Spotlight on Pensions
PRESENTS
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Making good policy

Retirement income planning necessarily relies heavily upon a number of assumptions. The timescales involved both in the period up to retirement and during it, together with uncertainties around longevity, make planning something of a dark art. Effective planning also requires that all relevant factors are considered together.

It is right that assumptions are regularly reviewed and as and when there are clear and significant changes to underlying data, that they are fed into policy reviews. The challenge is to recognise when a change point is reached. Given that the relevant data comes from multiple sources and is updated at different times, that point can be difficult to spot.

Change point reached?

A pensions policy-challenging change point has arrived with the publication of the latest national population projections from the Office of National Statistics. These projections are developed from 2020 base figures and so as always are necessarily subject to an element of uncertainty. However, they seem to confirm trends that have been observed elsewhere, that suggest the emergence of a different picture from that upon which current Government, employer and individual pension planning policy is based.

Assumptions underlying current policy

Around the turn of the century there was a significant upward correction in the life expectancy assumptions, based upon the discovery that those then in use had failed to recognise and account for improvements over the previous decade or so. That prompted a major recalibration over a short period of time, suggesting that life expectancy was increasing at a hitherto unseen rate (and prompting some questionable predictions of future lifespans akin to immortality).

If that was indeed correct, then there were major implications needing to be addressed quickly. This resulted in major hits to DB scheme funding rates, and a scramble to increase state pension ages (SPA). This included bringing the female SPA into line with the male one (over a short timeframe), generating much angst and even prompting litigation from some affected groups.

New projections

The latest more muted ONS life expectancy projections suggest that the current upward trajectory for DB funding and plans for the increase in the SPA should at least be reviewed - and possibly halted. In extremis the trajectory might even be reversed, although it is doubtful that the figures are sufficiently different to make that call at this stage.

The ONS figures also paint a picture of a largely stagnant domestic population size, getting rapidly older, incorporating a declining birth rate. This could be mitigated by an increase in net migration of working age people into the UK. The ONS projects this to be a net increase of 2.2 million over the next decade, but in view of the political policy climate post Brexit it would be reasonable to treat this figure with some caution.

Whether or not the migration figures prove accurate, the country is still looking at an increased age dependency ratio and greater financial burden placed upon a declining number of people of working age. This, to some extent restricts the scope for easing benefit limitations suggested by the reduction in the life expectancy projections. The conflict between these factors makes for a complex assessment of where the balance should currently lie.

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SPA review

Nevertheless the ONS figures do indicate the need for the balance to be reset. Under the Pensions Act 2014, the Government is required to undertake regular reviews of the SPA. The next review must be published by 7 May 2023 and it was announced in December 2021. It requires two separate reports, the first being an assessment by the Government Actuary of the age of entitlement in legislation by analysing the latest life expectancy projections. The latest ONS figures will feed directly into this.

The second report is more interesting from a wider policy perspective and opens up the potential for more significant reform. It is worth looking at its terms of reference in full:

"The independent report should explore what metrics Government should take into account when considering how to set State Pension age. It should include the following factors:

- *a consideration of recent trends in life expectancy in every part of the United Kingdom;*
- *whether it remains right for there to be a fixed proportion of adult life people should, on average, expect to spend over State Pension age?*
- *what metrics would enable State Pension costs, and the importance of sharing these fairly between generations, to be taken into account when making State Pension age decisions?*
- *what additional or alternative metrics would be appropriate to take into account when making State Pension age decisions?*

In conducting analysis and reaching conclusions, the independent report should have regard to both the sustainability and long-term affordability of the State Pension and the views of organisations, individuals, and other interested parties.

The Government Review is expected to take account of a range of evidence including: life expectancy, socio-economic issues and the future affordability and sustainability of the State Pension. The independent report is not expected to cover questions related to the structure of State Pension including, for example, how State Pension is uprated."

