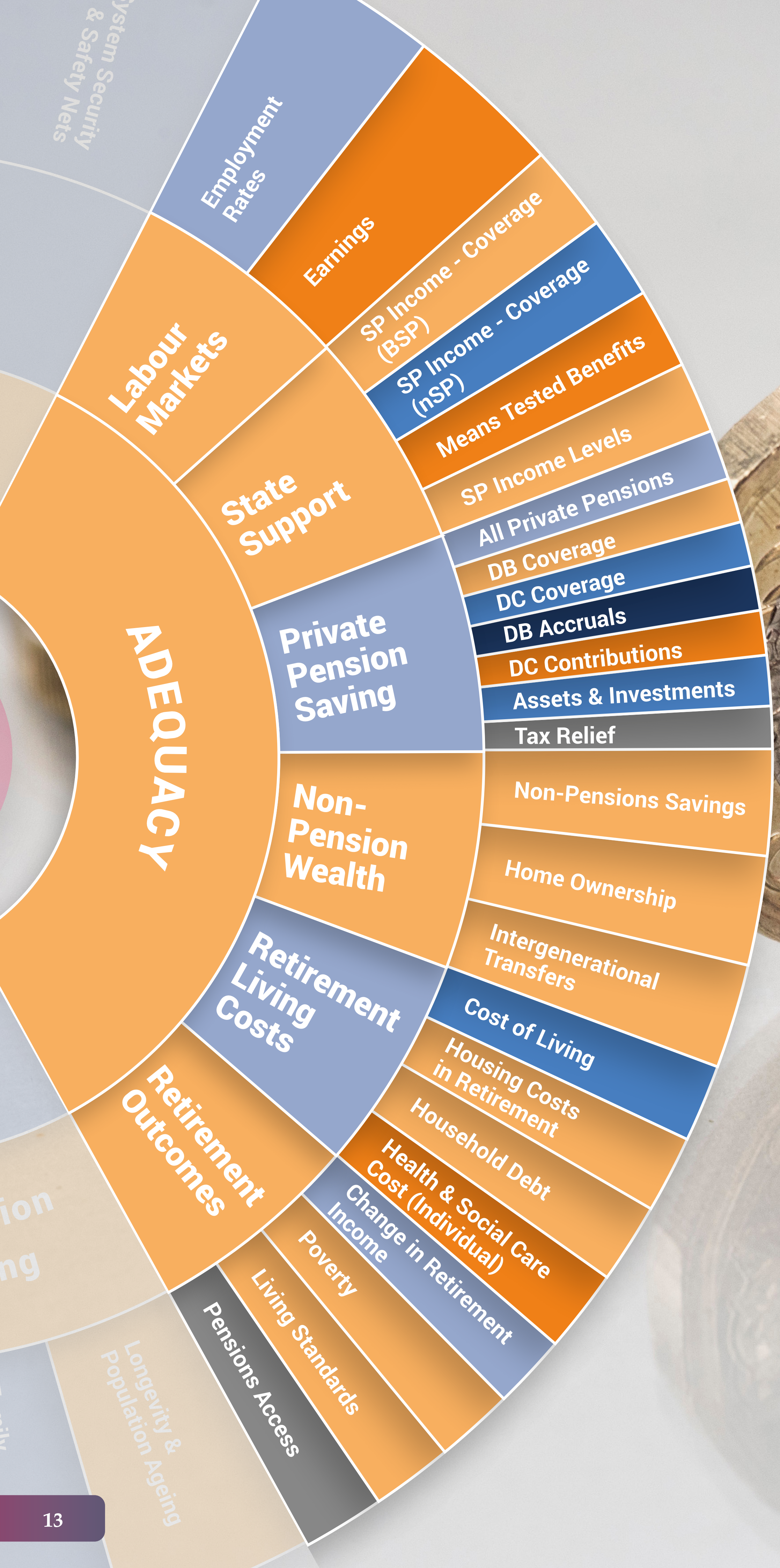
The system was less likely to support objectives related to adequacy. Adequacy and sustainability can be seen as competing system objectives due to tensions over the availability of public and private resources at any point in time. Adequacy is critical to pensions policy because people expect to be able to live with dignity and security in retirement, protected from poverty and with a standard of living comparable to that which they experienced during working life.[3] The overall adequacy outcome is most heavily influenced by a combination of indicators from across sub-objective groups that together highlight the risks to financial security facing lower- and middle-income households in later life. These risks arise from undersaving in DC pensions, low earnings growth and financial resilience, and the relatively low level of the State Pension and means-tested benefits for those who depend on them for the majority of their income.

FAIRNESS

A comparable pattern was evident among fairness indicators. Fairness reflects the notion that a compromise between adequacy and sustainability necessarily involves distributing costs and benefits unevenly between different groups, and can only be achieved if outcomes are deemed to be fair. Although "fair" means different things to different people, in the Framework it means that people have an equal opportunity to participate in and benefit from the pension system, and that they can achieve outcomes which meet their needs and preferences equally.[4]

Analysis shows considerable income inequality in the older population and differences in the extent to which people can access the benefits workplace pensions. In many cases, women, single pensioners, ethnic minorities, and those with low income and those with low levels of financial literacy, are likely to be most at risk of poor outcomes in retirement. Although many of these differences have evolved as a product of work and savings patterns or through legacy differences in the system, others are the product of trade-offs driven by recent changes and reforms in the pension system. Measures to mitigate differences and protect savers during working life, particularly those who do not engage with their pensions, are helping to offset some impacts, but gaps remain for those approaching and living through retirement with Defined Contribution (DC) benefits.

[3] Hutton (2006), Mercer (2020), European Commission (2018)
[4] Brain, A. (2021)



ADEQUACY

The fact of being enough or satisfactory for a particular purpose

A clear system that enables people to plan reliably for a retirement that provides protection against poverty, financial resilience, and the ability to maintain living standards from working into later life.

A multitude of factors in the UK pension system present risks to retirement adequacy among current and future pensioners, although some reforms have had a positive impact

Adequacy in the UK pension system is most heavily influenced by a combination of indicators that together highlight extensive differences in saving patterns and variation in retirement outcomes.

Overall, trends and outcomes relating to private pension saving and retirement living costs show a modest net positive impact on overall provision of adequacy. However, findings relating to labour markets, State support, non-pension wealth and retirement outcomes were more likely to have net negative implications for adequacy among current and future pensioners. Beneath the averages, findings highlight persistent risks to financial security and adequacy among lower- and middle-income households in later life, particularly those who depend on the State Pension and benefits for a high proportion of income.

Private Pension Savings
Some support for adequacy

Adequacy remains highly dependent upon the type of private pension provision people have throughout working life and retirement

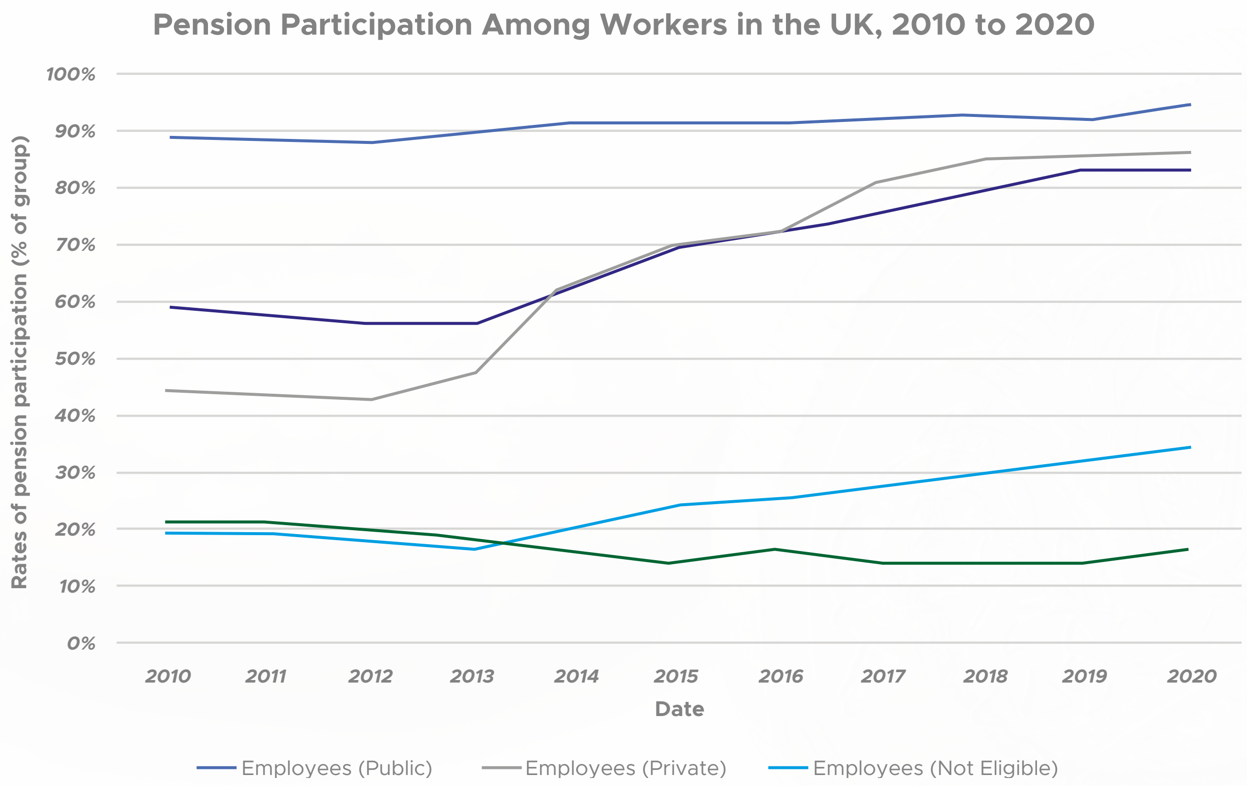
Millions more people are saving into private pensions, but widespread undersaving is a challenge to ensuring adequacy in later life.[5]

Defined Benefit (DB) accruals continue to offer the best provision for retirement adequacy of all forms of saving. More than half of DB savers received employer contributions of over 20% in the period 2018-20, a rate received by only 3% of DC savers. However, just one in four employees has access to **DB coverage** and rates are falling at all ages. Overall, women were much more likely to have DB pensions than men, on account of the higher proportion of women in public sector roles.

In contrast, automatic enrolment is helping to improve adequacy prospects by increasing **DC coverage** among employees to 49%. Overall, these changes helped to improve **Overall Private Pension Coverage** (public and private provision) to more than three in four workers in 2021, and narrowed the participation gap between the two sectors (Figure 1.2). However, opportunities for improvement remain, as one in five employees and four in five self-employed workers is still not saving into a pension.

[5] UK Pensions Framework Indicator Appendix (2022). Indicators A3.1, A3.2, A3.3,A3.4, A3.5, A3.6 and F1.1

Figure 1.2: Automatic enrolment has narrowed the gap in workplace pension saving between public and private sectors, but remain low among the 14% of workers who were self-employed.



Performance in DC **Pension Assets and Investments** varied over the pandemic. However, most fund strategies are contributing to adequacy goals by providing returns above a benchmark comparable to the NEST default fund, while limiting volatility through consistent diversification. Of greatest concern to adequacy is that, despite automatic enrolment, a typical employee makes DC Contributions of around 8%, of which less than half comes from their employer. Research estimates that contributions would need to represent around 12-16% of worker income throughout their life for working-age living standards to be replicated through retirement. Although undersaving is not a new problem, many savers are unaware of the potential shortfall in retirement savings, believing instead that employer contributions will be adequate, and may be surprised if savings don't yield results they expect.

Retirement Living Costs
Some support for adequacy

Retirement income grew slightly faster than living costs to 2020-21, but the unpredictable nature of needs and debt remain a concern

For most pensioners, growth in disposable retirement income has outpaced inflation in recent years, but costs related to health and social care, housing, and household debt have seen some increases.[6]

Until inflation began to rise in 2021 (from which time retirement income data is not yet available), **Cost-of-Living** measures suggested that adequacy was improving slowly for the typical pensioner household. Over the ten years to 2020-21, average disposable household income rose by 36% compared to the Consumer Prices Index (CPI) which rose by 18%. Disposable income grew faster than gross income, but improvements in adequacy varied slightly, and the poorest single pensioner households saw a slight real-term fall in income.

For those with **Housing Costs in Retirement**, the cost of renting privately is becoming less affordable and consuming an increasing proportion of income over time. The proportion of people over 65 with **Household Debt** has risen slightly to 16%, although fewer people report their debt as being burdensome than in the past, and, of those who are concerned about debt, 67% are concerned about credit card debt.

The costs of **Health and Social Care** to individuals remain an unpredictable yet potentially catastrophic risk to adequacy in later life. They also tend to dominate concerns over how much people need to set aside to fund their care, or to fund their living costs should they leave employment due to ill health or caring roles. Those who are unable to fund shortfalls through savings could be at risk of a drop in living standards. Although the overall proportion of people of all ages who report providing informal care fell slightly from 8% in 2010-11 to 6% in 2020/21, the number of people providing a level of care high enough to qualify for Carer's Allowance rose from 1 million in 2011 to 1.26 million in 2021.

[6] UK Pensions Framework Indicator Appendix (2022). Indicators A5.1, 5.2, 5.3 and 5.4

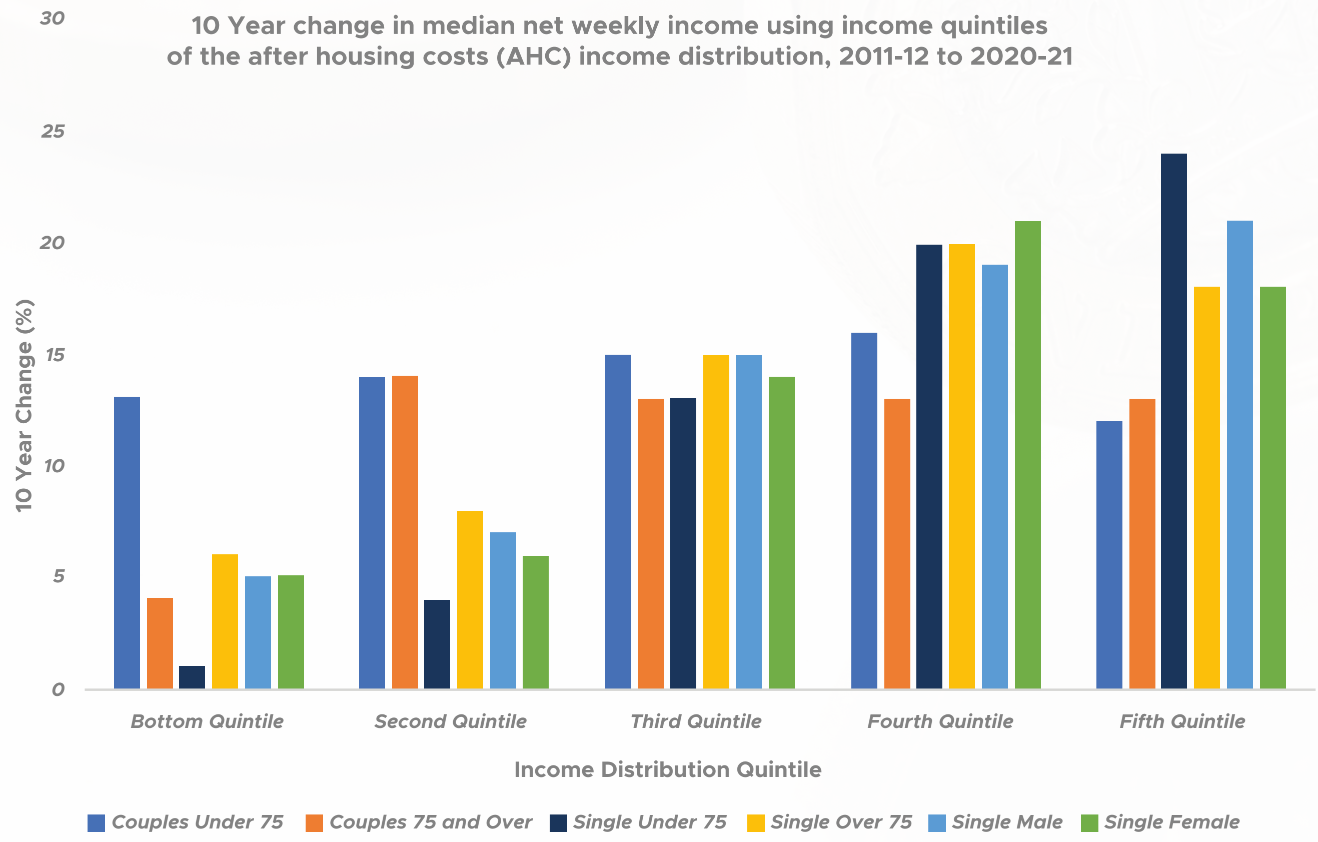
Retirement Outcomes
Somewhat fails to support adequacy

