Introduction

The Pension Commission was set up in 2002 against a background of:

- company insolvencies, leaving people with depleted pensions;
- the emerging reality of increasing life expectancy;
- the exposure of defined benefit pension scheme deficits on company balance sheets;
- the dramatic underlying decline in private pension saving and employer engagement with work place pensions.

Lord Turner of Ecchinswell led a Pension Commission committed to publish a rigorous analysis of the nature of the problem, identifying the parameters of the solution and obtaining public agreement to that analysis. In the First Report the simplicity of the narrative was important in winning hearts and minds about the nature of the problem before the solution was proposed:

- People were living longer;
- State expenditure on pensions was targeted to fall on the assumption that private pension savings would rise to fill the gap;
- But in reality private pension saving, including employer contributions, was falling, so voluntary measures alone would not reverse the decline;
- Unless radical action was taken, future generations of pensioners would be significantly poorer.

The challenge was how to build a sustainable state and private pension system for the future that delivered an adequate level of savings and replacement income in retirement. Sustainability and adequacy: the persistent problems. For the Commission the solution, set out in the Second Report, lay in a combination of:

1. Saving more
2. Working longer
3. A flat rate state pension, uprated by earnings

The objective of the proposed state reform was to focus constrained tax resources on ensuring as generous and non-means tested flat rate state pension provision as possible, such that would provide a firm foundation for private saving and face the reality of the long term public expenditure versus State Pension age (SPa) trade off. The reforms required an acceptance of the consequence that public expenditure on state pensions and pensioner benefits must rise from 6.2 per cent of GDP as at 2005 to between 7.5 per cent and 8 per cent by 2045.

Any solution had to incur a sustainable level of public expenditure, particularly given the state's exposure to longevity risk in the provision of health and social care. It had to address market failures in the provision of pension products, the behavioural barriers to long term saving and the decline of employer engagement in workplace pensions. The reforms had to work for women. The Beveridge view of the working man and the dependent wife was no longer appropriate.

The key recommendations included:

- A rising state pension age reflecting the increases in life expectancy;

- A flat rate state pension targeted to produce a 30 per cent replacement rate of income for the median earner, indexed by earnings, to reduce dependency on means tested benefits and provide a firm foundation for private pension saving;
- A new employer duty to auto enrol workers into a workplace pension on a default pension contribution of 8 per cent on a specified band of earnings - intended to target a 15 per cent replacement rate of income for the median earner - with a contingent employer obligation to contribute at least 3 of the 8 per cent;
- Recognising that employer engagement and workplace provision were key to restoring private pension saving and the decline could not be reversed by voluntary incentives alone;
- The creation of a default pension scheme for employers, the National Employment Savings Trust (NEST), to address market failure and enable workers, particularly in SMEs, to save in a cost efficient way.

Now, more than a decade later, it is relevant to reflect on what is happening in this field and the extent to which the Commission's recommendations have stood the test of time.

Current reality: what is happening in this field

State Pension
A single tier, flat rate, new state pension (NSP) was introduced from April 2016, accelerating the replacement of the two tier system of the basic state pension (BSP) and the state second pension (S2P). This was faster than the Commission timetable but with the same end game. In a world of austerity the politics allowed a quicker transition from a two tier to a single tier state pension. The Commission view was that the move could be done quickly or through more gradually flat rating the earnings related second tier. It went in favour of the latter for pragmatic reasons.

The phasing out of the earnings related second tier S2P needed to go hand in hand with the introduction of auto enrolment and the 8 per cent minimum contribution. The Commission did not know how quickly Government would introduce such a policy – with the benefit of hindsight, it would prove slowly.

A rapid move to a NSP required a rapid abolition of the facility to pay lower employer and employee national insurance (NI) contributions and 'contract out' from the second tier S2P. Such rapidity was problematic in 2004 given anxieties about the rising cost and closure of defined benefit (DB) schemes. By 2016 a great many private sector DB schemes had closed to both new members and future accruals, public sector pensions had been subject to two cost containing waves of reform, and auto enrolment was well underway.

Significant improvements have been made to the crediting of carers with accrual of state pension benefit: for example, a parent caring for children up to age 12, grandparents who give up work to care for grandchildren, those caring for 16 or more hours a week for people in ill health or with a disability. In those instances where crediting is not automatic, sadly too many such credits remain unclaimed.

The move to a NSP with a full value of £155.65 per week (£8093.80 pa 2016/17), greater in value than the previous first tier BSP at £119.30 per week (£6,204 pa) has significantly benefited the self-employed, who were previously excluded from the state second tier S2P.

The NSP also improved the position of older women who had not reached the SPa and had been disadvantaged by unfair rules of accrual in the past.

The Pensions Commission recommended restoring the link with earnings. Legislation provides for the legacy BSP, and the NSP, to be uprated at least in line with earnings. A Government commitment remains in place until 2020 to uprate by a triple lock of prices, earnings or 2.5 per cent, whichever is the greatest.

Inefficiencies still remain in the design of the state pension. Developments in the UK labour market have seen the growth of low paid non-guaranteed hours, minimal hours and casual work contracts. A worker has to earn £112 per week (just over 15 hours at the national minimum wage) in any one job to reach the qualifying threshold for entitlement to contributory NI benefits. Income from more than one job cannot be aggregated in order to reach that threshold. Workers with one or more jobs each with earnings below that threshold can be excluded from the NI system, including state pension accrual.

State pension expenditure is controlled either through the value of the pension paid or the age at which it is paid. The reality of the long term public expenditure versus SPa trade-off has been recognised. Increases in the SPa have been accelerated in the face of improving life expectancy. The Pensions Act 2007 – increased the SPa to 66 over two years starting from April 2024, to 67 over two years starting in April 2034, and to 68 over two years starting in April 2044. The Pensions Act 2011 brought forward the increase from 65 to 66 between December 2018 and October 2020 and consequently brought forward the increase in women's SPa, to reach 65 by November 2018.

These increases were further accelerated when the Pensions Act 2014 brought forward the increase to 67 to between April 2026 and April 2028. It also introduced a duty on the Secretary of State to review pensionable age by May 2017 and at the end of every period of 6 years thereafter. In the 2013 Autumn Statement the Chancellor set out the guiding principle that people should expect to spend up to one third of their adult life drawing a state pension.

Private Pensions

On private pensions the Commission's recommendations lost some ground. It recognised that a sustainable pension settlement required a political consensus and invested a great deal of effort to secure one, including employer agreement to auto-enrolment and a contingent compulsory contribution. When Lord Turner handed the Second Report to the Government he had already made substantial efforts to build that consensus.

Industry providers however offered some resistance, disagreeing with the need for a national default pension scheme (NEST) to address market failure. NEST has exerted a positive influence on market practice, particularly in the design of default investment strategies, but the constraints placed upon it restricting contribution levels and the transfers in of existing pension savings, weakened its ability to mitigate market failure.

NEST was not introduced as a default scheme but as one of many providers in the market which employers can chose to deliver their workplace pension; however it retains a focus on workers employed in SMEs. In 2016, 175,000 businesses signed up to NEST: of those 95 per cent were small or micro-businesses. NEST now has more than 4.5 million members, of which over 2.7 million are active savers, and in excess of £1.6 billion of assets under management.