Encouragingly, the terms end "The content of the independent report is the sole responsibility of the person appointed to conduct the work who will have the final say on all key outputs and recommendations". Nevertheless the final decision in respect of any recommendations will remain firmly a political one.

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Wider impact of the SPA

The impact of the SPA is of course wider than just the age from which people can access their state pension. It influences private pension decisions and directly affects the cost to the Exchequer. If the new longevity figures are correct, bringing it forward from the current proposed ages would remove the windfall to the public purse that would otherwise occur from an overall drop in the term over which the pension would be payable.

It may be that, taken in the round, the acceptable political decision should be to cut (whether directly or through just allowing it to decline over time) in real terms the value of the state pension. That would place greater emphasis upon private provision to fill the gap. Despite the success of automatic enrolment in terms of increasing coverage of pension provision, there is still some way to go on current terms to provide a desirable retirement income for all workers, let alone taking up any future slack from a reducing state pension.

If the automatic enrolment system is to deliver on wider national expectations, then reductions are required to the current qualification age of 22, the £10,000 earnings trigger and the £6,240 lower earnings limit for contributions. In addition, given the growing numbers of self-employed workers who are not currently covered by the system, a solution to engaging them with the private pension savings system is urgently required. The Government's current position on automatic enrolment is that no changes are necessary. However, pressure is growing for reform, including a Private Member's Bill put forward by Richard Holden MP to try to force through the changes to the terms for employees.

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Integrated approach

All this adds up to a complex puzzle, with multiple interrelated parts. Although policy reviews are becoming more integrated, progress in this respect is slow, and they are still too often undertaken in silos, with the more challenging issues tending to end up on the "too difficult" pile.

One such is pensions for the self-employed. The Taylor Review of Modern Working Practices published in 2017 recommended that "the Government should think creatively on ways to improve pension provision amongst the self-employed, making the most of opportunities presented by digital platforms and the move to more cashless transactions". However, despite Government acceptance of the recommendation (while also reasonably noting the difficulties involved) the issue remains unresolved. Work is apparently ongoing on a digital tax form to make it easier to operate an automatic enrolment arrangement, but a solution to the fundamental issue has still to emerge.

This all has echoes of the situation that existed in 2002, when the Pensions Commission was convened to take an holistic view of the UK pensions scene, balancing the various competing issues and suggesting an integrated solution. Its reports in 2004 and 2005 led to the groundbreaking Pensions Acts of 2007 and 2008 which introduced key concepts such as automatic enrolment, backed by all-party political support. The matters identified in the terms of reference to be addressed by the second report under the SPA review flow from the Pensions Commission's work.

To be fair, today's situation represents a considerable improvement over that of 2002. However, as we have seen, there are still significant issues to address.

It is time to resurrect the Commission, with a similar remit to review the pensions scene, but this time also specifically including provision for the self-employed. The original Commission was faced with a major task of first gathering relevant data, which at that time suffered from large gaps. That is no longer the case. Also, any new Commission would have the benefit of the last Commission's work upon which to build. All this means a smaller workload, and that the timeframe for a new Commission to produce a report with recommendations can be much shorter – an important consideration given the need to find solutions as soon as possible, before the retirement prospects of too many more citizens are prejudiced.

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Moving forward

The very nature of pension provision makes it a challenging subject. The need to develop and implement plans over a long timeframe involves making and regularly reviewing assumptions, and making adjustments where the evidence identifies a need. That is so whether the provision comes from the state or from private sources.

The new ONS figures clearly illustrate the need both for regular policy reviews and for regular testing of the efficacy of current policy. The second independent report on SPA gives hope that this area at least will be thoroughly reviewed. Hopefully the recommendations and the Government's response will be consistent with the need for change implied by the new figures.

But it is time to go further. Even a revised SPA policy (if it happens) will not be enough by itself to address the poor pension prospects of millions of UK citizens. Automatic enrolment provides a good starting point but it needs to be expanded, both to improve outcomes and to take more workers under its wing. The close relationship between all these elements means that policymaking needs to be brought together.

Pendragon