

FAIR PENSIONS?



■ A pension scheme will never deliver an adequate income in retirement if the initial contribution rate into the scheme is too low

A decent retirement for all – the case for a Sustainable Pension Commission

TOO MANY workers are facing inadequate levels of income in retirement. Current pension policy is focused on implementing major reforms, such as the single-tier state pension and automatic enrolment.

But these will not solve the problem for everyone and government, employers and workers will have to address inadequate pension income soon.

Low retirement income

Much work can be done to address tax policy, charges and ways of converting savings into retirement income. But to solve the problem of low retirement income, we need to look at the most important factor: the level of contributions that are made in the first place.

No matter how well-designed and run a pension scheme is, it will

never deliver an adequate income in retirement if the initial contribution rate into the scheme is too low.

Minimum contribution level

The minimum level of contributions under automatic enrolment is a de facto target for millions of workers and will remain so. But current minimum levels of contributions under automatic enrolment cannot deliver adequate levels of income in retirement for all.

While there were understandable reasons for initially having a low minimum level of contributions, the policy will fail a significant proportion of workers.

With the growing acceptance of automatic enrolment, and the success in rolling it out, it is vital that we address this.

So what should the minimum level

of contributions under automatic enrolment be?

Any changes to the fundamental features of automatic enrolment should be based on evidence and capable of attracting broad support.

Prospect believes an independent commission should be set up to review all relevant factors and assess the minimum level of contribution that would be required for a median earner to accumulate a pension pot over a typical career that would deliver an adequate level of income in retirement.

Such a commission, drawn from employee, employer and academic backgrounds, could provide analysis after each State Pension Age review and present its recommendations to government in the same way that the Low Pay Commission makes recommendations on the National Minimum Wage.

Prospect makes the case for a sustainable pensions commission

MOST PEOPLE can agree on the main aim of pension policy: to enable workers to enjoy a decent standard of living in retirement.

The replacement ratio (see Table 1) is generally accepted as the best way to assess whether this outcome has been met.

Automatic enrolment

Automatic enrolment has had broad political consensus since it was first recommended by the Pension Commission in 2005 and has been implemented successfully under ministers of all political colours.

Although automatic enrolment has already significantly increased pension scheme membership, many people are likely to be contributing at the minimum levels and the average level of contributions has fallen (see Graph 1).

So despite the successful launch of automatic enrolment, Prospect believes that a typical worker, contributing at the minimum level of contribution under automatic enrolment over a typical career, will not save enough for an adequate level of income in retirement.

The policy as currently implemented is therefore potentially failing millions of workers

Retirement age

To assess the minimum level of contribution under automatic enrolment, retirement age has to be defined.

Retirement age is simply the age at which workers plan to stop working and start drawing their pension (although increasingly this is a process rather than an event).

Graph 1



Table 1

Level of earnings	Projected replacement ratio allowing for single-tier state pension and minimum contributions under automatic enrolment
£12,200	80.7%
£26,500	45.9%
£42,386	34.8%

In practice, retirement age will be a choice based on:

- the level of pension savings
- expectations for retirement
- attitude towards work and
- other factors.

It is reasonable to base any

assessment of automatic enrolment on a retirement age of State Pension Age (see box, State pension age).

Workers can retire before State Pension Age or work beyond this date if they choose. We simply want to assess whether different pension policies deliver a decent standard of living over a typical retirement for workers.

Sources of income in retirement

Workers in retirement usually rely on income from three main sources: the state, work-based pensions and personal savings.

For the purposes of assessing the adequacy of automatic enrolment

State pension age

STATE PENSION Age is the age that state pension becomes payable. It will be 65 for both men and women by November 2018. It will gradually increase from then and will be 66 for men and women by October 2020. It will increase to 67 between April 2026 and April 2028.

Current legislation provides for the State Pension Age to increase to 68 by April 2046. But this is likely to be superseded by regular reviews of State Pension Age in every Parliament (the first to be undertaken in 2017).

Under the latest life expectancy forecasts, the Office for Budget Responsibility projects State Pension Age to be 68 by 2036, 69 by 2049 and 70 by 2063.



REPLACEMENT RATIO

The replacement ratio is a person's income after retirement divided by his or her income before retirement.

This can be calculated gross or net of tax though it is more commonly calculated gross of tax.

If a person's total pension income was the same as their earnings before retirement the replacement ratio would be 100%.