When auto enrolment (AE) was introduced in 2012 few barriers existed to providers entering a private pensions market already characterised by weak consumers, opacity and conflicts of interest. The governance of the UK private pension system remains a challenge. The last five years has seen a continuous stream of consultations, reviews, new legislation and new regulations, each seeking to protect the saver and all adding greater complexity.

The Pension Commission assumed individuals would be required to use their tax advantaged private pension savings to secure an income stream in retirement. Its reforms targeted an underpinning 45 per cent replacement income for the median earner, from combined state and private provision. In 2014 that assumption was displaced when the Chancellor of the Exchequer announced a radical reform giving people from age 55 freedom in how and when they accessed their private pension savings, subject only to their marginal rate of income tax, thereby ending the effective compulsion to annuitise or restrict the rate of income draw down.

That freedom has been followed by even more statutory and regulatory intervention as the Government has sought to protect weak consumers and increase their capacity to make informed decisions.

The Government needed European Commission clearance for AE into contract based provision. Industry providers argued that contract based, as distinct from trust based, pensions could be exempt from AE and subject only to ‘target’ opt in participation rates. That would have breached the near universal nature of AE for workers and may have tipped employers in favour of contract based schemes, resulting in lower participation rates.

More people are now saving. The legislative changes set out in the Pensions Acts 2007, 2008 (and updated as part of the Pensions Act 2011 and 2014), and associated regulations formed part of a wider set of pension reforms requiring employers to AE eligible workers into a qualifying workplace pension scheme and to make a minimum employer contribution. Workers can opt out at any point, but are re-enrolled every three years. Eligible workers are aged between 22 and the SPa and earning over £10,000 per year. Some 11 million are in the eligible target group and the DWP expect 10 million will be newly saving or saving more by 2018.

AE is being staged in between October 2012 and February 2018 by size of employer, starting with large and followed by medium sized businesses. Smaller employers (those with fewer than 50 employees) are being phased in since 2016. At September 2016, an estimated 1 million small or new employers were still to be staged, with an estimated 5 million eligible workers to be auto-enrolled. As at the end of March 2017 almost 7.7 million workers have been automatically enrolled by 500,000 employers. DWP analysis suggests AE is having a larger impact among those groups for whom coverage pre reforms was lower, including low earners and younger age groups.

The statutory minimum contributions for auto-enrolment, 8 per cent on a band of earnings set in line with the NI lower and upper earnings limits (£5,876-£45,000 for 2017/18), of which at least 3 per cent must come from the employer, and 1 per cent from tax relief for the basic rate taxpayer, are being phased in. These began in 2012 with total minimum contributions of 2 per cent until April 2018, of which at least 1 per cent must come from the employer, then increasing to 5 per cent, of which at least 2 per cent must come from the employer, before rising to 8 per cent by April 2019.

By September 2015, 69 per cent of eligible workers were participating in a private sector work-place pension scheme compared to 42 per cent in 2012. Public sector participation was high at 91 percent. The overall eligible employee participation rate in 2015 was 75 percent, up from 55 per cent in 2012.

However, some people remain ineligible for auto-enrolment, either through not being employed (i.e. self-employed, unemployed or economically inactive) or not meeting the eligibility criteria on earnings and age. In 2015, 5.3m workers were ineligible for auto-enrolment based on this criteria. A further 4.5m self-employed were also ineligible.

B. Stresses and Strains: What are the pressures on the current reality and from where?

In the past decade the UK pension system has been subject to unprecedented levels of change and Government and regulatory intervention. The Pension Commission believed a consensus was unlikely to hold without a standing body to appraise Government policy and track outcomes against objectives. That recommendation was not accepted. Given that state expenditure on pensioner benefits, and tax revenues foregone in support of pension savings are both big ticket items, it is hardly surprising Governments are reluctant to concede influence over their discretion and policy decisions in these areas.

There have been many positive developments: the state pension has been reformed, people are working longer, auto enrolment is resulting in millions more saving, more employers are engaged, and levels of saving are set to increase further as the minimum contribution rate rises to eight per cent.

But stresses and strains continue to put pressure on achieving sustainable state and private pension systems for the future that deliver an adequate level of savings and replacement income for individuals in retirement.

State Pension and Working longer
The NSP accelerated structural reform but the long term intent for its value is unclear. Uprating by the ‘triple lock’ rather than earnings costs more. Its introduction was a political response to the impact of the fall in earnings post 2008 on the value of the basic state pension, BSP. Pressure on public expenditure, uncertainties on Brexit outcomes, and the growing cost of health and social care all point towards the removal of the triple lock. The uprating of state pension is a politically sensitive issue, given the propensity for older citizens to vote. The debate on the ‘triple lock’ has become binary – to keep or to remove, but in reality the range of political choices is much wider, including making the state pension means tested.

The Office for Budget Responsibility Fiscal Sustainability Report of January 2017 estimates that by 2065/66 State Pension expenditure might rise to around

- 7.56% of GDP, should the triple lock and currently legislated changes in SPA be maintained;
- 7.02% of GDP, should the triple lock be maintained but rises to the SPA be brought forward and a longevity-linked SPA maintained;
- 6.14% of GDP, should the triple lock be abandoned and replaced with an average earnings link, rises to the SPA be brought forward and a longevity-linked SPA maintained.

The state system is not meeting the needs of all workers, such as those with one or more jobs each paying below the entry point to the NI system or eligible carers who are not claiming their state pension credits. There are administrative complexities in doing so and Governments have been resistant.

In support of the current review of the SPa, the Government Actuary is required to prepare a report on life expectancy. John Cridland, ex-head of the CBI, has been commissioned to report on the SPa in three contexts - affordability, fairness and fuller working lives - and on the extent to which wider factors should be taken into account. Increases in SPa have attracted growing comment on the differential impact on socio-economic groups.

Over the last 25 years male life expectancy has been rising at about three years a decade, with smaller increases for women. Entry into the labour market has been delayed by increases in the length of participation in education. The proportion of life spent in work has declined and funding pressures for non-working years has increased. There is a policy focus on getting people to work longer. The current review of the SPa may well result in a date being set when it rises to at least 69. The Cridland recommendations support the continuation of a universal state pension age, changes to the welfare benefit rules to address socio-economic differences in life expectancy and bringing forward to 2037-39 the increase in the SPa to 68.

Future Governments will not row back from the now published principle that people should expect to spend up to one third of their adult life drawing a state pension. As the OBR Fiscal Sustainability Report January 2017 reported "*over the very long term, the third-of-life principle would have the effect one might assume, with around a third of the effect on spending of changes in expected mortality being offset by changes in the assumed path of SPA rises*".

Even before the notified increases in Spa, the employment of over 55s has been rising, but significant numbers are still not in paid employment. The DWP report on Employment Statistics for Workers aged 50 and over (November 2015) reveals the employment rate for people aged 50 to 64 has grown from 55.4 to 69.6 percent over the past 30 years, and for people aged 65 and over it has doubled from 4.9 to 10.2 per cent. The largest increases were in two groups: for women aged 60-64 the rate grew from 17.7 to 40.7 per cent; and for women aged 55-59 it grew from 48.6 to 68.9 per cent.

