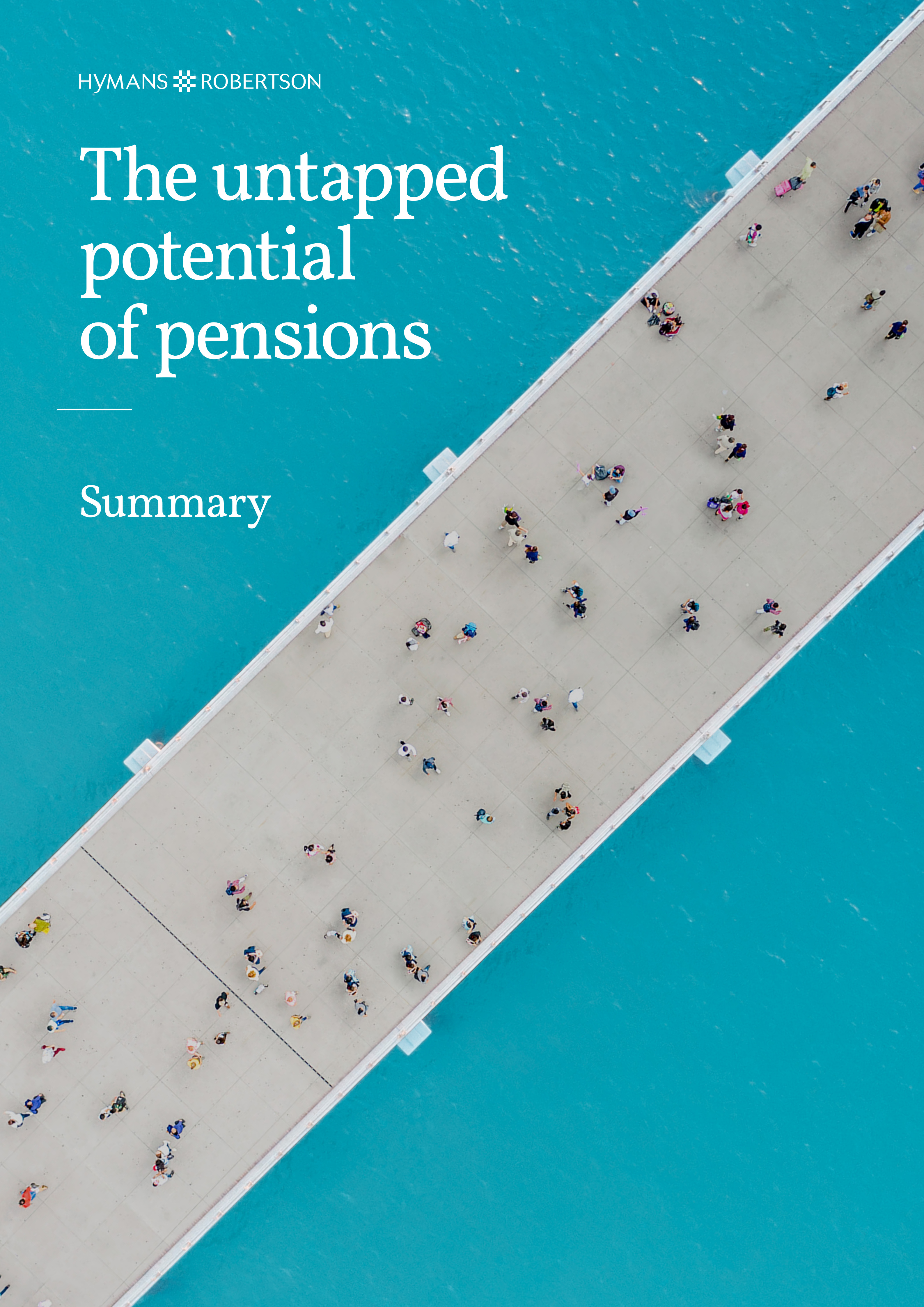

HYMANS ROBERTSON

The untapped potential of pensions

Summary

Policy team

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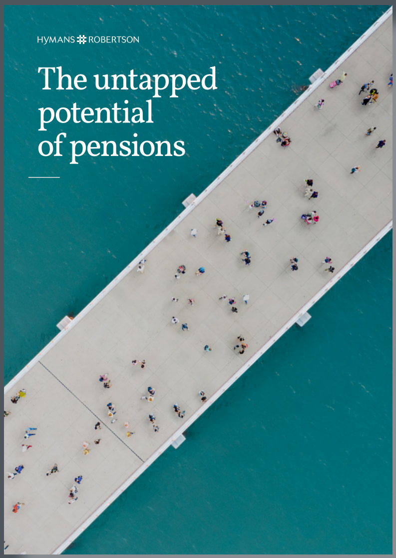
This is a summarised version of a longer and more detailed policy document. If you would like more explanation of the ideas outlined here, including the analysis, modelling and costing, please view the full version of the document here.