Overall retirement adequacy is relatively low and just one in three households meets income targets for a moderate standard of living

Although adjusted disposable household income does not appear to fall substantially as people reach SPa, growth in retirement income has been slow and uneven, most pensioner incomes are below the target level for a moderate standard of living, and rates of pensioner poverty are high by international standards.[7]

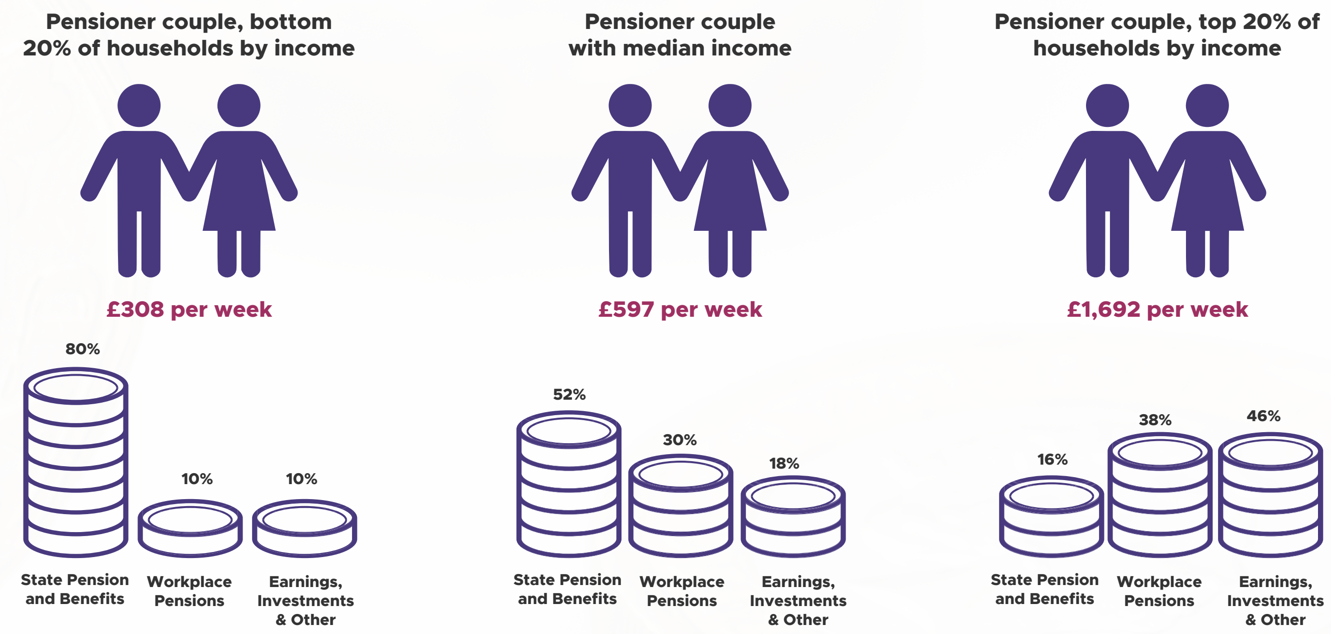
Average **Retirement Income** grew by around 5% in the year to 2020-21 and almost half of all pensioner households had income equal to or higher than population-wide average income. However, uplifts mask differences between groups and a slow pace of real-term growth over ten years. (Figure 1.3).

Figure 1.3: Couples with average or above average income, and single pensioners with high incomes saw the fastest growth in retirement income over ten years



Fewer than half of all pensioners receive half their income or more from private sources, with more among those recently reaching SPa. For lower income households, benefit income (including State Pensions) comprised around 80% of retirement income (Figure 1.4). However, the composition of retirement income has seen a marked change among all groups, as the proportion of income that people receive from earnings is falling and being offset by a rise in the proportion from occupational pensions. Pensioner households in the top income quintile receive around four times the income of those in the lowest groups, and income inequality is widening among single pensioner households.

Figure 1.3: Couples with average or above average income, and single pensioners with high incomes saw the fastest growth in retirement income over ten years



Overall, the risk of relative **Poverty** among older people is comparable to that of the total population, but UK rates are high compared to Organisation for Economic Co-operation and Development (OECD) peers. Although poverty rates fell in 2020-21 as retirement income grew, data collection was affected by the pandemic, so the reversal of rising trends is not clear.

Adequacy of **Living Standards** in retirement can be difficult to measure. On an equivalised basis, average income among households aged 65 to 74 was equal to more than 90% of income among households aged 55 to 64, and among those over 75 it was approaching 80%. This implies that average households may not be experiencing a significant drop in living standards around the time that they retire, even though overall income is relatively low. However, one in four pensioner households did not have sufficient income to meet the PLSA target for a minimum standard of living in retirement in 2019-20, and just one in three was able to meet targets associated with a moderate or comfortable living standard. Single pensioner households had poorer outcomes than couples.

[7] UK Pensions Framework Indicator Appendix (2022). Indicators A6.1, A6.2, A6.3 and F2.1

Labour Markets
Somewhat fails to support adequacy

Low earnings growth is diluting the positive impact of high employment on pension saving

Retirement outcomes remain highly dependent on employment patterns in working life, but although overall employment is high, one in four workers does not qualify for a workplace pension, and low earnings growth is compromising the extent to which individuals can build financial adequacy and resilience through savings.[8]

Employment rates remained near an all-time high at 75.2% in 2021. As the gap between men and women in work continues to narrow, the proportion of people in full-time work continued to grow and falls in the number of older workers brought about by the pandemic were reversing. Together, changes help a record proportion of people to improve their pensions adequacy outlook through workplace pensions, employer contributions, tax relief or savings. However, more than one-third of workers are either self-employed or in part-time work, and even through coverage is rising among ineligible employees, one in ten employees may not have access to a workplace pension on account of automatic enrolment rules.

A real-term decline of 2.8% in total average **Earnings** over the year to mid-2022 follows a period of relatively slow earnings growth over the past ten years. These changes offset the positive impact of high employment rates because they negatively impact the ability of households to grow retirement savings for later life, whilst maintaining living standards during working life. However, overall levels of earnings inequality between gender, ethnicity and income groups are narrowing slightly.

State Support
Somewhat fails to support adequacy

The value of pensioner benefits remains low, but State Pension reforms are improving adequacy outcomes for at-risk groups

The new State Pension (nSP) is improving adequacy for younger pensioners, but variation among those under the old system has led to high levels of dependency on income related benefits.[9]

The **new State Pension (nSP)** has improved adequacy among younger pensioners by increasing average State Pension income among low- and middle-income groups, and narrowing gender gaps. However, there is considerable variation in the extent to which the **basic State Pension (bSP)**, for which most pensioners are eligible, provides an adequate retirement income. 95% of men receive the full basic rate or higher compared to 70% of women, and the gap is wider at older ages. Women over 75 in the lowest quartile of the income distribution receive around £92.50 per week, compared to men over 75 in the highest quartile who receive over £200 per week.

State Pension income has mostly improved or remained stable compared to earnings and inflation in recent years (Figure 1.5). However, its latest increase is well below the sharp rise in inflation in 2022, and also below recent levels of earnings growth. The uncertainty of future of uprating measures presents a risk to both short- and long-term retirement adequacy, particularly as the UK has ranked consistently in the bottom third of international peer comparisons for replacement rates.

Dependency on **Means-Tested Benefits** remains high among low-income households, particularly single pensioners, of whom 30% are eligible. However, the Pension Credit minimum guarantee rate has fallen below the Minimum Income Standard and one third of eligible households do not take up income-related benefits in later life, suggesting they do not fully meet the goal of providing adequacy for those in need. Working-age benefits for those who leave the labour market before SPa are considerably lower, putting those without private savings at even greater risk of poverty or a fall in living standards.

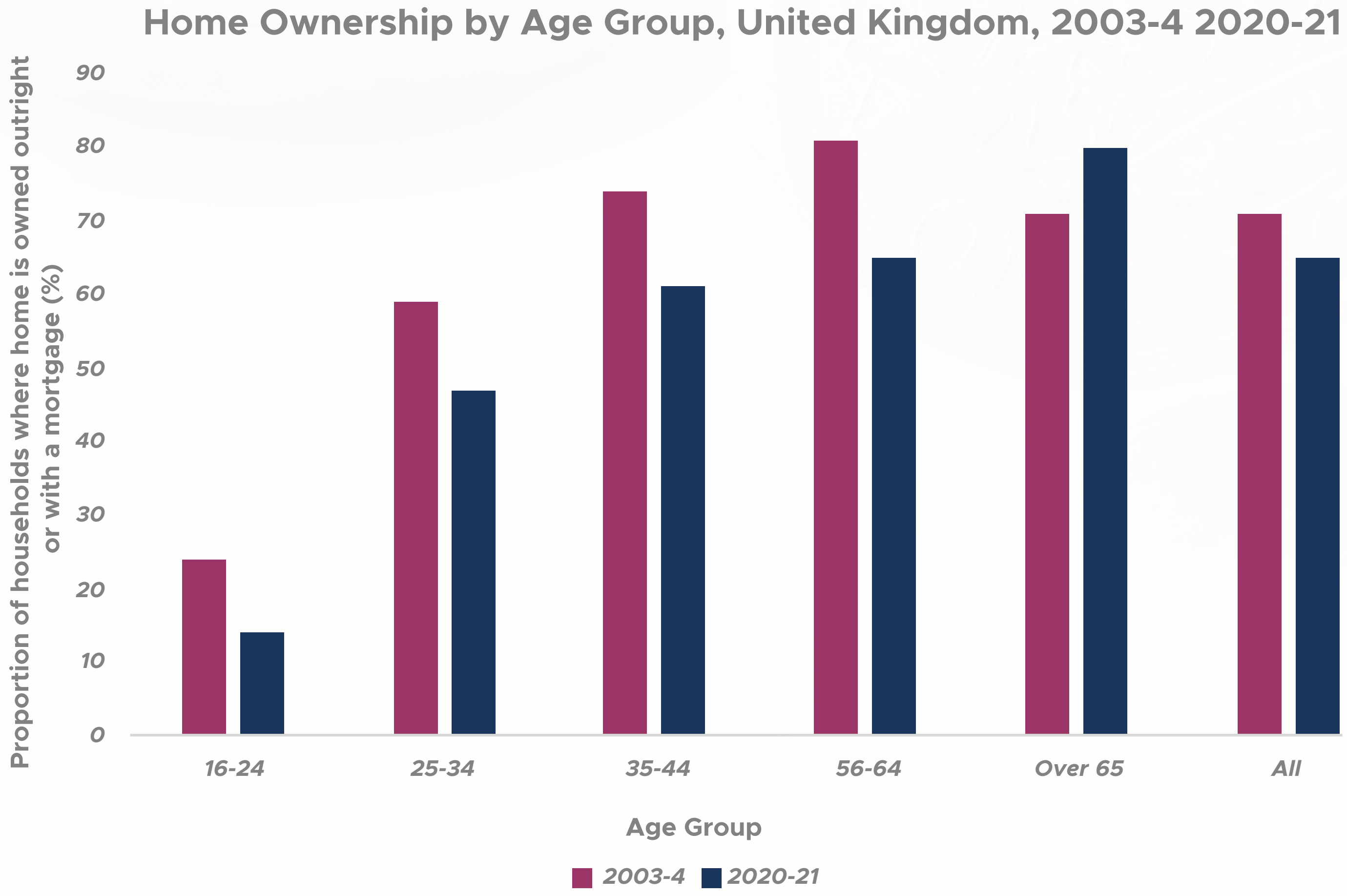
[8] UK Pensions Framework Indicator Appendix (2022). Indicators A1.1, A1.2 and F2.1
[9] UK Pensions Framework Indicator Appendix (2022). Indicators A1.1, A2.2 and A2.3

Falling home ownership signals adequacy risk for future pensioners and most people do not save outside their pension for retirement

For most people, home ownership is a key route lower living costs in retirement, but rates are falling and saving in non-pension assets is not typically sufficient to make up for a shortfall in income.[10]

Home Ownership among people over 65 remains near a record high of more than 80%, and almost one in ten pensioner households also owns a second home. However, rising property prices and tightening levels of affordability are driving down home ownership among working-age groups, where just 65% of 45-to-64-year-olds owned their home in 2020-21, compared to 81% in 2003-4. This means that without a proportionate increase in retirement income, housing costs could be a risk to adequacy for a growing number of people in later life, and fewer people will own property as a capital asset (Figure 1.5).

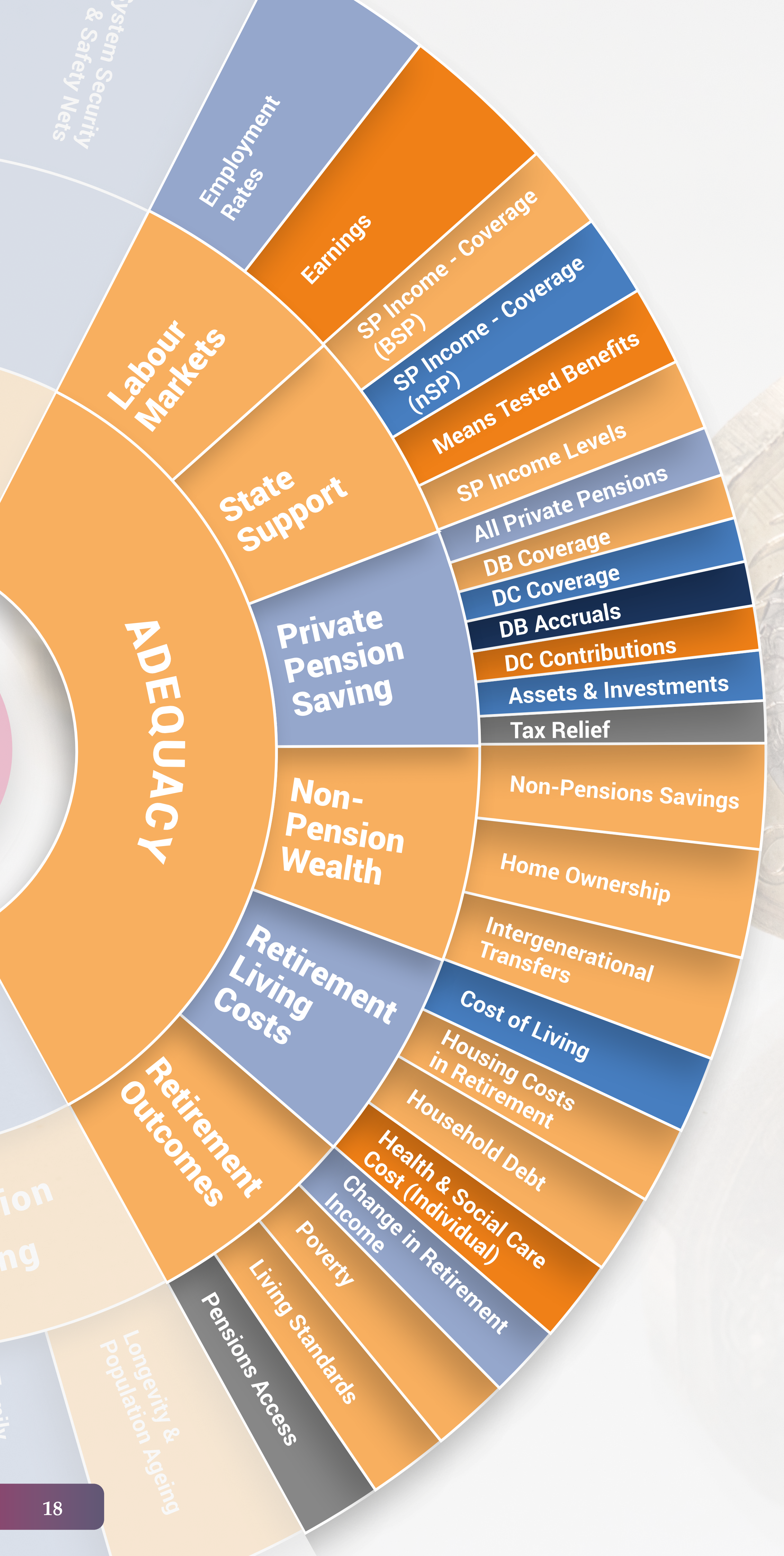
Figure 1.5 The proportion of households where the home is owned outright or with a mortgage is at a record high among people over 65 but falling in all other age groups



The typical value of **Non-pension Savings** is around £18,000 at 65 and rising. Although this can provide some financial resilience in later life, it is not enough to supplement income throughout retirement. Around half of people are saving among all age groups, but fewer people are saving with the stated aim of providing for an income in retirement, suggesting that savings aspirations appear to be focused on short-terms goals, even if funds are eventually used in later life.