The example of the 70-74 year age group is notable: over the last 10 years the employment rate for this group has almost doubled, increasing by 4.4 percentage points to 9.9 per cent, an employment level of 258,000. Over the past 5 years women aged 60-64, who are directly affected by the equalisation of Spa, is the group with the highest growth in its employment rate, increasing 6.8 percentage points up to a rate of 40.7 per cent. Employment rates keep rising but a realistic increase in rates for age groups below the current SPa may make only a moderate difference to dependency ratios. Employment rates for those over SPa also need to increase.

The number of people aged 50 and over who are in work has increased. In its report 'Beyond The Headlines' however, recent analysis by Age UK, using Labour Force Survey data, found that although headline employment rates have increased for both men and women at all ages explored (from 45-64), many people are in fact working fewer hours, which will impact their earnings and potential to save. For some this will be a result of their own choice; for others it will be a symptom of a changing labour market that is preventing them from using their skills or pushing them into poorer quality work in the ‘gig economy’. In both cases, it will mean reduced income until SPa – which is rising and could rise further.

The Age UK analysis replicates a study looking at the emergence of similar patterns in Belgium, France, Germany and the Netherlands. As Age UK observes, “in the contemporary UK labour market, which is subject to a rapid pace of change, it is not sufficient to base public policy on employment rates. A full understanding of employment transitions among older workers requires a significant amount of further investigation”. In both cases, it will mean reduced income until State Pension age – which is rising and could rise further.

Uncertainty as to what foundation of state pension provision will be sustained over the long term has increased given the rising cost of health and social care, the uncertainties on Brexit, and the frailty of a political consensus. It may mean that over time there will be an even greater shift of responsibility from the state to the individual than is reflected in the current value of the NSP, increasing the importance of people working longer and saving more.

Private Pension - coverage

AE is increasing the numbers of people who are saving but significant gaps in coverage of the workforce remain. Structural changes in the labour market, increasingly evident over the last ten years, together with a Government decision to raise the earnings trigger for eligibility for AE to £10,000 pa, are excluding significant numbers. Only 36 per cent of the eligible target group for auto enrolment is female.

The self-employed are excluded from automatic enrolment. The latest ONS data reveals that around 15 per cent of the workforce, 4.75 million, is self-employed; 1.7m of them are low paid. Self-employment accounts for around a third of the increase in employment since 2010.

Approximately 730,000 workers are in insecure temporary work and 810,000 employed on non- guaranteed hours contracts, many of whom are excluded by the earnings threshold. DWP figures for 2015 suggest around 26.3m people are employed in the UK (excluding the self-employed) around three quarters (20.1m) of whom meet the qualifying criteria for automatic enrolment. Of the 6.2m ineligible workers 3.5m are earning below the £10,000 earnings threshold in any one job. Those who are ineligible include: 32 per cent of female workers (4 million) compared to 16 per cent of male workers; 30 per cent of disabled workers; and 81 per cent of employed carers compared to 23 per cent of workers without a disability.

Of those working for smaller employers with 10 or fewer employees, 61 per cent meet the eligibility criteria compared to 90 per cent of workers for larger employers with 500 or more employees; 55 per cent of people employed in the service sector meet the criteria compared to between 70 and 90 per cent of workers in other sectors. DWP analysis suggests these discrepancies are largely driven by workers not meeting the earnings threshold.

The opt-out rate for AE has been lower than the predicted 15-20 per cent. The National Audit Office estimates it at between 8 and 14 per cent, the DWP estimates it at around 9 -10 per cent. The rate varies by age, working pattern and gender. As the staging of employers progresses, DWP analysis reveals that the smallest employers have the highest opt-out rate at 17 per cent. Contrary to popular stereotyping, the youngest age group have the lowest opt out rate at 7 per cent. DWP figures illustrate that most eligible employees are saving persistently, at 79 per cent in 2015. The proportion not saving persistently was 1 per cent, but for a significant remaining 20 per cent there is an indeterminate amount of evidence to categorise them as either persistent or non-persistent.

Level of Savings

Many more millions are saving into a workplace pension but contribution rates are low. The statutory minimum commenced phasing in at 2 per cent in 2012 rising to the full 8 per cent by April 2019. Workplace pension savings are expected to increase by an extra £17bn per annum by 2019/20. The total annual amount saved into a workplace pension in 2015 was £81.8 billion consisting of £48.7bn in employer contributions, £24.8bn in employee contributions, and £8.3bn in tax relief on employee contributions.

Total employee contributions into workplace pensions grew from £19.8bn in 2012 to £24.2bn in 2014 which equates to a reduction per participating saver from £1850 in 2012 to £1741. Total employer contributions increased from £47.5bn in 2012 to £48.1bn in 2014, a reduction per participating saver from £4437 to £3560. DWP Update of analysis on Automatic Enrolment 2016 confirms that in the private sector the amount saved per eligible saver is falling. This is likely to be the result of continuing replacement of DB by DC and expanding coverage of AE in the private sector bringing in more lower paid workers. The level of decline is expected to change when the 8% minimum contribution are phased in. The increase in total saving appears to be driven largely by the increase in numbers of savers.

As to employer influence on the level of pension saving, the DWP Employers' Pension Provision Survey 2015 reveals some strains. Overall, 62 per cent of 'staged' employers (excluding most small and micros) were paying contribution rates in line with the phasing in minimum of 2%; only around a third were making the full statutory minimum employer contribution of at least three per cent from the start. Of those employers that were phasing in, 85 per cent planned to make an employer contribution at the legal minimum (3%) following phasing, nine per cent planned to contribute between three and six per cent and two per cent of employers planned to contribute more than six per cent. Employers that had not yet staged, reported planned contribution rates which were similar to those who had already staged, with only 14 per cent planning to contribute above the legal minimum.

For some employers contributions may be anchoring at the current minimum contribution levels although analysis published by the Institute for Fiscal Studies suggests total average contributions for eligible workers at large and medium sized private sector employers has increased. The levelling down of contributions by some employers may be outweighed by some employers enrolling at levels above the minimum. The DWP surveys over time will monitor whether adequacy in aggregate savings is hiding a distribution of pension savings which is too unequal.

AE has accelerated the trend towards DC away from DB schemes. Ninety one per cent of those auto-enrolled from March 2015 to March 2016 went in to DC schemes. Active DC savers in 2015 numbered 12.3 million, compared to 1.5 million active DB savers in the private sector. For the majority of savers in the private sector pension outcomes will become explicitly dependent on the value of contributions paid into their pot.

The Government is understandably cautious in not pushing the debate on increasing the statutory minimum contribution rate. It is focused on achieving a successful phasing to the 8 per cent without a significant increase in the opt out rate, and so consolidating the success of AE. But moving beyond 2019, the issue of how to encourage a higher level of saving and the level fiscal support for any incentive to save will gain an increasing importance.

AE has been a compelling lever of change, the behavioural intervention that has harnessed inertia for the public good and got millions to start saving or saving more. It is unlikely that any Government will reverse the policy. They could however, weaken its effectiveness by policies which introduce friction into the process or weaken the employer engagement.