The untapped potential of pensions

The government is committed to change in pensions. We're encouraged by how quickly the pensions and retirement review, and new pensions bill, have moved ahead. The promised second phase presents an opportunity to make lasting changes to pensions, so they can give people financial independence in later life for as long as they live.

But it's also an opportunity to meet other important aims, which might seem unrelated at first glance. These include improving equity, unlocking billions of pounds and investing in economic growth at a huge scale.

People expect the government to set adequate default rates for pension saving. Auto-enrolment has been successful in getting people saving into pensions, but the current default rates aren't enough to give people adequate retirements.

The industry knows this, but most savers don't. They will when Pensions Dashboards launch, laying bare the retirement income inadequacy before this parliamentary term ends. The government needs a plan to get people on the path to adequate retirements.

This sounds like a plan that's expensive for the Treasury, employers and savers – and times are tight. But what if there were a way to get there while **making** money?

Our package of proposals would make money for the Treasury, save money for employers and enhance people's financial wellbeing. It would also stimulate investment in the UK, bringing us the £100bn a year that we need for 3% economic growth.

A big change requires lots of work, and this would be a big job for the pensions industry to implement. But the opportunity is also huge – to help current and future generations of workers, and the economy.

What we could achieve

In addition to more adequate pensions for all workers...

The Treasury would get **£28.5bn** a year

- £22bn from tax changes
- £3bn from DB surpluses
- £0.5bn from collective pension saving auto-enrolment changes
- £3bn from reforms to the state pension

Employers would get **£14.2bn** a year

- £1.2bn from offering collective pension schemes
- £13bn from DB pension surpluses

To invest in

- £26.5bn national wealth fund
- £1bn pension for self-employed workers
- £1bn auto-enrolment increases

Employees would get **50%+** more

- Pension income
- Deposit-free mortgages for first property purchases
- Financial resilience through a dedicated savings vehicle

Industry ideas to match the government's ambitions

Last year, we published a pensions plan for the new government. As the Labour government has shown its ongoing ambitions for pensions, we've developed our ideas to help it meet those ambitions. We see pensions as a force for good, with tremendous untapped potential for people today, the economy and future generations.

We've developed some of our ideas into detailed, costed proposals, in the context of a holistic view of retirement saving. Many of our ideas have broad industry agreement, and we expect them to ease the pressure on working people, deliver growth and massively alleviate fiscal pressures in the near term. In the long term they provide people with better pensions, for life.

Our package of proposals comes in two parts.

The first part covers proposals to save money; the second, proposals for where to invest it.

Cost is a barrier to increasing pension contributions, both for the contributors themselves (workers and their employers) and the Treasury (in the form of increased tax relief). We therefore propose four areas for saving money, which, once in effect, would unlock £28.5bn a year.

- Tax changes on pensions
- Collective pension saving
- Using pensions surplus for UK investment
- Sustainable state pensions

We then propose directing these saving to the Treasury to three areas.

- Investment where it's needed
- Enhancing auto-enrolment
- Including self-employed workers in pensions

Tax changes on pensions

Changing the way pensions are taxed can give the government **£22bn extra to invest in UK growth every year**, now rather than decades in the future.

We propose changing the tax arrangements on pensions in a way that's cost-neutral for employers, workers, pensioners and the government, but gets the money to the Treasury sooner and makes future pensions savings a much smaller drain of Treasury finances.

Currently, the government provides tax relief on pension contributions as an incentive to save. It gives this relief upfront and gets most of it back as people retire, as most workplace pension income is taxed when it's paid to the pensioner.

We propose no upfront tax relief on pension contributions. Instead, the government would pay a simple and transparent 'top-up' bonus into a saver's pension. Any pension income in retirement would then be fully tax-free.