If pension was half earnings before retirement it would be 50%. By the time we have retired outgoings are often lower than when we were working (eg mortgage may have been paid off or children may have become financially independent) and a target replacement ratio of less than 100% will often be enough for a decent standard of living in retirement.

Obviously the replacement ratio can only be a rule of thumb for a group or for an individual starting to save for retirement; it is only when personal circumstances, expectations and preferences become clearer that a more definitive view can be taken on the appropriate replacement ratio to target.

Prospect would like to see a pension system that enabled workers to achieve replacement ratios of 60% to 75%.

as currently implemented, we will look at workers who rely on the state pension and a work-based pension with contributions at the minimum level under automatic enrolment.

We have assumed that those workers have a 40-year career, have paid contributions on all their income and have chosen to take 10% of their pension pot as tax-free cash on retirement.

Outcome under current minimum levels of contributions

The expected level of single-tier state pension is £151.23 per week.

Table 1 shows the expected replacement ratios. These allow for a full single-tier pension and for 90% of the pension pot accumulated through the work-based pension to be used to buy an inflation-linked annuity from State Pension Age, for workers on different levels of earnings.

The minimum level of contribution under automatic enrolment will deliver an adequate replacement ratio

for some, but not all, workers.

With a fixed amount of state pension income that is not related to income while working, the lowest earners have the highest reported replacement ratios.

Prospect is concerned that even at a median level of income, and assuming a lengthy career of full-time working, current policy will not deliver adequate pension income for many workers.

Independent body

PROSPECT IS not suggesting that the government changes the law to increase the minimum required level of contributions. It is best to have a wide degree of consensus before making significant changes to pension policy and there is no consensus for such a change at the moment.

But we are calling for an independent body to assess the adequacy of minimum contribution levels under automatic enrolment at regular intervals and to report its conclusions to government. ▶

GENDER PENSIONS GAP

The European TUC estimates that the gender gap in pensions across the European Union is 39%

THE GENDER PAY GAP is a well-known and understood – but few people are aware of the gender pension gap.

It is not surprising that there is a gender pension gap. Most pension systems do not adequately account for caring responsibilities. Pensions are related to pay, so lower pay will imply lower pensions. Women also live longer, are more likely to survive their partner and live alone in retirement.

A Prospect motion debated at the 2015 Trades Union Congress calls for greater awareness of the gender pension gap.

If what gets measured gets managed, then not producing statistics on the UK's gender pension gap is a recipe for sweeping the issue under the carpet. Official estimates of the gender pension gap in the UK would focus attention on the problem.

Increasing the minimum contribution rate under automatic enrolment would eventually improve outcomes for women.

A Sustainable Pension Commission could look at working patterns by gender (including the greater caring responsibilities and higher levels of part-time working by women) to consider whether more fundamental reforms to address the gender pension gap are required.

► A low pension commission

We believe such a body could command a wide degree of confidence and could take politics out of this important aspect of pension policy.

It would make sense for such a body to undertake this work after the regular reviews of State Pension Age.

It should draw its membership from employee, employer and academic backgrounds but also have a secretariat based at the Department for Work and Pensions.

Parliament could debate its reports and it would be up to government to accept or reject any recommendations.

This body could be based on the Low Pay Commission and its work on the National Minimum Wage.

We would hope that a body looking at adequate contribution levels would be equally successful at building a consensus for change and improving outcomes.

Sustainable Pension Commission

We have provisionally called our proposed body a 'Sustainable Pension Commission'. As Table 1 shows, the body would need to analyse projected replacement ratios for median earners rather than the

lowest earners.

This is because the single-tier pension will mean that for a given level of contribution to work-based pensions, replacement ratios will fall with earnings.

A Sustainable Pension Commission would have to conduct far more detailed and complicated analysis than we can do in this leaflet.

In particular it could maintain a rigorous equality impact assessment of the implementation of automatic enrolment.

Prospect would be particularly interested in whether gender – and different typical work patterns for men and women – led to different outcomes (*see Gender pensions gap*).

Summary

Prospect believes its proposal for a Sustainable Pension Commission builds on progress in pension policy in recent years, particularly the Pension Commission's good work.

Our proposal is modest – we are simply calling for an independent body to carry out a review.

We hope the proposed body would build a strong consensus and keep the position under regular review to ensure that automatic enrolment continues to deliver for workers into the future.



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