Tax Relief

AE will see fifteen million workers saving into DC pensions. More saving means more tax relief. Relief on just the additional workers' pension contributions as a result of AE is estimated at £2 billion a year. The tax implications have caused flutters before, influencing the phasing timetable for the 8 per cent. After the events of 2008 AE came close to going on the back burner and was reviewed again by the Coalition Government in 2010.

Tax relief for pension saving is big. The cost of tax and employers' N I relief on pension savings is one of the most expensive sets of relief offered by the government. In 2014 to 2015 this cost around £48 billion, which included NI rebates on employer contributions of around £14 billion. The government collected around £13 billion in tax from pensions in payment. The lion's share of the tax relief went to DB savings.

The type and level of incentives to both employers and employees supporting long term savings is attracting increasing scrutiny. This was evident in July 2015 when the Government issued 'Strengthening the Incentive to Save: a consultation on pensions tax relief', giving rise to concerns by some observers that the Government was seeking to address current fiscal demands by heavily reducing pension tax relief at the expense of building an adequate level of pension savings.

There is a tension between the Treasury, which sees tax relief at the point of saving as an undesirable cost given current fiscal demands and the budget deficit, and those who believe tax relief at the point of saving is an integral part of supporting workers and employers in building an adequate level of private pension savings.

The Government is giving further consideration to tax relief policy. Meanwhile the reduction in pension life time and annual allowances, together with initiatives such as raising the Individual Savings Account limit to £20,000 pa or more, and the Life Time ISA will potentially shift more savings away from the EET (exempt, exempt, taxed) pension savings regime into TEE (taxed, exempt, exempt) savings vehicles.

The distribution of pension income tax relief across the population has evolved over time. More than two thirds of the relief currently goes to higher and additional rate taxpayers. However, the introduction and gradual reduction of the pension lifetime and annual allowances have reduced the share of tax relief that goes to additional rate taxpayers since 2009, a trend that is likely to continue, as instanced by the tapered annual allowance introduced in April 2016 for those with an income over £150,000. Increases in the income tax free personal allowance have also led to a decrease in the share of pensions tax relief which goes to those with an income below £19,999.

The top decile by income before tax is forecast to pay 58.5 per cent of total tax and receive 49 per cent of reliefs. Defenders of the *status quo* would probably ask: “What is the problem?” From a public policy point of view, whilst an extra £1 in tax has a far greater adverse impact on those lower down the income distribution, in the reverse, in terms of tax relief, lower earners gain economically far more than the wealthy. This is a key argument deployed by those who support the argument for a more progressive distribution of tax relief.

The current public debate on tax relief and pension saving is very focused on the ‘individual’ incentive to save. Such a focus is supported if there is a desire is to move from an EET to a TEE regime and remove the employers’ incentive of NI exemption on pension contributions. Long term saving depends on many factors including employer behaviour but consideration of the behavioural response of employers to recent changes in pension policy or future changes in tax relief has received limited attention.

The Market

The introduction of AE into a UK pensions market characterised by weak competition and low barriers to entry has resulted in a significant increase in the number of contract and trust based providers of workplace pension schemes, and rising concerns about schemes’ sustainability, governance and value for money. The use of inertia to increase the number of savers exposed the current high costs and charges for millions of modest or low earners. High charges which Lord Turner described (Hansard, January 2014) as derived from the fundamental inefficiency of the market:
‘*It is a system absolutely shot through with market failure where the process of trying to provide in a competitive fashion simply does not work well’*.

His view was supported by the OFT, commenting in its 2013 report on DC workplace pensions:

“*competition cannot be relied upon to ensure value for money for savers in the DC workplace pensions market”*.

The governance of the UK private pension system remains a challenge. Administration, conflicts of interest, high charges, complexity, lack of transparency, mis-selling, scams, value for money, consumer protection, asymmetry of knowledge and understanding are just some of the issues Government and regulators have sought to address, adding more complexity as they have done so.

As the Chief Economist at the Bank of England, Andy Haldane, commented on 18 May 2016 at the annual dinner of the think tank New City Agenda,

“I consider myself moderately financially literate - yet I confess to not being able to make the remotest sense of pensions…. Conversations with countless experts and independent financial advisers have confirmed for me only one thing - that they have no clue either. That is a desperately poor basis for sound financial planning.”

Workplace pension provision is not a normal market. AE is designed to harness inertia, for a population of savers who do not engage. That disengagement helps to feed market failings. The worker does not choose a product, the employer does. *Caveat emptor* cannot operate.

The saver is restricted to a binary choice - to stay in, or to opt out and lose the employer contribution.

These features strengthen the importance of holding agents to account as that very inertia allows conflicts of interest to flourish. The Government and the Regulator are increasingly required to compel improvements in the market. When AE is bringing 10 million-plus new savers into the pensions system, the case for greater scrutiny and intervention becomes more compelling. Governance and delivery models have not yet evolved sufficiently to address the issues which auto enrolment into a DC pensions market has exposed.

One such inefficiency is the growth of 'small pots' as workers change jobs leaving savings with their previous scheme. The Government rejected the idea of approved pension scheme(s) to act as default aggregator(s) of an individual's pots but the decision to proceed with 'pot follows member' whereby small pots automatically follow the worker to their next workplace scheme, has been mothballed. Meanwhile small pots increase in number, a simmering problem still to be addressed.

The Government is focused on the creation of a 'pension dashboard' to allow individuals to see their state and private pension savings in one place. The fragmented nature of the pension market poses a design challenge and it is unclear whether it can provide for all savers to view all their pension savings. The project is managed on behalf of the Treasury by the Association of British Insurers (ABI) with the intended implementation of a full public-wide service by 2019. Businesses wishing to contribute to the project must pay £50,000 each. The full cooperation of the industry is needed to deliver a successful outcome; it is to be hoped that providers can manage their own conflicts and deliver the optimal solution.

The contribution of the 'dashboard' to mitigating the growth in the 'small pots' problem will depend upon the extent to which workers overcome their inertia and engage. It is unclear how savers will be nudged or encouraged into using the 'pension dashboard' to engage with and consolidate their savings although the opportunities could be considerable.

There are significant governance and regulatory matters concerning the 'dashboard' which will need to be addressed. Trustees and employers will need to be confident about consumer protection when considering whether to engage with the 'dashboard' and the implications for their own liability.

The growth of Master Trusts demonstrates the concern as to the sustainability of some workplace pension schemes and the argument for greater consolidation. Multi-employer Master Trust pension schemes grew rapidly while inadequately regulated, following the advent of automatic enrolment, from 0.2m members in 2010 to considerably more than 4 million in 2016 – rising to an anticipated 6.6m by 2030, with billions of pounds from millions of workers under management. Few anticipated just how quickly the structure of Master Trusts would evolve.

Low barriers to entry permitted set up on minimal requirements with members and their savings bearing the risk of the costs of scheme failure. New legislation before Parliament gives strong new powers to the Secretary of State and the Pensions Regulator tPR to regulate these trusts. All existing and future Master Trusts will need authorisation to continue operating. As Nicola Parish, Executive Director of Frontline Regulation at the tPR, commented in her blog on 20 January 2017:

“If this proposed legislation passes into law, and in a dramatic departure from the way that any other type of pension scheme is established, no master trust will be able to open for business without our prior approval. This will substantially improve consumer protection in this section of the pensions market”.