There is considerable variation in the extent to which **Intergenerational Transfers** impact adequacy in later life and average values mask extensive inequality. Just 4% of people receive inheritance over £1,000 and 6% receive a cash gift or loan over £500. For those who benefit, the average transfer will not significantly improve adequacy, but could help boost financial resilience or lower retirement living costs if used towards home ownership. In 2018-20, the median value of inheritance received by those in the highest wealth quintile was £50,000, more than twenty times higher than the lowest group, and the mean was over £100,000, or more than thirty times higher than the lowest group.

[10] UK Pensions Framework Indicator Appendix (2022). Indicators A4.1, 4.2 and 4.3



Policy Insights - Adequacy

- **Most DC savers are not contributing enough** to replicate working-life living standards in retirement, and many are likely unaware of the risks they face in later life
- **Extending the benefits of workplace pension saving** to those outside the automatic enrolment system can help to mitigate or narrow adequacy gaps among future pensioners, although it will be necessary to assess the extent to which lower income households might be at risk of oversaving
- Interventions that support the poorest households, including **maximising the take up of income-related benefits**, can help to mitigate income inequality
- The extent to which the **uprating of pensioner benefits** is commensurate with inflation will have implications for adequacy of retirement income, as well as confidence and trust in the welfare system
- The extent to which **growth in earnings and working-age benefits** is commensurate with inflation will have implications for the adequacy of retirement income for future pensioners who may choose to reduce pension saving in order to meet short-term household needs
- Further research into the growth of **people approaching retirement as non-homeowners** can help to inform the extent to which changes in tenure could impact adequacy outcomes
- Interventions to improve **outcomes for women after divorce** are needed to help preserve adequacy in later life

SUSTAINABILITY

The ability to be sustained, supported, upheld or confirmed

A stable, secure and affordable system which allows the needs of the present to be met without compromising the ability of others to meet their own needs.

Reforms aimed at improving long-term affordability are having a positive impact on pension system sustainability, but underlying risks persist

Sustainability in the UK pension system is most heavily influenced by indicators that reflect improvements in financial sustainability and system design, but costs arising from demographic change present an ongoing challenge to sustainability as a system objective.

Beneath the high-level findings, analysis highlights the fragile nature of sustainability and the extensive agenda of reforms that have been implemented with the objective of achieving it. It also highlights the continuous nature of risks that arise from growing older population, and from complexity brought about by the cumulative impact of change over time.

Financial Sustainability
Some support for sustainability

Transferring risk away from institutions towards individuals has improved financial sustainability

Strong financial sustainability for employers in the UK pension system, coupled with stable levels of financial sustainability for schemes and the State, have improved overall measures of system sustainability.[11]

Employer sustainability, which examines the long-term affordability of providing access to pensions to private sector employees, has had a strong positive impact on financial sustainability in the UK pension system as the transition from DB to DC has evolved. The cost of providing workplace DC pensions, both in terms of contributions and administration, improved with the introduction of automatic enrolment. As a result, significantly more employers reported being able to absorb an increase in the cost of pension contributions without raising prices, lowering wages, or reducing staff in 2019 compared to 2013. The number of DB schemes closing to new benefit accrual has risen gradually over the past ten years. However, the rate at which open DB schemes are closing to new members is slowing and the number of DB schemes remaining open has levelled off.

The financial stability of workplace pension schemes, **Scheme Sustainability**, has a somewhat positive impact on overall financial sustainability. Overall, the increase in members brought about by automatic enrolment has improved the financial sustainability of DC schemes. However, a sharp rise in the number of small, deferred member pots (27% of all master trust pots are deferred in 2022) coupled with restrictions on implementing flat fees for these accounts, is likely to increase cost pressures for providers. Among DB schemes, funding positions are generally improving and many more schemes are now fully funded on an ongoing basis and close to being fully funded on a buyout basis, although funding challenges remain for some schemes in both private and public sectors. However, economic turmoil in October 2022 changed the value of gilts and bonds in which DB schemes are heavily invested. At present, the impact of falls on long-term asset values in relation to liabilities and the extent to which DB investment strategies could be affected remain unclear, but the crisis has highlighted the importance of prudential regulation and of learning lessons that can help to ensure appropriate levels of resilience in the future.

Measures to improve **Fiscal Sustainability**, in terms of the cost of pension-related revenues and benefits to the State, are having a somewhat positive impact on overall financial sustainability. Reforms designed to mitigate the impact of population ageing, including SPa increases and the nSP, are slowly improving the affordability of the State Pension by reducing the overall amount that Government spending on pensioner benefits as a share of GDP to 5% in 2021, and as a proportion of National Insurance contributions (NICs) since 2016. The cost of tax relief on pensions is rising in the short term compared to the level of tax paid by pensioners, with tax relief paid in 2019/20 worth 149% of tax received from pensioners, but is expected to yield long-term gains.

System Design
Some support for sustainability

The responsive nature of the UK pension system design is positive for its long-term sustainability

Strong system stability coupled with continuous innovation and reform somewhat support sustainability in the design of the UK pension system, but complexity and lack of reliable data and metrics present an ongoing challenge to development.[12]

System stability, as determined by the characteristics of policy-making processes, is strong and increases the likelihood that the design of the UK pension system is sustainable. Processes are relatively flexible and respond well to changes in the socioeconomic and policy landscape. Policies and policy changes are generally communicated in a clear and timely manner, and policy decisions typically seek to reflect the long-term nature of the system.

The pace and scope of **Innovation and Reforms** in the UK pension are helping to improve the overall design of the pension system. However, policymaking processes that relate to pensions and later life are complicated by the fact that several departments are involved in designing and delivering pensions-related public services and spending policy, some of which may have varying or even conflicting objectives. Policy decisions associated with long time horizons, such as those relating to demographic change, can become particularly problematic, considering that many decisions are taken over the lifetime of one parliament.

Although a degree of intricacy is necessary, **System Complexity** somewhat undermines the positive impact of system design on sustainability. Reforms to simplify State Pensions and increase the number of people saving into private pensions have reduced overall complexity in the UK pension system, but their success is somewhat offset by changes that have created new complexities in the private sector, along with a complicated and expensive system of pension tax.

Data and Metrics that are needed to support understanding and evaluation present a continuing barrier to improvement and sustainability of system design. Despite the wealth of information available across the UK pension system, barriers related to harmonisation, consistency and data sharing mean that it remains difficult for individuals, providers and policymakers to achieve oversight of how the pension system is working. The result is reduced transparency of system outcomes and an increase in challenges associated with engagement or informed decision making around retirement saving.

[11] UK Pensions Framework Indicator Appendix (2022). Indicators S2.1, S2.2 and S2.3
[12] UK Pensions Framework Indicator Appendix (2022). Indicators S3.1, S3.2 S3.3 and S3.4

Financial Sustainability
Some support for sustainability

Changes in the size and needs of the older population increase pressure on public spending

The cost of providing public services to meet the needs of people in later life, including the provision of health and social care, is rising as the older population grows, putting strain on the affordability of the UK pension system in the context of wider public spending.[13]

Factors related to **Longevity and Population Ageing** present an ongoing risk to the sustainability of the UK pension system. Although modest improvements are observed in the proportion of life people spend in good health and the proportion of life they spend in work, the long-term trend towards increased life expectancy has stalled, and economic inactivity has increased by nearly 2% among older people over the course of the pandemic.[14] Although current measures of economic dependency in the population remain stable thanks to rising SPa and employment rates, forecast declines in dependency and economic activity ratios signal an ongoing risk to long-term sustainability.

The cost of **Health and Social Care** to the State is of particular importance to overall public spending, and to the extent to which the pension system may have to compete with other sectors for public resources. Pensioner benefits, which fell from 5.6% in 2012/13 to 5.4% in 2020/21, represent a very slowly declining proportion of the overall costs to Government of supporting people through later life. However, total UK healthcare expenditure as a share of Gross Domestic Product (GDP) rose from 9.9% in 2019 to 12.0% in 2020, as the global pandemic generated a sharp rise in healthcare spending and a contraction in GDP. Healthcare expenditure is projected to continue rising as the population ages, putting added pressure on UK public finances and the overall affordability of benefits and services to support those in later life.

Family Arrangements, such as household composition and marital status, can significantly impact retirement income and the extent to which people have access to support in later life. Changes in family circumstances can also impact sustainability by altering the level of support that people need from the State. In 2020/21, there were 4.1million pensioner couple households and 4.3million single pensioner households. 50% of women were likely to live alone in later life compared to 30% of men. Overall, however, modest declines in divorce rates and the proportion of pensioners living alone, both of which are known risk factors for adequacy (particularly among women), suggest an improving outlook for sustainability. These changes do not detract from the need for policies targeted at improving outcomes among both groups, where the fair division of pension assets in the event of divorce is of particular importance.

[13] UK Pensions Framework Indicator Appendix (2022). Indicators S1.1, S1.2 and S1.3
[14] ONS (2022a)

Policy Insights - Sustainability

- Reforms to tackle the impact of population ageing should take into consideration **ratios of economic activity** and inactivity across the population, which provides a clearer picture of trends in economic dependency than the age-based dependency ratios alone
- **Older women remain at increased risk** of poor retirement outcomes due to a combination of differences in saving patterns and the increased likelihood that they live longer than men, live alone or may not receive adequate pension provision after a divorce
- **Complexity in the private pension system** remains an ongoing barrier to engagement and reform. Simplification could help increase access or improve outcomes for people with different characteristics.
- The **proliferation of small pots** presents a challenge to DC providers and members, which could compromise long-term sustainability and adequacy
- **Data adequacy** presents a barrier to fully understanding outcomes in the UK pension system and the extent to which people are making good decisions around retirement savings, particularly when they retire
- **Public spending on pensioner benefits** has stabilised in recent years, but measures to reduce it or further constrain growth in response to wider public spending pressures could, given the growing older population, compromise adequacy in later life

FAIRNESS

Impartial and just treatment or behaviour without favouritism or discrimination

An inclusive system which engenders trust, provides fair benefits for all, protects people equally from risk in retirement and upholds the commitments that are made within and between generations.

Variation in the level of financial security people have in retirement is improving, but persistent differences in some outcomes and processes continue to undermine broader fairness objectives

Fairness in the UK pension system is most heavily influenced by a combination of indicators that together highlight continuing differences in the access that people have to different forms of retirement saving, the extent to which they are protected from risks, and the outcome they are able to achieve as a result.

Overall, trends and outcomes relating to process fairness and outcome fairness show a modest net negative impact on overall provision of fairness. However, findings relating to protecting savers show that policies aimed at mitigating retirement risk and minimising avoidable differences between groups are having a positive impact. Beneath the averages, findings highlight persistent risks to women and lower- to middle-income households in later life, particularly DC savers without good financial literacy.

Protecting Savers
Some support for fairness

Measures to protect savers are helping to improve fairness by mitigating some risks

Reforms that seek to improve Value for Money measures, alongside expansion of safety nets and system security, are improving protection for savers positively impacting on fairness.[15]

Trends in **Value for Money** have a somewhat positive impact on fairness. Regulation on Value for Money is under development and covering increasingly more scheme members. In addition, investment returns are growing in 2021, compared to previous years and member charges are falling, with average charges for members in non-qualifying DC schemes falling from 0.79% to 0.53% between 2015 and 2020, and remaining at just under 0.5% in qualifying schemes. The number of DC trust-based pension schemes has fallen from 3,680 in 2012 to 1,370 in 2022, suggesting that smaller schemes are consolidating.

System security and safety nets designed to protect those who use the system from risk have a somewhat positive affect on protection for savers, and on overall system fairness. Wide-ranging safety nets exist to help people accrue entitlements to the State Pension throughout working life, resulting in more than 98% of people over age 70 receiving State Pension income in 2020. Measures within the State and private pension system are also designed to help people to meet or maintain and minimum level of income in retirement although some gaps exist. However, there is significant variation in the private sector where those with DC pensions face considerably greater risks to the long-term security of their savings than those with DB, and effective safety nets can be more complex to implement.

Process Fairness
Some fails to support fairness

Variation in access to, and differences in outcomes associated with, earnings-related retirement income underpin persistent income inequality and fairness outcomes in later life

Although gaps are narrowing, the cumulative impact of differences in employment patterns and workplace pension provision throughout working life continue to produce unequal outcomes in retirement that have negative implications for fairness.[16]

Differences between groups, which are evident in the majority of areas in the pensions landscape, result in unequal outcomes and have a somewhat negative impact on fairness. While rates of private pension participation are rising among all groups of employees, retirement outcomes vary by the type and nature of workplace scheme that employers provide, and already low rates of saving among the self-employed continue to decline. There are also differences in saving rate between people of different characteristics. For example, people from some ethnic minority backgrounds have rates of participation below those of the white population by around 7% for black people, 13% for Indian people, and 25% for Pakistani and Bangladeshi people. The cumulative impact of differences in saving behaviours continue to drive inequality in retirement income, whereby those in the top income quintile receive around four times the income of those in the lowest income households, and the gap is widening among single pensioner households.

[15] UK Pensions Framework Indicator Appendix (2022). Indicators F3.1 and F3.2
[16] UK Pensions Framework Indicator Appendix (2022). Indicators F2.1

Process Fairness
Some fails to support fairness

Process fairness is compromised by differences in the extent to which people are able to benefit, or be protected, from an increase in the choices and decisions around their pension

The Policy Wheel demonstrates that while the structure of choices and defaults in the system have a somewhat positive impact on the fairness of processes, relatively low levels of inclusion and poor levels of engagement result in a somewhat negative overall impact on the fairness of processes and overall system fairness.[17]

Choices and defaults currently have a somewhat positive impact on process fairness because they allow individual choice while offering a degree of protection from poor decision making to those who cannot, or choose not, to make informed decisions. While options, and their associated defaults, regarding how much to save and how to invest are highly regulated, there is less regulation covering how to access savings in retirement, meaning that there is less protection for consumers, and those in individual pensions or saving outside of a pension vehicle may struggle.

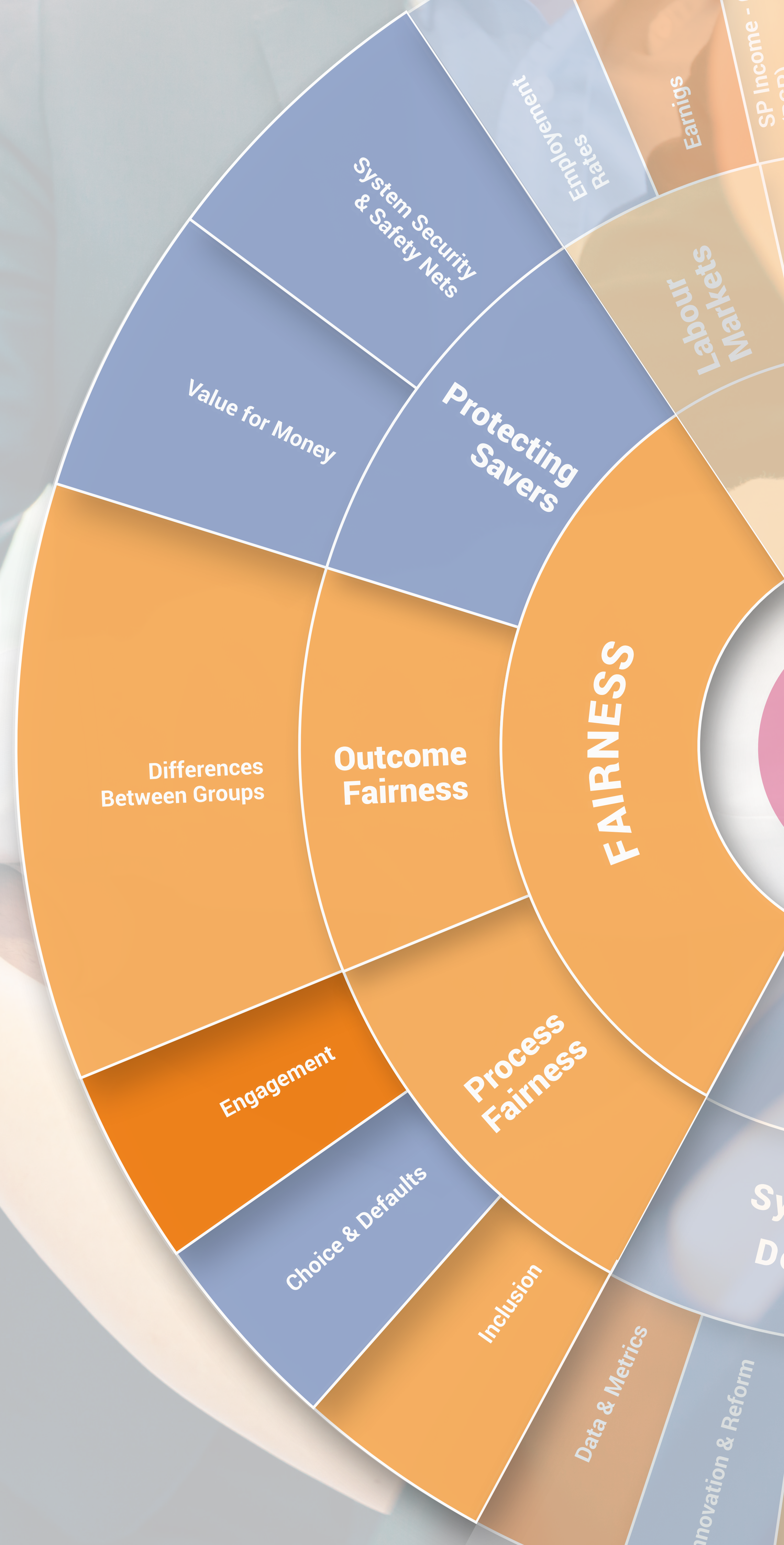
Inclusion demonstrates the extent to which individuals have levels of understanding and access to pension incentives, arrangements and services that meet their needs, and the support they need to understand them. Relatively low levels of inclusion have a somewhat negative impact on process fairness. A high proportion of people are able to access good quality pensions and pension services, but, although coverage gaps are narrowing, groups including women and those on low income are most likely to be missing out on opportunities to improve their retirement outcomes. Less than one-third of people report good financial literacy and understanding of pensions. A high proportion of people reporting lower levels of understanding highlights the importance of defaults and safety nets. Where savings incentives and safety nets are available, they are not always accessible equally among different groups.