Changing when pension income is taxed wouldn't disincentivise people from saving for retirement. Evidence shows that participation in pensions is driven by auto-enrolment rather than by the tax system.

Implementation would take years alongside operational innovation, but investment in anticipation of the extra cash flow could begin during this parliamentary term.

Collective pension saving

We'd love collective defined contribution (CDC) pensions to be accessible to more savers and employers. A CDC scheme pools risk between a group of members to give higher expected pensions than for an individual saver, for the same contribution.

CDC pension schemes are new to the UK, but a growing CDC market is a route to retirement adequacy and better outcomes for working people. CDC balances the interests of current and future pensioners, the government and employers. It also provides patient capital to invest in critical infrastructure for the long term.

To incentivise investment into CDC scheme development, we propose introducing a 'lifetime CDC' scheme, potentially leveraging some of the Pension Protection Fund's (PPF's) £13bn surplus, and its infrastructure and expertise.

To incentivise employers to pick CDC for their workers, we suggest a distinction between pure DC auto-enrolment contributions and CDC auto-enrolment contributions. With 20% take up, **a minimum CDC contribution rate of 1 percentage point less than for DC could save employers £1.2bn a year** and **save the Treasury £500m a year**.

CDC may deliver a **retirement income between 20% and 50% more than individual DC** with drawdown in retirement, for the same contribution. A successful CDC market has the potential to save money for employers, employees and the Treasury, while delivering higher overall expected pensions.

Using pensions surplus for UK investment

Connecting a vast store of surplus capital and wealth with the economy would stimulate growth and improve retirements for many people.

UK defined benefit (DB) pension schemes hold an estimated **£160bn** in surplus capital. Compared with our current trajectory, a shift towards growth-oriented assets over the next decade could unlock **more than £150bn** in growth assets and generate a **further £100bn in surpluses**, bringing total additional growth investment to over **£400bn**.

Legislation and pension scheme rules often mean that this surplus capital can't be distributed. But if the government lifted the restrictions and introduced incentives, we could mobilise hundreds of billions of pounds for the UK economy.

If half of the £260bn surplus is distributed to employers and taxed at 25%, it could raise **£3bn a year for the Treasury for the next decade**, enhance UK investment and improve DC pensions, with material amounts going back to employers.

A further step could be to increase DB schemes' risk appetite by using part of the PPF's £13bn surplus to provide a greater safety net.

A sustainable state pension

The government needs to make the state pension sustainable for generations into the future. The state pension is so important to many people – to have good retirements, they need confidence in it.

The government's 'triple lock' commitment to increase the state pension by the highest of earnings growth, inflation or 2.5% is more generous than in many countries, but it's unsustainable.

The state pension doesn't need to grow as fast as it does now once it's caught up with a minimum retirement income level – such as the Pensions and Lifetime Savings Association's (PLSA's) minimum retirement living standard (£14,400 a year for a single person).

By moving away from the triple lock in time, the government could **save £3bn a year from the late 2030s**, while still providing a pension above the minimum retirement living standard.

Investment where it's needed

The money saved should be used to boost the economy by investing in UK productive finance and growth assets. Pensions could play a much bigger role in the government's investment ambitions than currently envisaged.

Our proposals for tax changes would make £22bn a year available to the Treasury over 10 years. With a national wealth fund targeting £3 of private investment for every £1 of public money, we could make **more than £1trn available for investment in the UK**, for the benefit of current and future generations. The private capital could be raised from private-sector DB pension schemes, DC schemes, LGPS funds and other institutional or private investors.

For productive finance to work, we need clear plans and attractive opportunities. The government should identify where investment is most needed and make it attractive. Practical and tangible targets and goals will be vital to engaging and attracting investors.

Enhancing auto-enrolment

Many people are enrolled automatically on workplace pensions, but the amounts are not enough to give them adequate retirements. And many people aren't eligible for auto-enrolment.

We propose phasing in an **increase to the auto-enrolment minimum contribution** from 8% to 12%. We also propose **extending auto-enrolment to all workers**, not just those earning over £10,000 in a job.

Once the auto-enrolment minimum reaches 12%, the cost to the Treasury would be £1bn a year if our tax proposals are implemented (allowing for NI costs), or £2bn a year under the current tax system.