As the staging of auto enrolment completes in 2018 it will be apparent which trusts have achieved scale and which have not. It is expected the regulator, tPR, will force consolidation in the market. There are tens of thousands of employer sponsored small DC schemes, many of which struggle to achieve adequate standards of governance and administration, or to provide value for money. Encouraged by tPR, many such schemes may consolidate into authorised Master Trusts.

Freedom and Choice in Retirement

Following the publication of the Pension Commission report, at first policy focused more on reversing the decline in pension savings and less on accessing those savings. This changed in The Queen’s Speech of 2014, through which the Chancellor announced the radical “freedom and choice” reforms. These gave people from age 55 freedom, choice and flexibility in accessing their pension savings, subject only to their marginal rate of income tax, thereby ending the effective compulsion to annuitise. Members of unfunded public service DB schemes were not given access to those freedoms.

Given the persistent inefficiencies in the annuity market and the impact of increasing longevity and quantitative easing on annuity rates, it was hardly surprising that Government would take action to give the pension saver more options and ease the requirements on compulsory annuitisation and restricted drawdown. Freedom and Choice was hailed as a hugely popular measure, particularly for older workers who had already accrued their savings – there was no political appetite in any quarter to listen to cautionary voices.

In a single bold policy move, preceded by no consultation and no published impact assessment, the Government gave individuals the freedom to decide how to spend their pension savings unconstrained by any requirement to secure an income stream in retirement. In so doing it overturned a long held to principle of public policy that workers who saved and employers who contributed were supported by the State through favourable tax and NI relief, because pensions delivered an income stream for the pensioner in retirement. Freedom and Choice turned the private pension system into a long term saving system, heralded the nature and principles of tax relief being revisited and signalled a potential reassessment of the employer incentive to contribute to workplace pensions.
The new freedoms introduced new ambiguities. In announcing the reforms the Government sent out a clear message to the individual — it is your pot, you saved it, you spend it as you like - the role of tax relief and the employer contribution was omitted from the narrative. Unlimited access to pension savings from age 55 risked contradicting the message to work and save for longer.

The Government’s message to the employer was also ambiguous: pension savings were for workers to do with as they liked from age 55. The premise upon which employers were made subject to a compulsory pension contribution, to support workers’ replacement income in retirement had been modified. When the then Pensions Minister told the BBC's assistant political editor Norman Smith he was "relaxed" about how people spent their money - adding

I'f people do get a Lamborghini, and end up on the state pension, the state is much less concerned about that, and that is their choice" - he was begging the question, albeit unintentionally, if the Government was not concerned that an individual might have to survive on the state pension, why should the employer be concerned.

With greater freedom come greater risks attached to individual decision-making, increasing over time as many new pension savers are likely to have lower incomes and levels of financial literacy. As the FCA observed in the interim report on its Retirement Market Study, consumers will be poorly placed to drive effective competition; the retirement income market is not working well; and the introduction of greater choice and potentially more complex products will reduce consumer confidence and weaken the competitive pressures on providers to offer good value.

Complexity and behavioural barriers will mean many people are not well equipped to make informed decisions. Guidance and advice are important but may not be sufficient for all individuals managing the responsibilities and risks that have been transferred to them.

The continued absence of a public policy framework for low risk default arrangements, a reliance on an ever more complex system of regulation to protect the consumer, and an unsettled, untested policy on access to advice and guidance are all placing strains on the pension system. The speed of introduction of such extensive freedoms is adding further to the consultations, regulations and new FCA duties as manifestations of inefficiencies in the market emerge, producing yet more complexity.

C. What could influence the future and how could this play out

AE was a policy intended to support a pensions system centred around the rebuilding of the second – occupational – pillar as a mass savings vehicle, placing the workplace at its heart, accepting the reality of individual inertia, harnessing it for the public good and compelling employers to engage. A decade later the footprint of reform appears less clear. The future of pensions as a distinct vehicle for long term savings, defined by an employer's contribution, a worker's contribution, preferential tax treatment, and access only at retirement to secure an income stream, appears uncertain.

Over recent years the Government has introduced a range of reforms to promote saving and to ensure that the right incentives and products are in place to meet savers' needs. The evidence-based strategic policy supporting the building of a long term savings culture has not always been clear. The public debate following the announcement of the Lifetime Individual Savings Account (LISA) demonstrated the confusion as to what are considered the right incentives and the right products, for whom, in what circumstances and for what intended outcomes. For employers, providers and consumers the answers seem increasingly uncertain.

To borrow an observation from the Pensions Policy Institute PPI in their report 'The Future Book',

"the future of the long term savings landscape is uncertain and depends on many factors all of which are unpredictable on some level: worker behaviour, employer behaviour, industry behaviour, economic effects and public policy changes. Given the long-term nature of pension savings and the shift of responsibility to the individual such uncertainty makes decision making even more difficult for people".

Increasing life expectancy and advances in modern science and medicine do not represent a crisis; they are evidence of human progress. The challenge is in adapting and managing the consequences of living longer, which will require people to work longer and save more, supported by sustainable State expenditure. Public policy and regulation have an important role to play in that process.

Working longer

A rising SPa needs to be accompanied by increases in the employment rate (pre and post SPa), as part of meeting the economic cost of increasing life expectancy. DWP reports suggest a one year increase in working life would raise the labour force by around 1.75 per cent and boost the level of real GDP by 1 per cent. The interplay of major considerations that lead people aged over fifty to feel forced to stop work (and which can be specific to certain occupations or industries) are health conditions, disability, caring responsibilities, redundancy, workplace factors and financial security. A segmented approach to State intervention is needed if it is to be successful.

Most people are passive rather than active when making decisions about working longer, they are susceptible to nudges and react to events and options presented by employers or by Government, who play a key role in influencing their decisions. Interventions directly targeted at securing changes in choice may be more effective than approaches aimed at changing attitudes when it comes to participating in the labour market.

The DWP recognise there is a need to plug the notable gap in the evidence base regarding barriers to change in employer practices and the array of existing employer nudges that affect early withdrawal from the labour market. If that gap is not filled and greater employer engagement does not happen then higher employment rates for older workers are far less likely to be achieved. Increases in the SPa in the short run will probably result in an increase in the rate of unemployment; a key determinant of the speed of adjustment will be the extent to which businesses react and provide the necessary capital to enable the expanded labour force to work.

State Pension

In his 2016 Autumn Statement, the Chancellor of the Exchequer advised:

"We manage public spending so that we can invest in the public's priorities. The Government have underlined those priorities with a series of commitments and protections for the duration of this Parliament. I can confirm today that, despite the fiscal pressures, we will meet our commitments to protect the budgets of key public services and defence; keep our promise to the world's poorest through our overseas aid budget; and meet our pledge to our country's pensioners through the triple lock. But as we look ahead to the next Parliament, we will need to ensure that we tackle the challenges of rising longevity and fiscal sustainability, so the Government will review public spending priorities and other commitments for the next Parliament in light of the evolving fiscal position at the next spending review".