Overall **Engagement** with pensions and retirement planning is relatively poor, and has a strongly negative impact on process fairness. More than a third of people under age 60 do not know how much income they will need to live on in retirement, and two in five people do not know how much they or their employers contribute to their DC pensions. However, there is considerable variation in the extent to which people engage with retirement planning, which can, in turn, produce considerable variation in outcomes in a system where outcomes are increasingly dependent upon choices people make. Women, those on low incomes and those with low financial literacy are most at risk.

[17] UK Pensions Framework Indicator Appendix (2022). Indicators F1.1, F1.2 and F1.3

Policy Insights - Fairness

- Current **workplace pension defaults** effectively reduce the proportion of people with no private retirement savings, but may not adequately protect people from undersaving
- **Inconsistencies in the use of defaults** and the extent to which they protect savers from harm associated with poor decision making or inertia, are likely to underpin long-term variation in outcomes
- Widespread underreporting and poor law enforcement means that the risks posed to retirement outcomes by **pension scams and fraud** remains very high
- **Income inequality is growing** among single pensioner households, where those with the lowest incomes saw the lowest growth of all older households compared to those in highest income households
- As SPa rises, there may be an increasing need for safety nets that can protect **people who leave the labour market before reaching SPa** from poverty or deprivation, or from potentially detrimental impact on long-term adequacy that arises from the need to access long-term savings to meet short-term household needs
- An **intergenerational divide** in support for the triple lock highlights the importance of considering the role of intergenerational fairness in policy reforms, particularly in the current economic climate



Non-Rates Indicators

It has not been possible to draw conclusions relating to Tax Relief, Pensions Access and Economic Social and Governance (ESG) factors in the 2022 edition of the Framework

Three indicators are marked unrated this year due to gaps in either data or metrics required for assessment

Despite a wealth of published information on UK pensions, barriers related to harmonisation, consistency and data sharing mean that it remains difficult for individuals, providers and policymakers to achieve oversight of how the pension system is working to deliver adequacy, sustainability or fairness in later life. They also present a challenge to analysing trends in the UK Pensions Framework, and to informing conclusions which can help to determine the overall status of the system. Although data gaps are evident across the Framework, three specific indicators could not be rated this year.

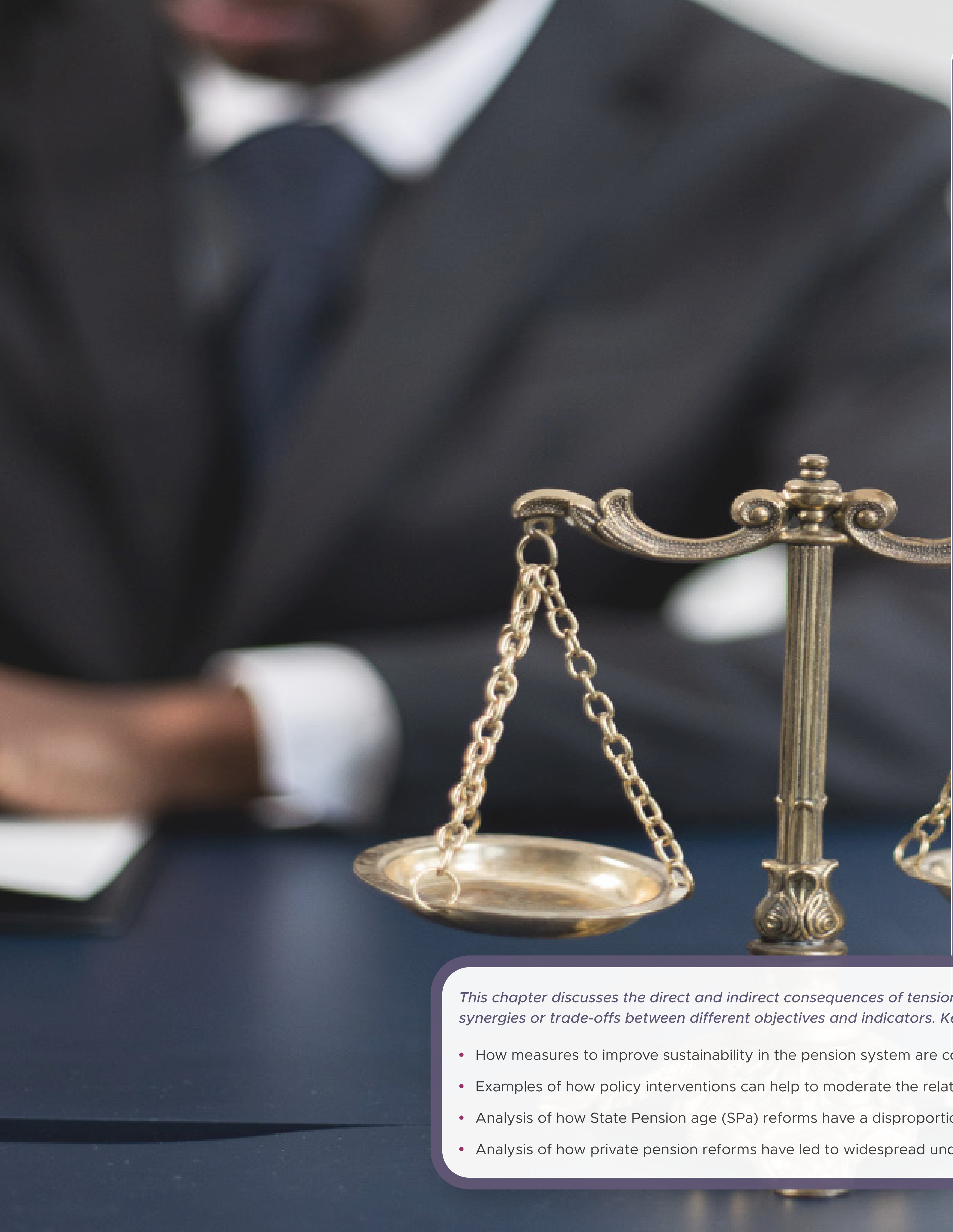
Pensions Access has not been rated because it is not yet possible to aggregate data across providers in order to understand how choices that people make about their savings relate to their overall financial position. Understanding an individual's overall position could provide information on the context in which decisions such as opting for drawdown, cash lump sums or annuities are taken, and therefore the extent to which they are likely to support adequacy, or the sustainability of adequacy, in retirement. Put simply, individual circumstances, experiences and expectations mean that what is right for one person is not necessarily right for another. Without this information, it is impossible to quantify whether people are making good choices around their retirement income. It is also particularly difficult to understand from an individual perspective how pension freedoms, one of the most significant policy reforms in recent years, could be impacting adequacy outcomes.[18]

The impact of **Tax Relief** from the perspective of adequacy, and specifically the extent to which it provides a saving incentive, could not be assessed, because inconsistencies in the reported value of data were discovered during the research process and preclude the assignment of an indicator outcome for 2022. Work to resolve these issues is ongoing and future indicator analysis will also take into account findings from the Treasury Committee, which is currently examining the role of tax relief in the UK pension system and the economy as a whole.[19]

Understanding the impact of **ESG** factors is an important metric for long-term financial sustainability of pension schemes. However, regulatory and reporting frameworks are relatively new, frequency and consistency of data collection is limited at present and there are still data gaps around embedding social factors into investment policies. The Framework team will monitor the availability of metrics and evidence on scheme behaviour, and, when appropriate and sufficient data is available to analyse the impact of ESG factors in the UK pension system, the indicator will become live.[20]

Pensions Policy Institute
PPI

[18] UK Pensions Framework Indicator Appendix (2022). Indicator A6.4
[19] UK Pensions Framework Indicator Appendix (2022). Indicator A3.7
[20] UK Pensions Framework Indicator Appendix (2022). Indicator S2.4



CHAPTER TWO:

TRADE-OFFS

This chapter examines how outcomes in the UK pension system can be derived from the changing nature of relationships between policy functions and objectives. It also looks at the potential implications of interactions and trade-offs for future pensions policy using two case studies: State Pension age Reform and Undersaving for Retirement

The main aims of this chapter are to:

- Examine how different components of the UK pension system relate to each other by using the Pension Policy Wheel to identify synergies and trade-offs in the UK pension system
- Expand upon findings related to trends in Chapter 1 by providing a high-level overview of key interactions between objectives and indicators that emerge from analysis of the UK Pensions Framework in 2022
- Use two case studies to present a more detailed insight into how relationships between policy functions and objectives can produce different outcomes for different population groups, and discuss what these outcomes could mean for future pensions policy

This chapter discusses the direct and indirect consequences of tensions and changes in the pension system, as well as the extent to which they are producing synergies or trade-offs between different objectives and indicators. Key areas of focus include:

- How measures to improve sustainability in the pension system are compromising improvements in adequacy and fairness on account of policy trade-offs
- Examples of how policy interventions can help to moderate the relationship between competing objectives or indicators
- Analysis of how State Pension age (SPa) reforms have a disproportionately adverse impact on people who are unable to work to retirement age
- Analysis of how private pension reforms have led to widespread undersaving for retirement, and low understanding over adequacy goals and how to achieve them

Key Findings

- Policy interactions and tensions exist across the UK pension system. They are evident not only in the way in which a change in one indicator could cause positive or adverse change in others, but also in how a shift in emphasis towards one system objective can result in a shift away from another.
- Trade-offs often arise from the ongoing need to balance changing economic, demographic and political risks to the pension system. They can also be the product of changes to system design which impact different groups in different ways.
- To improve outcomes in one or more areas of the pensions system it is sometimes necessary to reduce outcomes in others. However, some trade-offs can be mitigated by policy interventions that moderate the relationship between two or more components of the system, and their effects may diminish over time.

At any point in time, a shift in one objective or component of the UK pension system can, through a complex web of interactions and trade-offs, lead to a catalogue of impacts in others

Decisions about the development of the UK pension system, and about how to manage the economic, demographic, political, social and market risks it faces, invariably come with consequences for the State, individuals, employers, providers, the economy and society. The reason for these consequences is clear. No single component of the UK pensions system, nor the aims and risks associated with them, exists in isolation.

The PPI Pensions Policy Wheel demonstrates the widespread impacts of policy tensions, trade-offs and interactions that have evolved in response to continuous reassessment of priorities, principles and preferences over time.

Some interactions lead to synergies between components of the pension system, whereby improvements in one area can lead to improvements in another. Others however, lead to conflicts or trade-offs, whereby changes designed to improve one aspect of the pension system could adversely affect outcomes elsewhere.

At a high level, the clearest trade-off in the UK pension system today comes from the impact of changes which effectively increase responsibility for retirement risks among individuals. The result is improved **sustainability** for the State and employers, but a mixed picture of **adequacy** and **fairness** for people, among whom low- and middle-income households are most impacted. Whilst neither outcome is classified as a strong negative or a strong positive overall, without a greater emphasis on shared responsibility or an increase in financial resources, the tensions between these objectives will likely be a continued feature retirement outcomes in years ahead.

Upon further examination, underlying factors become clearer too. Without measures to improve Fiscal **Sustainability**, the impact of **Population Ageing** on sustainability would be considerably more negative. However, measures to improve **Fiscal Sustainability** are putting pressure on the adequacy of **State Support** provided to people in retirement, and in particular the extent to which the State Pension and **Means-tested Benefits** protect people against **Poverty** or a fall in **Living Standards** in later life. Similarly, measures to improve **Financial Sustainability for Employers** are leading to low **Defined Contribution (DC) contributions**, which overall offset the positive impact of increased **DC Coverage** on adequacy in the private pension system. Were employer contributions to be increased as a way to improve adequacy however, changes could have a potentially adverse impact on **Employer Sustainability** or even **Earnings**, particularly as more than half the workforce are employed by Small to Medium Enterprises (SMEs). Despite record pension participation, high levels of self-employment and automatic enrolment eligibility criteria related to age and earnings have negative implications for **Inclusion**, and the growing need for **Engagement** with pension decisions in retirement is highlighting risks that people face from differing levels of financial capability. There are also tensions within **Choice and Defaults** between the need for people to choose how they manage their retirement and their need to be protected by **Safety Nets** from adverse outcomes, some of which may be the product of having too much choice as a result of system design.

As well as highlighting trade-offs, the PPI Pensions Policy Wheel can help identify where synergies exist and where policy interventions could be used to moderate tensions between system objectives.

Extensive reforms aimed at **Protecting Savers** from differences in levels of **Engagement** and financial capability through a system of **Choices and Defaults** are contributing to fairer outcomes, improved System Stability, and ultimately improved **System Design**. They also help to offset the added **Complexity** that DC arrangements bring to the private pension system, alongside the benefits of the simpler **new State pension (nSP).** In recent years, above inflation rate increases in the State Pension brought about by the triple lock, coupled with good long-term investment returns and high levels of **Home Ownership**, have contributed to modest increases in disposable Retirement Income. However, the benefits are not felt equally amongst all groups and **Differences Between Groups** remain significant. To tackle these differences, the **nSP** is aleady improving retirement adequacy and reducing dependency on means-tested benefits among low-income households, but full effects will take time to emerge as the proportion of retirees claiming the **nSP** grows over time. A series of frameworks designed to support long-term policy commitments and protect retirement outcomes, such as the SPa review and the triple lock, will remain critical to **System Stability** over time.