Alongside these changes, we propose **introducing a savings vehicle** to give flexibility and financial resilience. This 'side car' concept has been trialled by Nest Insight. Employee contributions would be directed to the 'side car' until it reaches at least £1,000; from then on, they'd go into the pension.

We propose **allowing pension saving to be used as collateral for mortgages for first-time buyers** only. This arrangement would let people get on the housing ladder without a deposit, and benefit from lower interest rates as lenders take on less risk of negative equity. Crucially, the money in the pension is still invested.

Increasing auto-enrolment contributions and extending auto-enrolment to all workers can help achieve retirement adequacy and narrow the pensions gender gap. Removing the £10,000 earnings threshold would make an additional 1.2m women and 328,000 men eligible.

Including self-employed workers in pensions

We would set a default pension provider for self-employed workers, and extend auto-enrolment and the 'side car' savings vehicle to them.

Only 18% of self-employed workers save for retirement, compared with nearly 90% of the employed population eligible for auto-enrolment. Any plan to fix retirement adequacy needs to include self-employed workers. Our proposals would be a first step to getting more of the self-employed workforce to save into pensions – we can improve pensions for **3.4m** workers in this way.

We propose treating self-employed workers the same as company employees, regardless of how much they earn. The first phase would be to introduce an increase in NI contributions for the self-employed, bringing them in line with those for the employed, and pay the extra money HMRC makes into the workers' pensions.

After the rate is equal to that of employed workers, we suggest phasing more rises, funded by the government, to equal the 1% contribution made by the government for the employed.

The second phase would make pension saving the default. The government could consider starting auto-enrolment for self-employed workers through the self-assessment tax return. The 'side car' would solve the problem of illiquid savings.

A better future for all

We hope our proposals stimulate discussion and help the government, policymakers and the industry to think big. Our plan is bold, costed and imperfect. We expect it will evolve, and we look forward to engaging the industry in delivering a better pensions future for all.

The principles behind our thinking

Hymans Robertson is not just another pensions firm. We're a certified B Corp, so we really care about all stakeholders and about sustainability. And we have a record of implementing industry-changing innovation.

We've been the scheme actuary to Clara-Pensions, the UK's first superfund, from its inception. We founded Club Vita, the industry standard for longevity analytics. Our Guided Outcomes (GO™) proposition changed the narrative in DC to focus on member outcomes and benefit adequacy. We've developed our technology, and GO now underpins our market-leading Hymans Robertson Expected Retirement Outcomes modeller.

We advise more UK DB schemes open to new members than anyone else – so we're used to advising on sustainability to help clients thrive in the long term.

Our proposals have been guided by 10 principles.

1
Clear policy intent
We assume the government wants to ensure financial independence from the state and dignity in later life.

2
Aligned time horizons
In the long term, collective pensions schemes open to new members will ensure pensions finance is productive, responsibly stewarded and plays its part in stimulating UK investment and UK growth.

3
Affordability
Pensions must be affordable now and into the future for the government, employers and workers.

4
Equity
Respecting difference and giving people what they need is key to an inclusive future.

5
Sustainability across generations
We need to stimulate growth and create jobs for the next generation in the spirit of a healthy social contract and exchange of gifts between generations.

6
Adequate retirement security
Retired people need to have financial security.

7
Financial resilience
People must have access to emergency funds for their financial wellbeing. And the economy needs to be resilient to financial crises by having a diversity of pension design and investments, not a monoculture.

8
No 'cliff edges'
Change must be gradual, so that all stakeholders know where things are going and have time to adapt. The introduction of auto-enrolment is a great example.

9
Costed and valued proposals
Any proposals should meet stakeholders' financial needs, and government incentives should be easy to see and appreciate.

10
Holistic policies
We're mindful of the role private pensions play in the context of the state pension and housing.

Tapping the potential

Our package of proposals would improve pensions adequacy and retirement security while helping government finances and economic development in the areas where it's needed.

Our proposals for:

- Tax changes on pensions
- Collective pensions saving
- Using pensions surplus for UK investment
- Sustainable state pensions

would give an extra

£28.5bn a year

to invest in pension adequacy and the wider economy

We can invest this money in productive finance and growth assets, use it to enhance auto-enrolment and include self-employed workers in pensions.

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