That statement draws out that future expenditure on pensions will be based on the view taken on the fiscal position at the time. There is no solidity of policy on the percentage of median earnings the state pension should deliver in replacement income or the percentage of GDP allocated to pensions and pensioner benefits over the long term? The potential for a trade-off between expenditure on pensions and expenditure on health and social care given rising longevity is trailed. It also hints at the tension between current fiscal needs and intergenerational fairness.

The notion of the full state pension providing a firm foundation for private saving, with an approximate value of 30 per cent of median earnings, (the NSP at £155.65 per week is near to that figure) is not secure. If that foundation does not hold then the adequacy assumption, 45 per cent replacement rate for the median earner (30 per cent state, 15 per cent private provision), which underpinned the auto enrolment 8 per cent minimum contribution, does not hold. So either pensioners will get poorer or people will have to save even more and work longer. This will place further strain on the private tier to fill the gap and sustain an adequate pension system supporting future generations of pensioners.

Review of auto enrolment

The Government has announced a review of automatic enrolment in 2017. This will provide an opportunity to take early action to address inefficiencies in the existing policy and for the Government to give an early indication of the future direction of travel on the long term savings system.

The Government have confirmed that the scope of the AE review will:

1. Look at existing coverage and consider the needs of those not benefiting from AE, including workers with multiple jobs who do not meet the criteria for AE in any of their jobs;
2. Examine the AE thresholds for the earnings trigger and the qualifying earning bands;
3. Examine the age criteria for AE;
4. Consider how the growing group of self-employed people can be helped to save for their retirement;
5. Examine the level of the charge cap on AE default investment funds, including whether the level should be changed and some or all transactions costs should be covered by the cap;
6. Strengthen the evidence around appropriate future contributions into workplace pensions; consider how engagement with individuals can be improved so that savers have a stronger sense of personal ownership and are better enabled to maximise savings. The Government does not expect to make policy decisions in these areas during 2017.

The territory has been well mapped: the issue is how robust will the Government be in making decisions to deliver optimal long term outcomes, given current economic uncertainties. How to increase the level of savings and to improve value for money through the regulation of charges are both areas of importance to adequacy outcomes but where public policy is unsettled and uncertain. That uncertainty will continue as the Government has confirmed it will not make decisions during 2017.

The Government reference to improving engagement with individuals indicates that the behavioural assumptions and the deployment of behavioural techniques to underpin further public policy interventions are not yet settled. Will the emphasis be towards a view that if consumers only had enough information then they would make optimal choices or a view that the inability of individuals to act in the face of complexity and other behavioural biases will inhibit optimal decision-making? The terms of reference imply a presumption that improved engagement will maximise savings, they appear not to be preceded by the important question, what level of engagement is most appropriate for different individuals in order to produce the best outcomes?

The arguments are strong for extending coverage of AE to embrace more women, those with multiple ‘mini jobs’, the self-employed and those on earnings below £10,000 per year. The number of excluded is significant, and their continued exclusion will contribute negatively to the unequal distribution of long term savings.

An original argument for the exclusion from AE of those on lower earnings was that the state system in itself delivered an adequate replacement rate of income. ‘Freedom and Choice’ means individuals accessing their pension saving are no longer required to secure even a minimum income stream and are free to spend the money as they wish from age 55. Excluding lower earners from building a pot of long term savings is now neither fair nor rational and denies them the opportunity to build financial resilience in later life.

The Department for Business is holding an inquiry into a range of working practices, including the ‘gig’ economy, because it wants to ensure employment rules are up to date to reflect new ways of working. That argument applies equally to long term savings policy. Companies such as Uber and Deliveroo demonstrate the fluidity of the line between employment and self-employment. For the self-employed a nominated agent such as HMRC could take on responsibility for the process of auto-enrolment and Government may need to consider the role and extent of a state contribution given the absence of an employer contribution.

A realistic increase in employment rates for age groups below the SPa may make only a moderate difference to dependency ratios and the cost of increasing life expectancy. Inequalities in life expectancy and health between socio-economic groups may make across the board increases in retirement ages infeasible. Removing barriers to working post-SPA is therefore important, so continuing with an age criterion which excludes those over SPa and in work from AE and the benefit of an employer contribution is irrational. A policy which combined AE with abolishing employers’ NI for those over SPa may increase the employment rate of older workers.

The decisions which the Government make following the Review of AE will have significant long term implications for the adequacy of pension savings.

Housing wealth will also carry implications for public policy decisions on adequacy of pension savings and indeed on the funding of social care. For some individuals, the house as a pension option cannot be totally dismissed. There are good reasons however, to be cautious about the extent to which housing wealth reduces the need to increase pension saving.

Future returns on investments in housing are uncertain. It is not possible to determine if the current levels of prices in any geography is reasonable and what the future trend will be. To over rely on housing to fund retirement means investing in a non-diversified portfolio. Individuals currently approaching retirement have accumulated housing wealth in very favourable circumstances which may not exist in the future e.g. prices increased substantially relative to average earnings and higher inflation eroded the real value of mortgage debt.

Other life cycle issues may make potential claims on housing wealth. It may be needed to fund care costs rather than pensions throughout retirement. Changes in behaviour such as later house purchase and higher mortgage debt may result in a significant number of retirees owing substantial mortgage debt which may offset the impact of home ownership. The distribution of housing assets may mean they provide a partial pension substitute for some but not for others. If housing is to provide a retirement income for some it needs to do so in ways which do not require pensioners to give up their access to rent free living.

The risks involved in over reliance on home ownership and the diversity of individuals' circumstances are cautions against assuming housing assets are a substitute for pension saving.

Tax relief and the incentive to save

The tax relief incentives for pension saving are expensive so it is not surprising that there is growing concern that the benefits are unequally distributed and not focused more on those most in danger of under saving. If the objective of public policy is to encourage people to make adequate provision, the current skew towards higher rate tax payers is not optimal. An alternative approach is for tax relief or the value of a 'government matching' contribution to be at a common rate for everyone, but higher for basic rate taxpayers and lower for higher rate tax payers so addressing adequacy and sub optimal distribution.

Governments have limited tax relief for higher rate taxpayers through the lifetime limit on the final capital sum and the annual allowance on contributions/benefits accrued, but the incentive for the basic rate taxpayer has not increased. Rather the debate has shifted to the overall cost of pension tax relief and whether the Government's need to address current fiscal demands will lead to a significant reduction in overall tax relief at the point of saving. The concern that Government will change pension savings tax relief from an exempt, exempt, taxed (EET) to a taxed, exempt, exempt (TEE) regime, heightened when it published the Incentive to Save: a consultation on pensions tax relief, in July 2015.

The potential risks if the Government take such an approach are: the absence of evidence that a TEE regime would increase (not decrease) pension savings, the undermining of the momentum in workplace saving achieved through AE; a negative longer term impact on the Exchequer; people retiring in the future making a limited tax contribution but consuming high levels of public services, which would be unfair on future generations; the removal of taxed withdrawals in retirement so incentivising people to spend their savings too quickly.