Figure 2.1: To show how synergies and trade-offs are driving outcomes in the UK pension system, the PPI Pensions Policy Wheel can be rearranged by indicator outcome from positive to negative

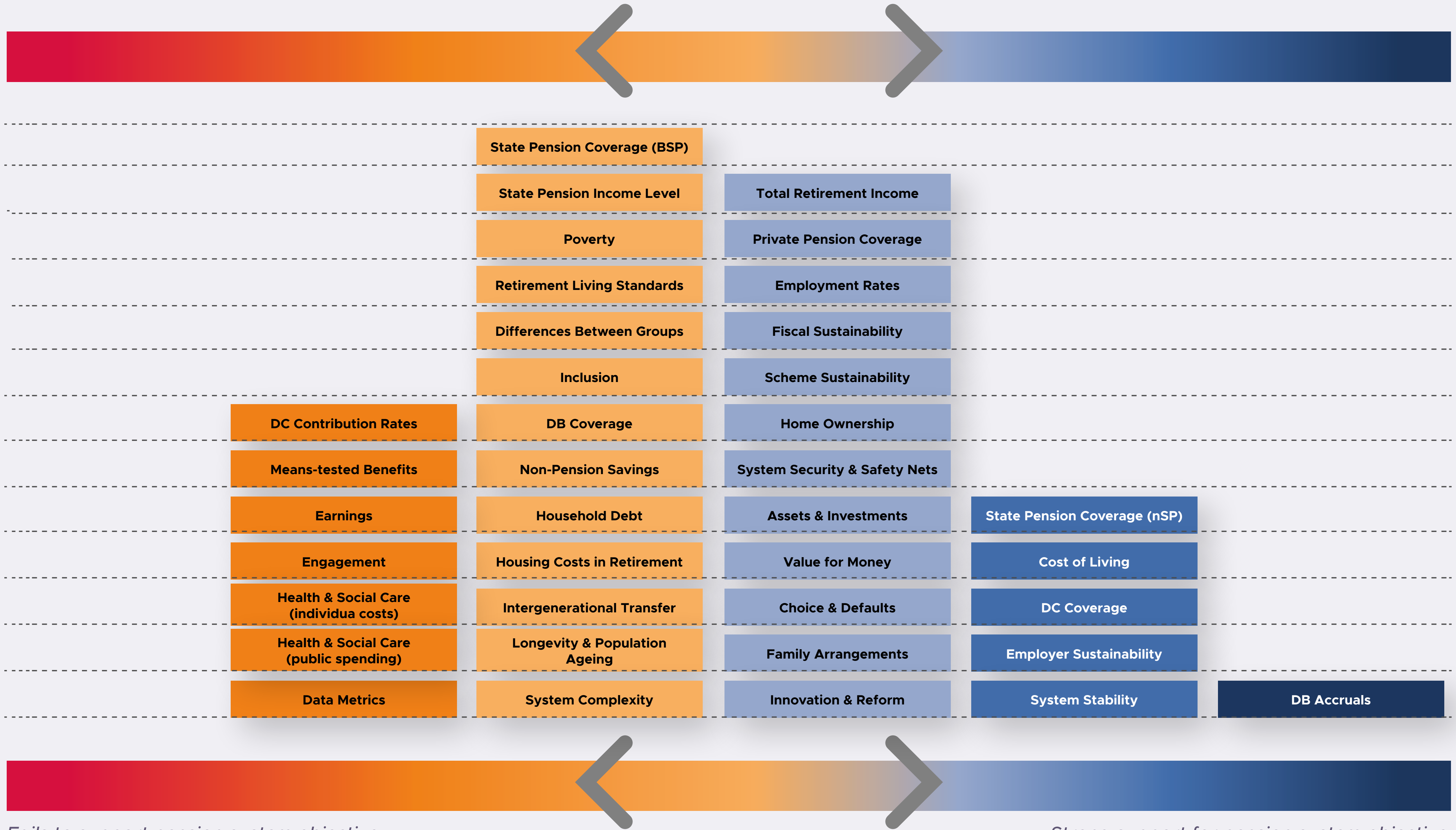


Figure 2.1 shows that indicators which positively impact pension system objectives are often those which compete for economic and political capital with those that have a negative impact. For a specific indicator to improve and move right along the chart, it is therefore possible that policy trade-offs could adversely impact other indicators which, in turn, would move to the left.

For example, low levels of **Defined Benefit (DB) coverage** outside the public sector have a somewhat negative impact on private pension saving and overall adequacy. However, for the benefits associated with DB pensions to become more widely available in the current demographic and economic climate, a solution would be needed to mitigate tensions between the value or structure of **DB Accruals** and benefits in their current form, and **Employer Sustainability**. Compromising affordability for employers could present a potential risk to **Employment Rates** and **Earnings**, particularly at older ages. However, since the impact of the shift from DB to DC effectively transfers longevity risk from employers to individuals, essentially improving sustainability at the expense of adequacy, an alternative form of collective risk-sharing structure such as Collective Defined Contribution (CDC) schemes could offer a potential way to improve outcomes by moderating the relationship between competing objectives and sharing risks more evenly.

Case Study 1: State Pension age reforms

A series of major policy reforms, including SPa increases, the flat-rate nSP, and the Triple Lock are transforming the State Pension system, with the aim of:

- improving fiscal sustainability and reducing the long-term cost of the State Pension;
- providing people with a solid base upon which to build voluntary savings for a good retirement income;
- reducing dependency on means-tested benefits by improving income among poorer households; and
- reducing complexity and helping people to be more aware of what they should receive at SPa, and what they need to save for an adequate retirement

This case study uses analysis from the UK Pensions Framework to look at how increases in SPa are leading to trade-offs between fiscal sustainability and adequacy, the outcomes for which are different depending on whether people retire just before or just after retirement age.

SPa reforms are mitigating the impact of Population Ageing on Fiscal Sustainability, but trade-offs adversely impact adequacy, particularly for people just under SPa.

Since the State Pension was introduced over 100 years ago, there have been many important changes to what people get, when they get it and how they claim it. The basis for many of these changes has been the need to respond to risks that challenge the long-term sustainability of the system, the adequacy of income that it provides people in later life, and the fairness of the way in which costs and benefits are distributed across and between generations.

In recent years, demographic change has emerged as a significant risk to the long-term stability of the pension system and has prompted the need for several major policy reforms. SPa increases are one of them. Among women, SPa rose gradually from age 60 in 2010 to age 65 in 2018, before rising again to age 66 for women and men in 2020. Introduced in response to a sharp rise in life expectancy which at age 65 had risen by almost half in less than 40 years, the changes have driven a number of significant direct and indirect consequences across the UK pension system.

Increases in SPa are offsetting the impact of demographic change on public spending by reducing the size of the population over SPa.[21]

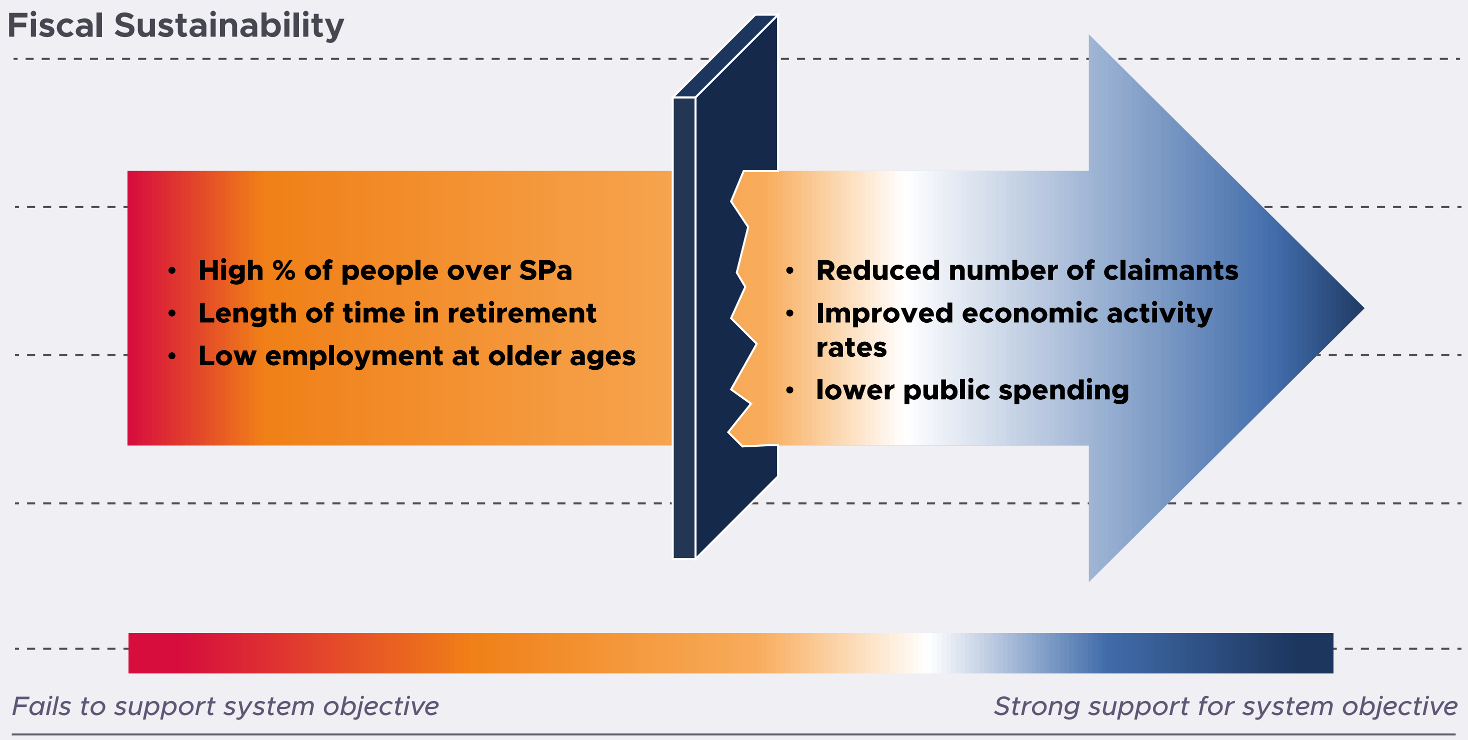
By most measures, spending on retirement benefits fell slightly throughout the late 2010s, as the effects of an ageing population were partly offset by an increase in SPa that reduced the proportion of people in retirement. The result of reforms is that, despite rising longevity and a shrinking working-age population, the number of adults over SPa per 1,000 adults under SPa fell from 312 in 2010 to 280 in 2021. Over the same period, the ratio of economically inactive adults to economically active (which accounts for adults of working age who are economically inactive, and adults over SPa who are economically active) fell from around 590 per 1,000 in 2000, to 570 per 1,000 in 2020, before rising to 581 in 2021 due to workforce changes over the pandemic.[22]

In 2020-21, spending on retirement benefits totalled £114bn, representing 10% of total public spending, 46% of the social security budget, and 5% of GDP. The State Pension, the largest item, accounted for 41% of the social security budget at a cost of £101 billion.

SPa reforms are not only reducing the size of the population with access to pensioner benefits, but they are also increasing the size of the working population which supports them (Figure 2.2)

Behind these changes, employment among women aged 55 to 64 rose by almost 10% to 67%, as rising SPa meant that more women stayed longer in the labour market. Among men of the same age, employment rose by just 3%. For both men and women, the proportion of people working over age 65 roughly doubled over twenty years to 2021, reaching 14% and 8% respectively. However, employment among older workers fell during the pandemic, particularly men aged 55 to 64, among whom the employment rate fell by more than 2% between 2019 and 2021.

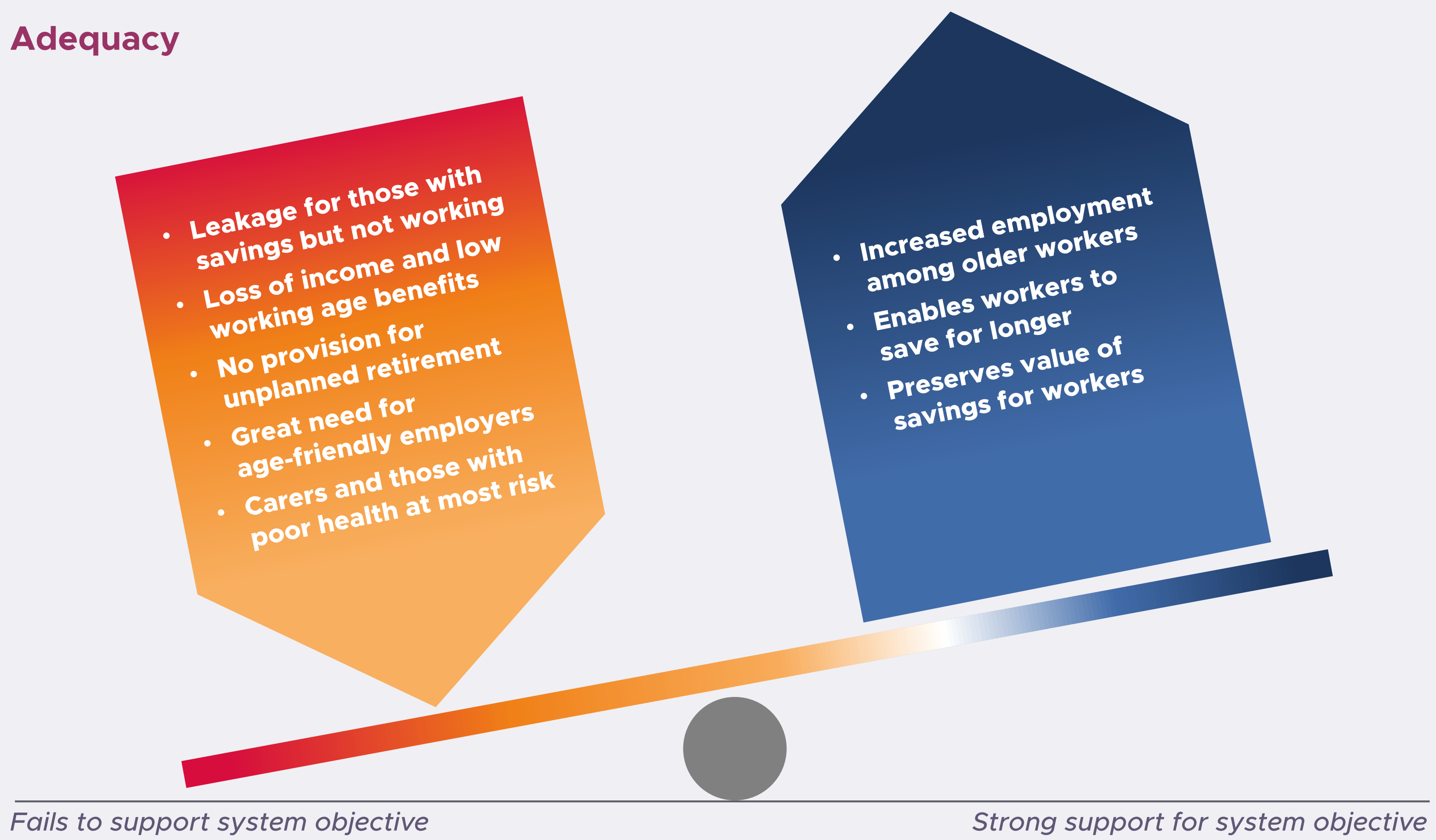
Figure 2.2: SPa reforms are leading to improved fiscal sustainability through lower public spending on retirement benefits



SPa is due to rise to age 67 by 2028 and age 68 by 2039, with the objective of maintaining a formal link between pension age and life expectancy, whereby people spend no more than one third of their adult life in retirement. However, the forecasted rates of growth in longevity that underpinned these plans have not materialised and life expectancy has stalled in recent years.[23] Instead, recent research has suggested that based on actual data, the increase in SPa from 66 to 67 could be delayed by more than twenty years whilst still maintaining pace with life expectancy, allowing over 20 million people to access retirement benefits a year earlier than had previously been planned.[24] This is important, because, as Figure 2.3 shows, SPa increases come with a multitude of different impacts upon adequacy for individuals, some positive and some negative, with the poorest households, carers and those with poor health or disabilities, at greatest risk.

[21] UK Pensions Framework Indicator Appendix (2022). Indicator S2.1
[22] UK Pensions Framework Indicator Appendix (2022). Indicator S1.1
[23] UK Pensions Framework Indicator Appendix (2022). Indicator S1.1
[24] LCP (2021)

Figure 2.3 SPa reforms provide access to some additional adequacy for those who are able to work until later ages, but present a major risk to adequacy among those who are just under retirement age but unable to remain in employment



Increases in the proportion of people working to older ages can positively impact employment and adequacy prospects in the UK pension system, enabling people a longer period of time over which to accumulate pension contributions and preserve the value of their savings.

Although future SPa increases would further improve fiscal sustainability in the UK pension system, without the expected increase in longevity, trade-offs with adequacy at the individual level would likely be felt more acutely and by more people. Reducing the length of time that people spend in retirement, and essentially the length of time that they have access to retirement benefits, means that many people face a difficult choice over when and how to retire as they approach later life.

For those who continue working, the expansion of age-friendly working environments and roles which support the retention, retraining and recruitment of older workers will continue to be critical to ensuring that good jobs and working conditions are available to those who want them. For many workers, flexible working can also help to bridge into retirement. In 2021, 63% of workers over 65 were part time, twice as many as those aged 55 to 64.[25]

However, regional differences in population health mean that in some areas, people may need to leave work as much as six or seven years before reaching SPa, whereas in others, the majority would be able to continue working to SPa.

On average in 2021, women left the labour market more than two years before reaching SPa. In comparison, men left the labour market around six months before reaching SPa, and the gap between men and women has widened as SPa has increased.[26] Underlying these figures, however, is extensive variation based upon personal circumstances, not least the time that the typical adult can expect to live in good health. Overall, years in poor health have risen faster than years in good health because life expectancy has generally risen faster than healthy life expectancy (HLE).[27 28]

For many people, remaining in employment may not be straightforward and outcomes associated with leaving the labour market before SPa can be particularly challenging for women, poorer households and those with health conditions or caring responsibilities.

HLE can impact caregivers too. For people with disabilities and health needs, support from individuals and family members (informal care) is essential to maintaining wellbeing and independence. However, caregiving responsibilities can significantly reduce the amount of time that people are able to spend working, with older workers and women most likely to be affected. The number of people over 50 who were eligible for Carer's Allowance, because providing informal care was their main role, rose to 1.26m in 2021, an increase of 25% since 2011. Of these, two in three was a working-age adult.[29]

In 2020/21, around 4.2 million people were providing informal care, of whom:

- More than half were women
- Only half were in full-time employment
- Half provided at least 19 hours a week of care
- Half cared for someone in their household
- People aged 45-64 were most likely to be carers and least likely to return to work after caregiving ended

SPa reforms have a disproportionately poorer impact on low-income households where people are unable to work to SPa, because working-age benefits are considerably lower than pensioner benefits

One of the most important challenges facing people who leave work before reaching SPa is how to fund a significant loss of income and period of time without access to pensioner benefits, but relatively low levels of engagement and retirement planning suggest that many people are likely to be unprepared for what might happen if they need to leave work early. Despite the high proportion of people who will depend on the State Pension for more than half of their retirement income, only around half of UK adults have checked their SPa and only two in five have checked how much they are likely to receive from the State Pension in later life. When looking for information, advice or guidance to help plan for retirement, around three-quarters of people aged 40 to 75 who were not retired had used at least one source, and a quarter had not consulted any information at all, although awareness is likely to improve when pension dashboards are released.[30]

Among individuals with adequate private provision, a degree of leakage in the years approaching SPa may be an acceptable trade-off in return for leaving work. Among those with lower levels of saving, however, leaving work early is likely to prompt a difficult decision between jeopardising long-term adequacy or financial resilience by drawing upon pensions or savings sooner than anticipated to, or facing a potential drop in living standards until retirement benefits can be accessed.

Those at greatest risk from an unplanned exit from the labour market and rising SPa are the poorest households, where losses that result from a transition to working-age benefits represent the largest share of income.

The gap between the working and retirement age benefits has been widening for more than twenty years. For people reaching SPa in 2021-22, the full nSP was worth £179.60 per week, or 29.4% of average weekly earnings. For a single person just under SPa, however, the basic benefit was just £77.28, or 12% of median weekly earnings before adjusting for other entitlements such as housing costs, disability or carer's allowance.[31] In August 2022, around 417,000 people over 60 were claiming Universal Credit, an increase of around 10% over one year and 30% over two years. Around four in five of these people were not in employment.[32]

Developing practical solutions that can help to mitigate the trade-offs associated with rising SPa will require coordinated response from the State, employers, providers and individuals

At the heart of trade-offs is the notion that those most affected fall between two policy systems – working-age benefits and pensioner benefits. For many people, it is unaffordable, if not impossible, to set aside sufficient private savings to cover the loss of income that could result from an unplanned labour market exit. Were the State Pension higher, early access in return for reduced payments could offer one solution, but, for some, this would reduce long-

[25] Pensions Framework Indicator Appendix (2022). Indicator A1.1
[26] UK Pensions Framework Indicator Appendix (2022). Indicator A1.1
[27] DWP (2022)
[28] ONS (2022b)
[29] UK Pensions Framework Indicator Appendix (2022). Indicator A5.4
[30] UK Pensions Framework Indicator Appendix (2022). Indicators A6. 1 and F1.2
[31] UK Pensions Framework Indicator Appendix (2022). Indicators A2.3
[32] DWP State-Xplore

term retirement income to below that of the threshold for means-tested benefits.

For those who do have private savings but want to cut their hours and supplement income with a private pension, relatively few schemes offer flexible or partial access to savings that could help people meet their needs in a straightforward way. Initiatives that can help people to work longer, expand age-friendly work environments, support healthy ageing initiatives, and provide carers with the support they need to look after their loved ones without having to give up work, will all be important. However, none of these interventions can provide the income that some will inevitably need to avoid an unexpected drop in living standards. The step towards a solution will be firstly to determine which area of the benefit system is responsible for supporting those who effectively retire before reaching retirement age. The second will be to develop coordinated approach between employers, providers and individuals that can better allow people the flexibility they need to adapt to changes in later life.

SPa Reforms – Policy Insights from the UK Pensions Framework

- It will be important to **revisit the basis of planned SPa increases** to assess the extent to which future changes could be detrimental to adequacy and fairness
- The benefits of SPa reforms for retirement adequacy are only available to those who can continue working to retirement age. **People unable to work to SPa face risks to adequacy from** loss of income or pension savings leakage.
- There are limitations to the extent to which **pensions policy can** mitigate issues that arise from **working-age policies**
- Policies aimed at **narrowing the growing gap in support available to people before and after SPa** can protect low-income households below retirement age, including those with poor health or disabilities, from a disproportionate fall in living standards
- **Increasing levels of engagement** with retirement planning can help people to prepare for a potentially unplanned period of time without access to pensioner benefits
- Ongoing support to **help employers adapt to an ageing workforce, and to help individuals adapt to a changing labour market**, can help older people (particularly those with health concerns or caregiving responsibilities) stay in work longer
- Initiatives to support families and communities by **mitigating the impact of caregiving on employment** can help to reduce the number of people who face a choice between working and caregiving that could put adequacy at risk in later life

Case Study 2: Undersaving for Retirement

Shifts from DB to DC are the product of tensions between providing adequacy and achieving financial sustainability in the UK pension system. However, the tendency for policy reforms to prioritise pension participation ahead of pension adequacy in recent years has led to concerns that people may be at risk of a retirement income crisis because they do not know how much they need to live on, or how long their savings will need to last. To save enough for retirement, most people need:

- to be enrolled in a workplace pension and contributing 12% to 16% salary a year; or more in the event they need to make up for unplanned time out of work or pension saving
- the value of their earnings, benefits and savings to keep pace with, or exceed, inflation
- to minimise pressures on savings from costs such as charges, outstanding debt or renting in later life
- to have sufficient financial resilience to navigate periods of high expenditure or low income without dipping into retirement savings

The PPI Pensions Policy Wheel highlights how changes are improving affordability but making it harder for individuals to accumulate savings that can meet their needs in later life. This case study examines why, and what could be done to moderate the trade-off.

Automatic enrolment is mitigating the trade-offs between improved Financial Sustainability for the State and employers and falling Adequacy for individuals by increasing Overall Pension Coverage, but trade-offs adversely impact DC Contributions and future Retirement Income for DC savers, particularly those in low and middle-income households.

Over 90% of all current DC savers may be at risk of not saving enough to replicate working life living standards through retirement, and anyone earning more than £12,700 per year in 2021 will need to contribute to a workplace pension if they are to meet target replacement rates set by the Pensions Commission in 2004. However, as DC pensions increasingly provide the bedrock of an adequate retirement income, typical contribution rates of 8% will not be sufficient for many people to meet objectives in later life.[33]

The shift from DB to DC in the private sector is well documented, and almost half of all employees now have DC pension savings.[34] DB schemes are intended to provide a level of income that allows people to maintain a standard of living in retirement that is commensurate with working life. The primary focus of this case study, therefore, is on workers who are not in DB schemes, and for whom State Pension income is not enough to provide adequacy in later life.

Adequacy can be measured in different ways, but PPI forward projections of pensions held by those aged 50 to 65 in 2021, using State and private pension income and excluding 25% tax-free lump sums (after allowing for housing costs), found that the following.

- **A quarter of people** (around three million) risk not reaching the Joseph Rowntree Foundation's (JRF) Minimum Income Standard (MIS) in retirement, and single-person households are around **four times** more likely to be at risk;
- **Only one-third** of people can expect a 'Moderate' retirement and one in ten 'Comfortable' under definitions of the Pensions & Lifetime Savings Association's (PLSA) Retirement Living Standards;
- **Only around a half** of people can expect to maintain a personally acceptable level of income in retirement compared to Pensions Commission replacement rates; and
- The challenge of maintaining acceptable incomes, as defined by replacement rates, is **greatest for the highest paid**, with 77% of those in the top quintile missing the target, in contrast with only 3% of the bottom income quintile.

In 2020-21, spending on retirement benefits totalled £114bn, representing 10% of total public spending, 46% of the social security budget, and 5% of GDP. The State Pension, the largest item, accounted for 41% of the social security budget at a cost of £101 billion.

The principal reasons for undersaving are not belonging, or not making sufficient contributions, to a workplace pension scheme for a period of time during working life, but policy design and economic climate have an increasingly important role to play in preventing the erosion of pot value.

Although employment had not quite recovered from the dip that followed pre-pandemic highs, more than 78% of men and 75% of women aged 16 to 64 were in employment in Q4 2021, and unemployment of 3.8% was approaching a record low.

Employment rates are a key driver of adequacy because they indicate changes in the proportion of people able to accumulate wealth for retirement saving through workplace pensions. Framework analysis shows that a rise of around 5% in employment over ten years is partly explained by an increase in people working to older ages, in part due to increases in SPa. Among women aged 55 to 64, 67% were working in 2021 compared to 59% in 2011, rising from 71% to 75% among men of the same age.

Of those in work, the proportion in full-time work is also higher than the average over ten years, but the gap between men and women in full-time employment widens with age. Until age 55, more than 90% of male workers were in full-time employment compared to 72% of women under 40 and 64% of women aged 40-54. A considerable gap opens up between ages 55 to 64, when the share of female workers in full-time employment fell to 55%, compared to 84% among men.

A relatively buoyant labour market has been somewhat supporting adequacy by increasing the proportion of people who can accumulate wealth ahead of retirement, and the income that they receive over their lifetime. But persistent differences in work and saving patterns highlight continued risks to adequacy for women, the self-employed and ethnic minority groups.

On average, women spend just over half their adult life in work, while men spend around two-thirds in work, although not all in full-time work.[35] Together, increases in overall employment, working to later ages, and the proportion of workers in full-time work, help people to stay on track with target contribution rates. This is in part because any period spent not contributing due to time out of (or reduced hours in) the labour market would require increased, and often unaffordable, contributions during working years to make up for a shortfall in saving. However, the cumulative effect of gender gaps in employment patterns, and the number of years that people work, continues to produce significant differences in savings outcomes in later life.

The proportion of both eligible and ineligible employees participating in workplace pensions has risen to near record levels in the public and private sectors, but one third of the workforce, including more than four in five self-employed workers, was not participating in a workplace pension in 2020.

Automatic enrolment has led to record levels of **Overall Pension Coverage**, as the proportion of eligible employees contributing to workplace pensions rose from 45% in 2010 to 86% or around 14 million people in 2020 in the private sector, and from 89% in 2010 to 94% or around five million people in 2020 in the public sector. Participation among ineligible employees also rose from 19% to 34% over the same period, as 70% of employees in the public sector and 30% of those in the private sector who did not meet qualifying criteria were opted into a workplace pension.

Despite unquestionable success in improving **DC Coverage**, however, the high proportion of workers who either do not qualify, or do not save into, workplace pension saving remain a concern for future levels of retirement adequacy. Among the self-employed, of whom around 4.4 million people made up approximately 14% of the total workforce, just 16% of people were members of a workplace pension scheme in 2020, down from 21% a decade earlier. Among employees, groups least likely to be saving included those on low incomes (£10,000 to £20,000

[33] Hurman et al (2021), PLSA (2018), Redwood et al (2013)
[34] UK Pensions Framework Indicator Appendix (2022). Indicator A1.1
[35] UK Pensions Framework Indicator Appendix (2022). Indicator A1.1

per year), and workers from ethnic minority groups, among whom participation was as low as 63%. There was no significant gap in participation between men and women.[36]

A typical DC saver is only contributing around half of what they would need each year to meet the Pension Commission target replacement rate of two-thirds of working-life income at retirement, throughout later life.

Altogether, almost 11 million workers, or one-third of the workforce, were not participating in a workplace pension scheme in 2020. Of these, two thirds or 7.2 million people were either ineligible or self-employed, and one third or 3.7 million people were eligible, but not saving.

In 2021, around half of all employees in DC schemes received employer contributions of 4% of salary or less and around half made employee contributions of 4% or less. Findings suggest that, although average **DC Contributions** are closer to 10%, the typical worker is saving no more than 8% a year into a workplace pension. Despite being in line with the automatic enrolment minimum, rates are around half of the 12% to 16% that most people are expected to need to replicate working life living standards in retirement. At the time of designing the policy and after significant consultation, however, an initially low rate of minimum contributions was considered a necessary trade-off in return for the primary objective of increasing pension participation, in order to mitigate the risk that higher rates could put pressure on affordability for employers and individuals, and reduce the likelihood that people opt out of the system.

The difference between average and typical contribution rates is likely explained by the minority of people who contribute above the minimum rate. Some of these savers may be incentivised to pay higher contributions through employer matching schemes and tax relief, and the likelihood of increasing contributions rises with age and understanding of the pension system. The combined effect of differences in employment patterns, contribution rates and uptake of savings incentives have a considerable impact on adequacy outcomes in later life. As Figure 2.4 shows, under current policy it will be difficult for anyone with non-standard employment patterns, or anyone not contributing considerably more than the minimum at some point, to accumulate enough retirement wealth to meet replacement rate adequacy targets by the time they reach SPa.

Figure 2.4 Comparison of total net combined retirement income from State Pension and workplace pensions; and as a proportion of median earnings, for linear and non-linear workers, at Spa.[37]

	Contributes 9% throughout employment	Contributes 9% to age 40 and 16% thereafter	Contributes 16% throughout employment
Linear Laura 40-year-old median earner who has worked full time since 22, retires in 2050 age 68 with full State Pension.	**54%** **£259,026** £16,122 per year	**61%** **£289,062** £18,469 per year	**69%** **£320,896** £20,597 per year
Non-Linear Natalie 40-year-old median earner, worked from age 22 to 26, took a career break to have children, returned to work part time age 40 at 0.4 FTE, retires in 2050 aged 68 with full State Pension.	**41%** **£209,365** £12,246 per year	**43%** **£216,521** £12,800 per year	**45%** **£233,756** £13,366 per year

Just one in five DC savers receive contributions of more than 10% from their employers, compared to nine in ten with DB pensions, whilst just one in thirty receives contributions of more than 20%, compared to half of those with DB. Just one in eight DC savers contributes more than 6% of earnings to their pension, compared to three in five with DB.[38]

The low proportion of people contributing at higher than the minimum level may be explained in part by low **Engagement** with DC pensions. Reasons behind poor engagement are complex, from not understanding future needs, inherited social norms and underestimating life expectancy, to reliance on other potential sources of retirement income.[39] However, low engagement may also, in part, be a consequence of automatic enrolment design. Automatic enrolment eliminates the need for people to make an active decision around whether to join a pension scheme by leveraging behavioural biases including inertia, and the tendency for people to have a short-term (or myopic) outlook on their circumstances. However, reliance on inertia presents the risk that, once enrolled, people remain disengaged from active decision making and instead remain opted into a series of pre-determined defaults around contribution rates, investment pathways and charges that may not necessarily meet their needs for retirement. To deviate from these defaults, people need to both actively engage with their pensions and have an appropriate level of understanding of the system. However:

- **half of all** active DC savers has low or very low engagement with pensions.
- **one in three** DC savers under 60 does not know how much income they will need in retirement.
- only **one in five** DC savers had thought a lot about how much they should be contributing to their pension, and two in five hadn't considered it at all.
- **two in five** DC savers do not know how much they / their employers pays into their pension.[40]

Low levels of engagement may also be partly explained by poor financial literacy, which is found among around 20% of the population, as well as poor understanding of the pension system and of how much people need to live on in later life. Given the need for people to engage with savings to optimise their outcomes, particularly at retirement, these issues have a negative impact on **Inclusion**, with women and low earners at greatest risk. Overall, less than 20% of people report a good understanding of the pension system, 20% find it difficult to keep track of pensions, and only half of people with DC pensions in accumulation report receiving and understanding their pension statement.[41]

Traditional economic incentives (such as tax relief and matching) aimed at helping people save adequately for retirement and reassuring them that it "pays to save", are an important policy response to population ageing. However, they assume that people make rational decisions to change their behaviour, but evidence of the impact they have on adequacy, coupled with the trade-offs that exist with financial sustainability and fairness, is hard to evaluate. In contrast, behavioural based incentives are designed to channel behaviours towards optimal outcomes, but their impact is equally uncertain. There is growing consensus that mitigating risks of undersaving will require policies that integrate a combination of economic and behavioural approaches, alongside other measures including regulation and support for decision making.