A shift to a TEE regime, removing the tax incentive at the point of saving, relies on consistency of pension policy over decades when there is little evidence it will hold. A TEE regime could be unsustainable if future Governments decided they needed to raise more tax to pay for public services. Individuals saving in a TEE system today may be subject to taxation later as a result of a policy change, so impacting the saving expectations of individuals.

A challenge for the Government is to balance current fiscal demands with building a sustainable private pensions system, a desire to reduce the cost of tax relief to aid budget deficit reduction and the need to incentivise individuals to save more and reduce their dependency on the State.

The recent debate on tax relief has focused increasingly on the individual incentive to save rather than the employer incentive to contribute, notwithstanding the barriers to rational decision-making by individuals, and the fact the vast majority of pension income derives either from state provision or from people being enrolled in pension schemes as a by-product of an employment contract. In large part, this is why AE has been so successful, underpinned by the role of the employer, encouraging and incentivising greater pension saving amongst employees. Overall in 2015 contributions by employees accounted for 30 per cent of saving, tax relief on contributions 10 per cent and employer contributions accounted for 60 per cent.

The extent of further voluntary pension saving by workers is likely to be heavily influenced by the willingness of employers to play a sponsorship role and increasing employer pension contributions beyond the compliance level is a difficult lever to influence in a voluntary regime.

The Employer Task Force on General Employer Attitudes: Pensions (December 2004) confirmed that an increasing number of companies believed that they gained limited labour market advantage from paying people via pensions rather than cash wages and no longer saw the short and medium-term benefits of providing a pension. These findings were also confirmed by focus groups held by the Pension Commission.

The decreasing belief among many employers that there are self-interested reasons to provide good pensions, may have been abated by the compliance requirements of AE, but increasing employer engagement remains important.

Increasing employer engagement with workplace place pensions was central to the decision to introduce AE as part of the tripartite settlement - Government, worker and employer - to rebuild the private pension system. The AE review will consider further how to increase savings beyond that delivered by the minimum 8 per cent and where the balance should fall as between the individual’s incentive and responsibility to save or the employer’s incentive to contribution and their role in driving saving. Where that decision falls will affect the adequacy of pension savings over the long term.

The impact of recent pension reforms on the employer incentive to make contributions is unclear and unconsidered. It is possible to speculate that recent decisions have reduced the extent of employer engagement beyond compliance with AE minimum obligations.

The recent levels of change could lead employers to lose confidence in the certainty and direction of Government policy on private pensions, to believe that pensions as a distinct concept will not survive, and that employer tax incentives in support of workplace savings will be removed, all of which could put a downward pressure on employer contributions into workplace pensions. The increasing tax relief complexities arising from the lifetime allowance, annual allowance and taper provisions for the additional rate tax payer may result in a decline in the relevance of pensions as a whole workforce proposition. The introduction of “Freedom and Choice” could discourage employers from engaging with workers’ decisions when accessing their savings for fear the workers may regret their decisions in the future and mis-selling scandals may emerge in the market.

The assertion that pension savings are for individuals to use as they wish from age 55 divorces those savings from any requirement to secure an income stream and may reduce their perceived value to employers in managing an ageing workforce. Employers may outsource the delivery of workplace schemes to authorised providers so transferring the regulatory burden and improving value for money but also to distance the involvement of their internal human resources functions in pension provision.

New pension freedoms give individuals much greater ownership of how they decide to use their retirement savings. A new tax relief regime focused wholly on the individual could unleash a sense of responsibility and impact the level of savings but the evidence suggests otherwise. Research suggests workers save for retirement when the employer gets involved and makes it happen and without their involvement workers will save less. That is part of the reasoning supporting AE and why it has been so successful.

Freedom and Choice

For many coming up to retirement now with a DB pension and who may have additional DC pots, pension freedom and choice is very attractive. Significant lump sums can be accessed while maintaining a guaranteed income in retirement. But in the private sector a DB pension is not the future. As the Pension Regulator noted in January 2017 there are around 14.8 million members of DC schemes compared with 11.7 million in DB arrangements and 85 per cent of those actively contributing to a private sector pension are contributing into a DC pension.

Individuals reliant on funds accumulated in DC pots who exercise their ‘freedom and choice’ will be vulnerable to the behavioural biases but public policy has not yet reacted sufficiently to assist people to make better decisions. It is largely limited to making information available which is unlikely to ameliorate problems significantly. Government has the analytical resources to allow it to identify more efficient solutions. It has been a leader in promoting behavioural economics and has available resource in the Behavioural Insights team, a social enterprise partly owned by the Cabinet Office.

The team’s first publication in 2010, “Mindspace”, a guide to the application of behavioural economics, underlined the importance of defaults in pensions. FCA economists in a paper published in 2013 “Applying behavioural economics at the FCA” highlighted how information remedies may be ineffective where behavioural biases influence how the information is assimilated and that defaults may be a better remedy.

Public policy decision making is now predicated on splitting pensions into two elements, a saving phase and a drawing down phase. At the saving phase policy recognises the inability of individuals to act in the face of complexity and other behavioural biases inhibit optimal decision-making. Regulated defaults have been introduced to address the problem (auto enrolment opt out and default investment funds). At the drawdown phase policy expects behaviours to be dramatically different with individuals bearing the responsibility for making optimal choices. This inconsistency does not seem rational.

‘Freedom and Choice’ is a policy which precedes an evidence base, introduced in the absence of a publicised decision on the formal monitoring of decision-making outcomes. Government is heavily dependent on the market to deliver the successful implementation of that policy even though the competition authority and FCA evidence revealed that the markets have not worked well and the consumer is weak. The Government gave individuals the choice, it fell to the Regulator to develop the underpin of safeguards to that freedom. The FCA is focused on the provision of an enhanced set of information, even though the research shows that for many savers this may not improve outcomes. There is a need for more evidence to reveal how the market and the saver are responding to those freedoms and what that means for long term outcomes.

Without a set of default products at retirement, subject to robust governance and for which charges are capped, to help people by configuring options to take account of human irrationality, individual savers will make sub-optimal decisions which do not produce good outcomes either for them or for society. Income drawdown products do not have the governance and value for money requirements that workplace pensions possess. There is little governing drawdown and the investment strategies maintaining retirement income. The rising number of unadvised consumers highlights the need to protect vulnerable individuals as they grow older and their capacity to understand the risks they have to manage and exercise effective choice will become more limited. Without such products many pensioners relying on DC pots are less likely to maintain an adequate income stream throughout their retirement and mis-selling risks will increase.

The Efficiency of the Market

The inefficient features of the UK pensions savings market strengthen the importance of holding agents to account, while a weak demand side and consumer inertia allows conflicts of interest to flourish. Reforms are bringing in 10 million-plus new savers but governance and delivery models have not evolved sufficiently in response to AE and “Freedom and Choice”.

Interventions to influence the cost and governance of pension saving provision have delivered increased regulation at the cost of yet more complexity, which risks weakening consumer engagement further. The regulators’ task in improving governance in the pensions schemes market is made even more difficult by the quality of governance in public policy making which has resulted in sudden and dramatic changes in policy. The FCA chairman in a recent speech at Cambridge University Judge Business School (13 February 2017) commented *“regulation acts most effectively as a support for Government policy not a substitute”*. When however legislation on pension reform, is introduced ahead of settled policy, the role of the regulator risks drifting into setting policy. A recent example is provided by the new pension schemes bill which attracted criticism from both the Delegated Powers and Regulatory Reform Committee and the Constitution Committee of the volume of substantive policy decisions still to be made.