Other factors which signal a negative outlook for the value of savings at retirement include recent real-term declines in **Earnings** and the value of the **nSP**, rising levels of **Household Debt, System Complexity**, falling levels of **Home Ownership** at younger ages, generally low and uneven levels of financial resilience and **Non-pension Saving**. Others include the unpredictable nature of **Intergenerational Transfers**. Furthermore, a complex system of **Tax Reliefs** and allowances provides unequal benefits across different income groups and means that those who exceed allowances face difficult decisions around paying higher taxes, retiring early, or looking for other ways to save and invest.

[36] UK Pensions Framework Indicator Appendix (2022). Indicators A3.1, A3.2, A3.3 and F2.1
[37] PPI Analysis of LFS (2022) and OBR (2021)
[38] UK Pensions Framework Indicator Appendix (2022). Indicators A3.4 and A3.5, Hurman et al (2021), PLSA (2018), Redwood et al (2013)
[39] Hardcastle (2013)
[40] UK Pensions Framework Indicator Appendix (2022). Indicator F1.2
[41] UK Pensions Framework Indicator Appendix (2022). Indicator F1.1

However, **Investment Returns** and measures to improve **Value for Money** have generally benefited adequacy in recent years, despite inconsistent performance over the course of the pandemic.

Developing solutions that can help to mitigate against widespread undersaving and improve automatic enrolment outcomes among DC savers will require an integrated, coordinated and long-term approach from the State, employers and financial services providers.

There is a fast-growing need for long-term, sustainable solutions to mitigate the trade-offs between financial sustainability and adequacy in the pension system that are driving undersaving among individuals

In recent years, the focus of pensions policy has been, somewhat necessarily, on increasing participation in retirement saving, but relatively few major reforms have been directed towards increasing the adequacy of pensions at retirement. The result is that more people are saving for retirement, but the majority are not saving enough, and several measures, some beyond the scope of automatic enrolment, will be necessary to improve saving levels. They include:

- maintaining high levels of employment and supporting people to work to older ages;
- widening automatic enrolment coverage to include the self-employed, younger workers and multiple job-holders, and particularly those in ethnic minority and low-income groups;
- leveraging or reforming existing policies to increase minimum contribution rates to between 12% to 16%;
- Implementing the recommendations from the 2017 automatic enrolment review, which include lowering the age threshold from 22 to 18 and calculating contributions from the first pound;
- making the pension system, and in particular the pension tax system, less complex and easier to understand, with better data and more clearly targeted policies;
- providing people with greater information to help them save and keep track of their pensions, while also providing appropriate defaults for those who choose not to engage with their savings; and
- considering how traditional economic and behavioural incentives can be combined to reduce undersaving, such as using automatic escalation to gradually increase employee contributions in line with wage increases over time.

At the heart of undersaving are questions over who should be responsible for retirement outcomes, in what capacity, to what degree and to what extent trade-offs between adequacy, sustainability and fairness are acceptable. Initiatives to help people better understand what they need from their retirement savings and how to achieve it are important. On their own, however, they are not the solution to undersaving. Instead, solutions are likely to require a steady and coordinated approach to ensure that those who choose to engage and those who choose not to, along with those can afford to pay more and those who cannot, receive the support they need to achieve the best possible outcomes in later life.

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- To address undersaving, future pensions policy will need to put **greater emphasis on adequacy** without compromising affordability and participation rates
- **There is a need for greater flexibility** in the labour market and in the pension system to better reflect the changing nature of longer working lives, less linear career paths, and variation in the mix of income and assets that people have when they reach retirement
- Many people will be faced with difficult decisions over **competing short and long-term pressures on personal finances** in the months ahead which, in the event people temporarily opt out of pension saving, could exacerbate long-term concerns over undersaving
- **Adequacy outcomes are sensitive to indexation** used for State Pension and benefits, and to the impact of potential economic downturns on private pensions including on unemployment, earnings growth, interest rates, inflation and investment returns
- There is a need for reforms to make the DC pension system **less complex and more accessible**
- There is continuing need to understand **how savings behaviours are determined** by individual circumstances, financial capability, social norms and the trust people have in the system, as well as economic and rational influences
- For reforms to be effective, particularly when they come at a cost or have varying distributional impacts within or between generations, people need to be **reassured of the benefits of saving** in order to preserve trust and confidence
- Future policy design can benefit from employing **both traditional economic and behavioural incentives**, neither of which has been found conclusively successful in isolation, along with robust regulatory frameworks and support for decision making

CHAPTER THREE:

TRANSITIONS

This chapter explores how the UK pension system is evolving in response to demographic and socioeconomic change, and how outcomes in the Pensions Policy Wheel reflect the progress of the transitions that changes how brought about in the UK pension system. It also analyses the extent to which transitions are shifting the balance between system objectives over time.

The main aims of this chapter are to:

- Explore how transitions in the UK pensions system are shaping the changing nature of the pensions landscape that exists today
- Expand upon findings related to trends and trade-offs in Chapters One and Two by examining the extent to which they may be driving, or driven by, transitions in the UK pension system
- Examine how transitions are producing policy interactions and trade-offs that could shift the balance between adequacy, sustainability and fairness in the UK pension system

This chapter discusses how overall shifts in responsibility and risks associated with providing retirement income from institutions to individuals are impacting adequacy, sustainability and fairness in the UK pension system by examining four key changes transitions:

- Greater responsibility on the part of the State for providing minimum income to marginalised groups
- The transfer of responsibility for generating earnings-related retirement income to employers
- The transfer of responsibility and risks associated with building, accessing and sustaining an adequate retirement income to individuals in the private sector
- The increasingly important role of the State in providing a fair and sustainable pension system to support retirement saving

Key Findings

- Shifts in the ownership of risks away from institutions, including the State, employers and financial services providers, and towards individuals are improving overall measures of sustainability, but jeopardising adequacy and fairness as people face decisions that they did not have to worry about in the past
- Although individuals bear greater responsibility for financial wellbeing in retirement, the State and other key stakeholders still have a role to play in risk-sharing and supporting fairness by creating the conditions necessary for people to achieve adequacy in later life
- Changes in the pension system have led to a more straightforward State Pension system and a more complex private pension system
- There is continued need for practical solutions that can help people to manage their risks in retirement, and to mitigate the risk of poor outcomes for those who do not engage with the system
- Transitions in the pension system are leading to shifts in the concept of what constitutes a pension, as savings pots increasingly replace guaranteed income streams in retirement

The PPI Pensions Policy Wheel demonstrates how transitions in the ownership of risks from the State and employers to individuals are improving sustainability but affecting fairness and jeopardising adequacy in the UK pension system

Had the PPI Pensions Policy Wheel been available ten or twenty years ago, it would have looked very different to today. Fast forward to 2022, and the first UK Pensions Framework analysis shows a picture of how a pension system inherited from the twentieth century is responding to socioeconomic and demographic change in the twenty first. It also shows how rapid shifts in the responsibility for retirement outcomes are addressing challenges and complexities in some areas of the system, while creating new ones in others.

Underpinning changes are trends that have included increasing longevity, low-interest rate economies, changes in financial regulation and advances in technology. Together, these trends have increased the need for greater levels of financial sustainability in the pension system which is, in turn, driving a pattern of risk transfer away from institutions such as the State, employers and financial service providers, towards individuals.[42]

Compared to the past, when many of the risks and responsibilities associated with retirement saving were shared, divisions today are clear. The State oversees a system in which people can generate the income they need to maintain living standards through later life, and the State Pension provides a foundation for saving. Employers provide and contribute to workplace schemes that allow people to generate earnings-related retirement income, but, overall, it is largely individuals who are responsible for determining how much to save, how to invest and access their savings, and how long their savings might need to last.

The result is a pension system in transition, and its progress is evident in the Pensions Policy Wheel. Reforms that relate to the early stages of the transition, in which measures designed to improve long-term **financial sustainability**, simplify the **new State Pension** and increase **DC coverage** were introduced, are already showing positive outcomes in respect of their objectives.

Measures that relate to later stages of transition, however, with a focus on addressing the impact of policy interactions and trade-offs brought about by changes and measures, show that solutions to ensure the system can help to secure **fair** and **adequate** retirement outcomes for individuals are either not yet fully developed, or not yet accessible to everyone. They also suggest that although a lot has been achieved in a short period of time, several major policy reforms are still relatively recent, the DC market remains relatively young, and that although some aspects of pension saving have become more straightforward for individuals, others have become more complicated. This means it will take time for the benefits of new policies to become embedded in the system, as industry and policy structures adjust to the change, and further interventions can help to ensure that people are able to achieve outcomes that meet their needs more equally, even if they choose not to engage with their pensions.

Transitions are taking place in both State and private pension systems, where the role of each is now clearly defined. Earnings-related retirement income is a major contributor to financial security in later life, allowing people to voluntarily supplement State Pension income to a level that better reflects their living standards in working life. Until 2016, responsibility for both generating retirement income through earnings, and the risks associated with paying earnings-related income through retirement, were shared between the State, individuals and employers through a combination of Additional State Pension and non-compulsory workplace pension schemes.

Figure 3.1: Responsibilities and risks associated with earnings-related retirement income and voluntary saving have been transferred away from the State and onto individuals and employers (including the Government as a public sector employer).

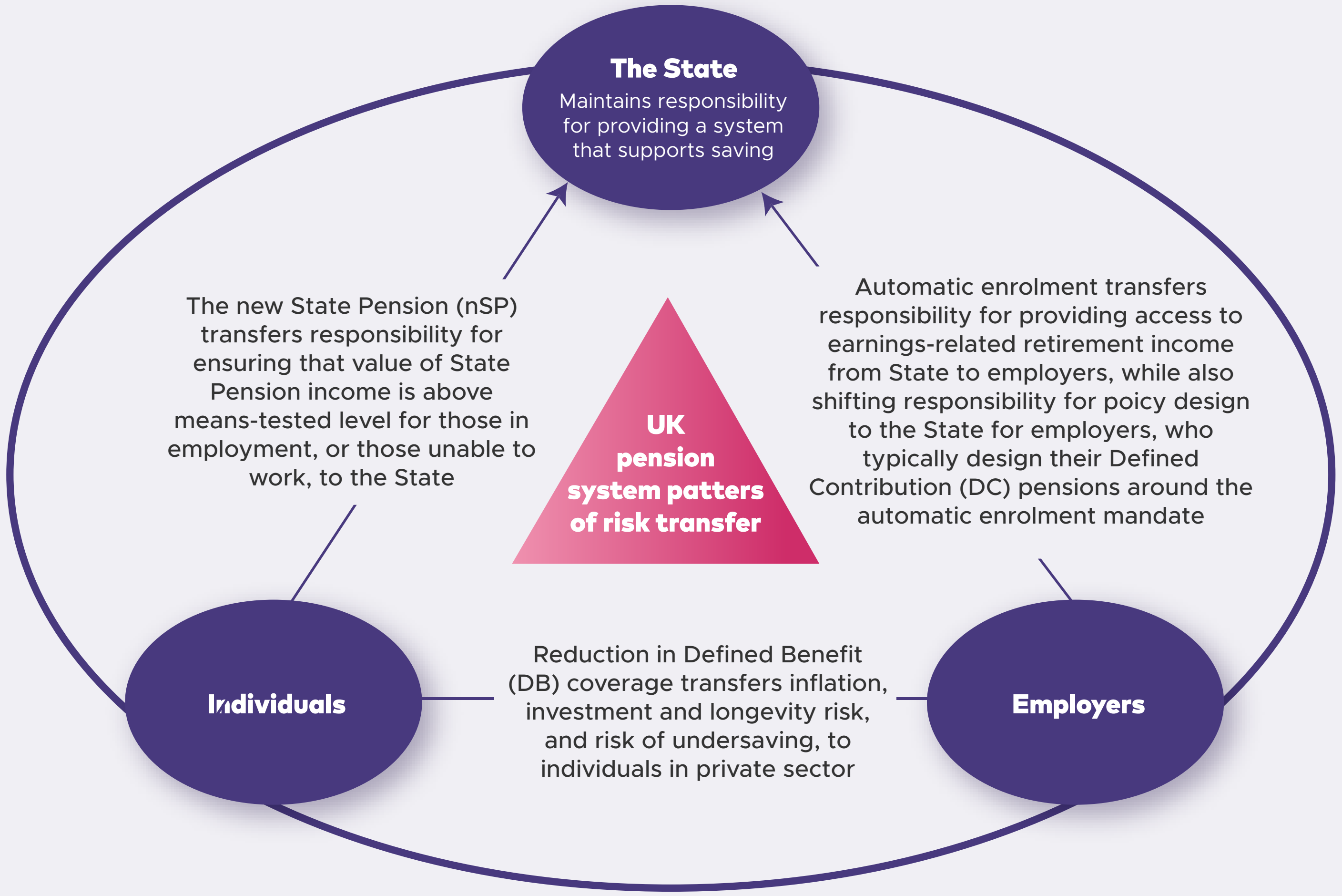

Figure 3.1 shows how some of the key transitions in the UK pension system have come about. Automatic enrolment, which to some extent replaced the State Second Pension (S2P), made access to workplace pensions compulsory and the accrual of S2P entitlements were brought to an end by the introduction of the flat-rate new State Pension (nSP). The nSP represents a departure from a "piecemeal" approach to pension reform and return to Beveridge's concept of a simple flat rate pension set above the level of the means test to provide a firm foundation for saving.[43] As Chapter Two highlights, State Pension age (SPa) increases, intended to offset the impact of rising life expectancy, are also placing greater responsibility for maintaining financial independence to later ages on

[42] IFoA (2021)
[43] DWP (2013)

individuals, by reducing the proportion of average adult life that people have access to retirement benefits.

Alongside automatic enrolment in the private sector, the rise of Defined Contribution (DC) schemes and closure of Defined Benefit (DB) schemes to new members, or to new members and new accruals, reflect a similar transition. Although it is now compulsory for all employers to provide qualifying employees with access to workplace pensions, low employer contributions are also indicative of a shift in responsibility for retirement outcomes away from the employer and towards the individual. In DB schemes, employees could expect their workplace pension to generate a guaranteed retirement income that would allow them to replicate living standards throughout later life with a considerable share of savings having been generated by the employer. In DC schemes, however, increasing contributions to a level that could produce comparable outcomes will typically require active decisions and considerably greater contributions on the part of the employee. It is also now the employee who takes on the longevity, investment and inflation risks associated with ensuring that their savings can sustain an adequate level of income throughout their retirement.

The State has taken on greater responsibility for providing minimum income to marginalised groups and the nSP is helping to improve fairness by narrowing the gap between the highest and lowest levels of State Pension income

The PPI Pensions Policy Wheel shows that the positive impact of the flat-rate **nSP** is helping to mitigate the negative impact of income inequality on **Differences Between Groups**. By raising State Pension income among the lowest income households who qualify for the nSP, changes are designed to somewhat correct considerable income inequality and a long-term relative decline in the value of the **basic State Pension (bSP)**. Under the old system, women, low earners and the self-employed were less likely to receive a significant earnings-related State Pension or access to a DB pension, and may not have had sufficient qualifying years for the full bSP, putting their income adequacy at greater risk in later life. Under the nSP, 84% of women and 92% of men qualify for the full nSP or higher, compared to just 70% of women and 95% of men who qualified for full bSP under the old system. Increasing State Pension income at the lowest levels while gradually reducing the level of earnings-related accruals at the highest, is helping to reduce **State Pension income** inequality. Under the new system, the gap in State Pension income between households in the highest and lowest quartiles of the income distribution is around £25 a week, significantly lower than the old system in which differences were as much as £75 a week. Despite these improvements, changes currently only benefit those who have reached SPa since 2016, meaning that legacy inequalities remain in the system, and it will not be until the mid-2050s that men and women are expected to receive equal State Pension payments.[44]

By raising the level of the nSP above the threshold for **means-tested benefits**, reforms are expected to reduce dependency on mean-tested benefits to less than 10%. Around 8% of pensioner couples and 30% of single pensioner households were eligible for benefits in 2020-21, but, although a very gradual downward trend in eligibility appears to be emerging among recently retired pensioners, it will take time for the impact of this policy to be felt across a greater share of the pensioner population. Mitigating the need for individuals to supplement a low household income to the minimum level by claiming income-related benefits is particularly important, as persistently high levels of non-take up mean that up to one-third of eligible claimants are not receiving income that they are entitled to.[45] Rates of relative poverty (after housing costs) among older people fell to 15% in 2020-21 from 18% in 2019/20, reversing a trend towards increasing levels of poverty that had emerged in the previous five years.

Although the value of the of the nSP is higher than the bSP, the long-term cost to fiscal sustainability is expected to be offset by the discontinuation of the S2P and reduced reliance on means-tested benefits. Going forward however, the value of the State Pension will depend heavily upon the method of indexation used to uprate payments each year (Figure 3.2).