Improving governance is complicated by the existence of two regulators, the tPR dealing with trust provision and the FCA with contract provision. The tPR is looking to raise governance in part through scheme consolidation into Master Trusts who will be subject to a new authorisation, supervision and wind-up regime, although the extent of its rigour will only become evident over time. Master Trusts expose members to a specific risk as the presence of a scheme founder can introduce a profit motive and can limit the powers of the trustees, but they fall outside FCA regulation. As Master Trusts move increasingly into decumulation products the extent of the regulatory overlap between the tPR and the FCA may become more pronounced. The current separation of regulatory functions in the defined contribution accumulation and decumulation market may not prove to be efficient over the long term, serving to deliver greater complexity particularly if pension savings cease to be a distinct concept within the wider provision of long term savings.

On the contract side of the market, scheme members lack any direct agent to represent their interests so the FCA requires providers of workplace personal pensions to set up Independence Governance Committees (IGCs) to represent members' interests in assessing value for money and challenging providers to make changes where necessary. IGCs are given an explicit fiduciary duty to act solely in the interests of scheme members but their effectiveness is not fully developed or evaluated.

The joint FCA/DWP report " Poor Value Workplace Pension Schemes: A Review (13 December 2016) commented however:

"… in specific instances, and particularly where actions have not yet been taken by providers to reduce the costs and charges on schemes, we believe that IGCs could have played a more proactive and rigorous role in driving providers to agree robust actions more quickly…......In a small number of instances the independence of the IGC may be compromised due to its composition and/or a strong senior management presence at meetings which could impact the IGC's ability to independently assess and challenge the provider's actions…..".

It is uncertain at what speed and with what determination the FCA will drive the IGCs to deliver quantitative and qualitative improvements in governance and to what extent Brexit considerations will deflect focus and resources away from holding the agents to account.

Securing value for money for the saver is public policy still in progress as evidenced by the FCA consultation paper (5 October 2016) that proposed rules to improve the disclosure of transaction costs in workplace pensions, considering it essential that any rules of disclosure "*enable the flow of information to the governance bodies of those schemes*".

The introduction of IGCs' new Trustee duties set out in the Occupational Pension Schemes (Charges and Governance) Regulations 2015, and setting a cap on charges incurred on workplace pension default investment funds, are all measures designed to deliver that value. That cap excludes transaction costs and the IGCs and Trustees appear to have had limited impact on enhancing transparency. In the majority of cases, trustees do not currently have access to information about transaction costs.

In November 2016 the FCA published its 'Asset Management Market Study' interim report, which provided a hard-hitting critique of the "sustained, high profits" that the industry had earned from savers and pension funds over the years — fund management firms, which three in four British households rely upon to manage their pensions.

The remedies proposed by the FCA include significantly raising the fiduciary bar to a new requirement to act in the best interests of investors. The report, which contains a withering critique of "active management", made it clear that small differences in fees and transaction costs can lead to significant losses for investors over time but found that more than half of ordinary investors are still unaware that they were paying fund charges, let alone what they are.

The DWP has a current undischarged legal duty to make regulations requiring that transaction costs be given to members of occupational pension schemes and the FCA has a similar duty with regard to workplace personal pensions.

In mitigation Lord Freud for the Government (Hansard, 19 December 2016) explained *“that there has never been a single agreed definition of transaction costs nor a way of calculating them….. many transaction costs are not explicit costs which appear on a scheme’s balance sheet but implicit “frictional” costs from trading, which need to be calculated. The wide variety of approaches to calculating transaction costs ….. quite significant differences in methodology, which can result in transaction costs differing by a factor of five….”*

The Government have also announced that the review of AE will examine the level of the 0.75% charge cap on administration charges in the default funds of schemes used for AE and whether some or all transaction costs should be covered by the cap.

Given the interests of asset managers and the increasing preoccupation with the implications of Brexit for the financial sector, the questions must be: to what extent will the Government force a pace on transparency? Will pension scheme members secure sight of all costs and charges? Will some remain hidden or will millions of people who save through inertia, for the benefit of the public good, continue to have their assets managed in a market that is not functioning well?

The complexity of private pensions, and indeed of any long-term investment product available to the ordinary saver, fed in part by regulation to protect weak consumers, means that it is increasingly impossible for people to understand all the detail. In future individuals will bear more risk at and during retirement than previous generations of pensioners but many will be ill equipped to manage those risks as the decisions become more complex. The assumptions behind public policy thinking on how to support individuals in making decisions or how behavioural techniques can contribute are unclear.

The Government and industry are working to provide support and guidance to savers, but many of these programmes are in their infancy and have yet to be fully developed and evaluated. Progress is impacted by the continuing lack of a settled regulatory definition of advice and guidance and where the boundary between the two lies.

The Government intend to create a public financial guidance body against

“a back drop of broader reforms and initiatives intended to help consumers build savings and improve financial resilience and capability”.

The new body will be free to adapt its service offer. For pensions guidance to be meaningful however, it would need to be independent and impartial so that it can go much further than guidance from a product provider fettered by its product suite. It needs to be specialist, as savers’ low level of knowledge means their presenting question often does not reflect the underlying matter that needs to be addressed. With these characteristics it can make a greater contribution to mitigating market failures and reduce an over reliance on making people pay for expensive advice.

An increasing number of individuals have been subject to unsolicited approaches and scams and have lost, or are at risk of losing, their savings. Cold callers, suspicious transfers and the abuse of small, self-administered schemes all require attention. The scams cover a wide spectrum, from mis-selling, to incompetence, to outright theft and fraud. It is important that the Government maps the scam problem, so that the actions it takes are fit for purpose. When savers transfer their pension money through a scam vehicle, the prospect of recovering their funds is remote. A ban on cold calling is a necessity, but not of itself sufficient. A more comprehensive set of measures is needed. Even then scammers will continue to evolve and adapt to those measure given the prevalence of ill equipped savers in the marketplace. Cold callers may move offshore in response to Government initiatives and become difficult to ban. People are already receiving unsolicited texts, letters and approaches through social media which may be more difficult to control. Unsupported savers with insufficient financial capability are providing a free lunch for the sharks.

Concluding Comment

Assumptions published by the Department for Work and Pensions show SPa will rise to 69 for those in their mid-30s and below. The OBR fiscal sustainability report (January 2017) however, observes that under the ‘old age variant’, a set of projections based on assumptions of low fertility, low immigration and high life expectancy, the SPa rises to 74 in the 2060s on the basis of the principle that people should expect to spend up to one third of their adult life drawing a state pension.

If the future is a world where people cannot get a pension until they are 74 then in a generation it will be necessary to secure transformational change in the approach to work, savings, health and care: a level of change for which public debate and the strategic approach of public policy are currently unprepared. The only people who will have real choice about when they stop working will be those who have significant savings or other assets of their own and are not dependent on the state pension.