Figure 3.2: The triple lock ensured that State Pension rose in line with, or above inflation, every year until 2022

Year	Earnings	CPI	Minimum	Change	Index Used
2011-12	+2.7%	+5.2%	2.5%	+4.6%	RPI (pre-triple lock)
2012-13	+1.4%	+2.2%	2.5%	+5.2%	CPI
2013-14	+1.1%	+2.7%	2.5%	+2.5%	Minimum
2014-15	+0.4%	+1.2%	2.5%	+2.7%	CPI
2015-16	+2.8%	-0.1%	2.5%	+2.5%	Minimum
2016-17	+2.5%	+1.0%	2.5%	+2.9%	Earnings
2017-18	+2.2%	+3.0%	2.5%	+2.5%	Minimum
2018-19	+2.6%	+2.4%	2.5%	+3.0%	CPI
2019-20	+3.9%	+1.7%	2.5%	+2.6%	Earnings
2020-21	-1.0%	+0.5%	2.5%	+3.9%	Earnings
2021-22	+8.3%	+3.1%	2.5%	+2.5%	Minimum
2022-23	-	-	2.5%	+3.1%	CPI (triple lock suspended)

Transferring responsibility for earnings-related retirement income to employers improves fiscal sustainability, but does not appear to adversely impact employer sustainability under current arrangements

Automatic enrolment has extended **DC Coverage** and the opportunity to save into a workplace pension to more than 10 million people and narrowed the gap in coverage between public and private sector workers from 45% in 2010 to 8% in 2020. It has also narrowed coverage gaps with at-risk groups including women and low to moderate earners, the main target group of the reforms. In doing so, it ends the responsibility for providing, and reduces risks associated with paying, additional State Pension income for the State over time, which together help to improve long-term **fiscal sustainability**. Automatic enrolment meant that many employers, particularly Small to Medium Enterprises (SMEs), began providing workplace pensions for the first time. However, the reforms do not appear to have had a negative impact on **employer sustainability**, because minimum employer contribution levels remain low, and Master Trusts such as the National Employment Savings Trust (NEST) can provide employers with access to a straightforward, low-cost pension scheme for their workers.[46]

However, income inequality is likely to persist and differences in private pension provision mean that even if employees contribute similar amounts to their earnings-related pension, retirement outcomes can vary depending on the pension scheme offered by their employer

As well as differences in the number of qualifying years that people accrued over their working life, inequality in State Pension income was driven by qualifying criteria that precluded some workers such as the self-employed and those on low-incomes, many of whom were women, from making earnings-related State Pension contributions. For those who did contribute, however, outcomes were proportionate with accruals.

Although automatic enrolment increased the number of people saving into a workplace pension, gaps in **inclusion** for low-income and self-employed workers were retained when responsibility for earnings-related retirement provision was transferred to employers. Some, but not all, of the resulting income gaps will be mitigated by increases in the level of the nSP. However, income inequality is, to some extent, compounded by widespread differences in the workplace pension scheme that the employer provides. Unlike the S2P, these differences can contribute to considerable variation in retirement outcomes, even if employees pay a comparable level of contributions throughout their working life.[47]

[44] UK Pensions Framework Indicator Appendix (2022). Indicators A2.1, A2.2 and F.21, DWP (2013)
[45] UK Pensions Framework Indicator Appendix (2022). Indicators A2.3
[46] UK Pensions Framework Indicator Appendix (2022). Indicators A3.1, A3.2, A3.3, F2.1, S2. And S2.3
[47] UK Pensions Framework Indicator Appendix (2022). Indicator F1.1

Around one in four workers, largely those in the public sector, has access to a DB scheme, two in four workers are eligible for a DC scheme, and one in four workers is not eligible for any workplace pension scheme either because they are self-employed, or do not meet automatic enrolment qualifying criteria. Within DC schemes, the use of net pay and relief at source schemes, levels of contributions, quality and charges differ, all of which make a difference to retirement outcomes. Although considerable progress has been made to **Protect Savers** and mitigate some of these differences through regulation on **Value for Money** and charge caps, unequal outcomes create additional difficulties in achieving **fairness** which are evident in the Framework analysis.[48]

The shift from DB to DC pension provision in the private sector means that individuals are faced with responsibility for decisions and risks that were previously owned by employers and providers, including complex choices around how to access their savings and sustain an adequate income throughout retirement

The State owns risks on behalf of State Pensioners, while institutions own risks on behalf of DB members, but unless people purchase an annuity, there is no external body owning the risks faced by DC members

The shift in provision for earnings-related income from the State to employers, coupled with the shift from DB to DC pensions in the private sector, means that DC savers are now responsible for many of the decisions and risks that were borne by employers and the State in the past. These include how much to save, how to invest, how to access their pension, and how to ensure that savings do not run out over the course of retirement. In contrast, the main risk facing those in DB schemes is the risk that their scheme and/or employer may become insolvent, a risk which is largely mitigated by the Pension Protection Fund (PPF).

Although transitions in the UK pension system are contributing to improved sustainability outcomes, they make adequacy harder to achieve for individuals who may need to actively engage with their pension in order to save sufficiently for later life.

As well as variation that results from the type of pension provision that people have, variation in the extent to which people are able and supported to make decisions around their savings can have a significant impact on retirement outcomes. These decisions are particularly difficult for those with low levels of engagement or confidence in their financial capability and understanding of pensions, both of which are prevalent among the population.[49]

Low levels of **engagement** are often related to low financial capability. Less than one-third of adults report good financial literacy, less than one-fifth of people aged 40 to 75 reported good understanding of pensions, and more than a third of people under 60 do not know how much they will need to live on in retirement. Women and those on low incomes fare poorly on **inclusion** measures, as they report least understanding. Variation in the extent to which people engage with retirement planning can result in considerable inequalities in outcomes in a system where these are increasingly dependent upon the choices that people make.[50]

The impact of these changes on levels of saving during working life is evident in the Framework analysis. Despite high levels of pension participation in the private sector, **DC contributions** are low and reduce the likelihood that earnings-related income can help people to achieve **adequacy** in later life. Although average DC contribution rates were around 9.9% of salary in 2020, the typical worker made combined employer and employee contributions of around 8%. In comparison, the typical worker in a pension with **DB accruals** received employer contributions of 20% or more, and made employee contributions of less than 7%, giving them a greater likelihood of adequate outcomes in retirement.[51]

The introduction of pension freedoms in 2015 has added a further element of complexity to decisions that people need to make around their retirement savings and have strengthened the trend for individuals now and in the future to bear greater pension and retirement risks than in the past.

Until 2015, those saving in DC pensions were effectively required to purchase an annuity, unless they had a significant level of savings and/or other pension entitlement. Pension freedoms effectively removed this requirement by allowing people to flexibly access their DC pension pots from age 55 and use the savings for a wider range of choices that include retirement income products, cash withdrawal or a combination of the two.

Annuities provide protection from investment and longevity risks, through paying out a guaranteed income for life, and inflation risk could also be protected against through the purchase of an escalating annuity. In this way, providers of annuities owned these risks on behalf of members, though annuity pools are also priced so that there is risk-sharing between annuitants. As a result of the freedoms, annuity sales have declined by around 80%, with 36% of DC plans accessed for the first time in 2021/22 taking partial withdrawals and 56% being fully withdrawn.[52] However, those taking their savings through partial or full withdrawals take on the market risks previously borne by annuity providers, and though drawdown providers are required to treat customers fairly, there is no underlying guarantee that these people will receive an inflating income for life.

As pension freedoms were introduced only seven years ago, it is difficult to fully assess their impact on retired groups. However, a lack of data and metrics relating to pensions access, and specifically the extent to which decisions may be beneficial to people in the context of their wider retirement position, is also a barrier to understanding how pension freedoms are impacting long-term retirement outcomes. Understanding more about pensions access is an important next step in providing people with the support and protection they need to make decisions at an individual level, either with or without the support from employers and other organisations, to maintain financial security throughout later life.

The shifts to DC pensions and pension freedoms underpin a shift in the notion of whether a pension constitutes a guaranteed stream of income, or a pot of savings where the risks are borne by the saver.

As well as bringing about increased risks for savers, the transition towards greater individual agency and responsibility for risk in the UK pension system also brings about increased flexibility. This distinction between a pension as an income, or a pension as an asset, has considerable implications not only for how much people choose to access, but also when they choose to access it, and what the outcome could mean for the likelihood of over or underspending in later life.

The pensions tax system adds a further layer of complexity to decisions around retirement saving, as "Pensions are one of the most complicated subjects for individuals to understand - both because pensions themselves are complicated and additionally the tax issues are not straightforward."[53]

Pensions tax can have significant implications for savings behaviours and **adequacy** in later life. Typically, those most affected are people with high levels of income or savings, or people for whom accessing pension savings could affect eligibility for means-tested benefits. However, tax thresholds do not always increase proportionately with increases in retirement income and savings, meaning that many people may be unaware of the extent to which tax could impact their retirement income.

As part of the pensions tax system, a series of measures are designed to limit the amount of relief received by higher earners and to ensure tax relief remains affordable to the State. However, new policies designs do not always account for the intricacy they add to the existing rules and the interactions between reliefs, allowances and benefits can make it hard to navigate options. Despite being intended to affect behaviour, tax complexity can present a barrier to engagement which, in turn, reduces its effectiveness as an incentive to encourage voluntary saving. This can result in a system that rewards rather than incentivises long-term saving, whereby rewards are accessed unequally by people with different levels of engagement and income. It can also lead people to make decisions around saving or employment that they may not otherwise have made.

The State maintains responsibility for providing a system that supports saving, in which transitions mean that the State Pension has become more straightforward and private pensions have become more complex

Despite shifts towards personal responsibility for retirement outcomes, UK Pensions Framework analysis shows that the role of the State in providing a fair and sustainable pension system to support retirement saving has become increasingly important as transitions have progressed.

[48] UK Pensions Framework Indicator Appendix (2022). Indicators F3.1 and F3.2
[49] UK Pensions Framework Indicator Appendix (2022). Indicator F1.1
[50] UK Pensions Framework Indicator Appendix (2022). Indicators F1.1 and F1.2
[51] UK Pensions Framework Indicator Appendix (2022). Indicators A3.1 and A3.4
[52] www.investcentre.co.uk; FCA Retirement Income data
[53] OTS (2019)

As well as reforming the State Pension and introducing automatic enrolment, the State provides ongoing support for saving through incentives in the form of tax relief on workplace and personal savings that can help to improve adequacy prospects in later life, and the regulation of private pension providers and other actors. Crucially, one of its key roles has also been to identify and implement policy interventions that help to improve long-term adequacy and fairness by moderating trade-offs and interactions brought about by transitions in the pension system, that overall can protect savers from negative outcomes in retirement.

Reforms such as the nSP and automatic enrolment have helped to simplify the UK pension system, but other changes such as pension freedoms and the expansion of DC saving have added complexity, which, without appropriate mitigations, could compromise adequacy and fairness

The outcome of transitions on **System Complexity** on system design and sustainability is mixed, as the benefits of a simpler State Pension system are offset by the need for DC savers to make more complex decisions around their savings.[54]

For most people, most of the time, contributing to and benefiting from the State Pension is now a straightforward process that requires minimal decision making, and relatively low engagement with the system. Where the system deviates from simplicity, it is typically for the purpose of maintaining flexibility (responsiveness to social and economic change) or fairness (honouring promises made under legacy policy arrangements such as the State Earnings-Related Pension Scheme (SERPs), for example). Reforms also enable people to better predict their level of State Pension income in retirement and provide a clearer delineation between State and private pension entitlement going forward. Although DB pensions remain relatively straightforward for those who continue to receive or accrue benefits, options at retirement are increasing in number and complexity and there are, somewhat necessarily, complexities around the regulation of transfers and advice.

In the private sector however, making it easier for people to access workplace pension saving is essentially the first stage in the transition towards a system that supports individuals' responsibility for long-term saving in a fair and adequate way. Under current provisions, adequacy will still depend on the need for people to engage with the system in order to do more than meet minimal requirements, as final pot sizes depend on a combination of contribution levels, length of time contributing, investment returns and charges. As a result, it can be difficult for people to know what their total retirement income will be when they retire, despite improvements to the State Pension, and complexity can present a barrier to engaging with retirement saving. Despite giving people greater choice, pension freedoms have also added a further layer of complexity to retirement planning and highlight inconsistencies in the extent to which people need to engage with their pensions at different times in life to achieve optimal retirement outcomes.

Layers of complexity also mean that individuals are more vulnerable to scams, as fraudsters seek to exploit low levels of understanding or engagement in the system. Around £2.5tn of pension wealth in the UK is estimated to be "accessible" to fraudsters because savers have the option to move their benefits, and around 5% of pension transfers are reported to have features which could indicate that they are linked to a scam or fraudulent activity.

Transitions in the pension system have raised important questions around the tension that exists between the need for people to choose how they plan their retirement, and their need to be protected from poor outcomes

For those with high levels of financial capability, or access to quality support, choice can improve overall outcomes and increase levels of adequacy. However, the potential benefits of increased choice need to be balanced with the potential for negative outcomes for those who struggle to navigate, or choose not to engage with, the system. In this way, the existence of choice itself can compromise fairness and result in less equal outcomes, and evidence around engagement and financial literacy shows that many savers are still not receiving the advice or guidance that they need to make informed retirement decisions.[55]

The majority of pension reforms introduced in recent years have been in response to consequences arising from the introduction of automatic enrolment and the pension freedoms, and as part of an overall policy agenda that has sought to offset the impact of population ageing. Measures aimed at mitigating the impact of choice on those who may not have sufficient capability or support, or who do not wish to engage, include:

- behavioural interventions and safety nets which aim to protect consumers from harmful outcomes,
- initiatives to equip consumers with information needed to manage financial risk through good decision making.

The use of behavioural interventions, such as defaults, to leverage cognitive and behavioural biases has been proven to successfully influence savings behaviour/decisions.

Automatic enrolment is a good example of how defaults can be used to protect unengaged DC savers from poor outcomes by moving people into workplace saving without the use of mandates, incentives, sanctions or restriction of choice. It is intended to mitigate against poor outcomes associated with inertia and other behavioural barriers. It also prescribes a minimum default level of contributions for employers and employees. However, people place a high degree of trust in these defaults, particularly when they are prescribed within the pension system and with the implicit backing of Government, and many people are not aware that defaults may not produce long-term outcomes that meet their expectations for later life.

Using **Choice and Default** policies to balance fairness for individuals who would benefit from choice against fairness for those who could face negative consequences, can help to boost overall system fairness. However, defaults are applied inconsistently throughout the retirement journey. During working life, they apply to workplace pensions access, minimum contribution levels and investment strategies. Within these defaults, further safeguards are in place to mitigate risks associated with **Value for Money** and the option to opt out is available to those who wish to exercise a greater degree of choice. At present, however, there are very few defaults and statutory obligations to protect unengaged DC savers in later life, meaning that people may be expected to make decisions at retirement without having had needed to engage with their savings before.[56]

Other measures to protect savers through **safety nets** and soft defaults suggest that **innovation and reform** in the pension system are helping to mitigate the unintended consequences of change. They also show a good level of flexibility and responsiveness that increase its overall sustainability. Measures include regulation on value for money, DB transfers, charge caps, default investment pathways for people in drawdown, advice and guidance, pensions dashboard, fraud and scam prevention, as well as increasing access to advice and guidance through platforms such as Pension Wise and Money Helper.[57]

Transitions in the UK pension system – Policy Insights from the UK Pensions Framework

- It is worth policy-makers considering the degree to which:
  - **complexity in the private pension** system hinders good outcomes for individuals, and whether the tax relief system could be simplified without jeopardising equality
  - the **current system of soft defaults** such as investment pathways, cash warnings and nudges towards guidance sufficiently fill the vacuum of these risks being owned by an external organisation
  - it is acceptable for some portion of society to have retirement risks owned by large institutions, while others face risks with **little external backup**
- Considerable progress has been made by industry and policymakers towards mitigating the unintended consequences of transitions in the pension system, but gaps still exist in relation to:
  - low contribution rates and **potential for undersaving**
  - **potential erosion of pot value** as result of system result of system design such as charges, proliferation of small pots, cost of consolidation and poor-quality investment strategies or assets
  - **system complexity** that could, coupled with low levels of financial capability and engagement, lead to poor decision making

[54] UK Pensions Framework Indicator Appendix (2022). Indicator S3.2
[55] UK Pensions Framework Indicator Appendix (2022). Indicators F1.3, F3.1
[56] UK Pensions Framework Indicator Appendix (2022). Indicators A6.2, A6.3, and F2.1
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