Workplace
Retirement
Income
Commission

Call for evidence

February 2011

Contents

Foreword by Lord McFall of Alcluith

Rt Hon Lord McFall of Alcluith

During my time as Chair of the Treasury Select Committee we saw a period of sustained economic growth as well as one of the longest and deepest global recessions brought about by the financial crisis. A new financial landscape will arise from the depths of that recession, but if we are going to get the economy going again we need to get people thinking about the long term to put the economy and our society on a sure footing.

That is why savings, and in particular long term savings, are crucial to the success of our economy and the long term prosperity of our population. I have always felt there was more to do to get people saving for their retirement. The demographic challenge is one of the biggest we face in our society. An ageing society costs more. If future generations are going to have a chance of providing for their own retirement and not just relying on the State, then we have to act now.

We have to address the serious lack of trust in savings and financial services in general. We need to:

- Make it easier for individuals to save for their retirement and ensure it is worthwhile for them to save.
- Make it easier for employers to provide support.
- Consider how people save for their old age.
- Consider the role of government in helping employees and employers meet the challenge of saving for retirement.

We cannot stand by and watch individuals not save enough for the long term. And we need to give people a greater sense that they can make their own informed choices about how they save for their older years.

So doing nothing is not an option.

We are not starting from scratch. Lord Turner's Commission set us on a welcome path towards getting more people saving into a pension for the first time and delivered a new approach in getting people to save for their retirement – the introduction of auto-enrolment and the new National Employment Savings Trust are landmark reforms. This will get more people saving something for their retirement. However, without a fundamental change in the way people view saving we will remain stuck in a world where individuals have to rely on means-tested benefits simply to get by in their old age.

This is why my fellow Commissioners and I have accepted the challenge of leading this Commission. We want to engage in the debate so we can set out a roadmap that shows how society as a whole can enjoy a worthwhile and dignified retirement, not just how it gets by.

My fellow Commissioners and I will focus on gathering evidence and understanding the scope and depth of the problem. We will do so by getting out and about, meeting a wide range of people – not just providers, but people who are trying to save for their retirement.

The Government has made a commitment to "reinvigorate occupational pensions". We want this Commission to show how that could be achieved as part of meeting the wider retirement savings challenge.

The Minister responsible has told me he is keen to see the outcome of our work. My aim is to produce a thorough piece of work that sets out the facts for industry and government and proposes radical solutions.

Write to us, email us, meet us. Rest assured that your input will be well received, whatever form it takes. I look forward to hearing from you.

Lord McFall of Alcluith

Commissioners

Rt Hon John McFall, Lord McFall of Alcluith

Chairman, Workplace Retirement Income Commission

John McFall was MP for Dumbarton and later West Dunbartonshire for 23 years. He was Chairman of the Treasury Select Committee and was made a Life Peer in 2010.

Graham Cole CBE

Graham Cole is currently the MD of AgustaWestland Group.

John Hannett

John Hannett is the General Secretary of the Union of Shop, Distributive and Allied Workers (USDAW).

Chris Hitchen

Chris Hitchen is the Chief Executive of rpmi the pension services company which runs the UK rail industry's pension arrangements.

Paul Johnson

Paul Johnson is the Director of the Institute for Fiscal Studies.

Imelda Walsh

Imelda Walsh is the former Group HR Director for J Sainsbury PLC.

Further details about the WRIC Commissioners can be found at www.wricommission.org.uk

Joanne Segars OBE, Chief Executive of the NAPF, will act as Secretary to the Commission.

Workplace
Retirement
Income
Commission

Chapter 1: Workplace retirement saving – an overview

As a nation we are not saving enough for retirement. Today, 12 million people are either not saving, or not saving enough, for their old age. In its 2004 report[1] the Pensions Commission concluded there were four possible policy solutions: work later, retire poorer, save more or pay more tax. A major element of the policy response has centred on saving more through auto-enrolment and mandatory contributions. And it is a response that has put saving through the workplace centre stage.

The new arrangements that will come into effect from October 2012 will undoubtedly be a big step forward in changing the nation's retirement savings habits. But they take place at a time of significant change – change in the way we currently save, and save for old age; in the way employers provide pensions; and in employee attitudes to pension saving. And they take place against a background of a rapidly ageing population.

Chapter 1 provides a brief overview of the retirement savings landscape and likely future trends. It is not intended to be a comprehensive analysis but a starting point for discussion.

Pensioner incomes today and tomorrow

According to the latest ONS data, average incomes for pensioner couples today are £564 a week (£264 for single women and £304 for single men). ONS data also reveal that since the mid 1990s, pensioner incomes have risen more than twice as fast as average earnings – 44% for pensioners compared to 20% for the working population[2]. The main reason for this rapid relative rise in pensioner incomes is the presence of occupational pensions. Mean income from private pensions for pensioner households stood at £11,200 (£7,100 for single male pensioners and £5,500 for single female pensioners).

With occupational pensions now in decline, pensioner incomes may not be expected to rise at such a rapid pace in future.

The Pensions Policy Institute (PPI) reports that, whilst auto-enrolment will have a positive impact on the *number* of people saving, the *level* of saving is uncertain. PPI modelling shows that the amount saved in workplace pension schemes could increase or decrease depending on how employers and employees respond to auto-enrolment[3].

[1] Pensions Commission, Pensions: Challenges and choices. The first report of the Pension Commission (2004)
[2] ONS, Pension Trends - Chapter 11 (2010)
[3] Pensions Policy Institute, Will Personal Accounts Increase Pension Saving? (2007)

The PPI reveals that pensioners are likely to have more varied baskets of assets and income in retirement in future, including housing wealth available for retirement income. But changes in the workplace pensions arena will also affect future pensioner incomes. The PPI conclude that, whilst changes to the state pensions system will mean that people on lower incomes should find it easier to meet replacement rates, "moderate to higher income pensioners may have trouble meeting replacement rates in future". It notes that the shift from defined benefit (DB) to defined contribution (DC) may mean that more moderate to higher income pensioners will find it hard to meet replacement rates from pension income alone[4].

Living and working longer

One of the most significant trends of the last few decades has been the rapid increase in life expectancy. In 1950, a man retiring at age 65 would have expected to live for an additional 12 years. A recent male entrant to the labour market today expecting to retire in the middle of this century would expect to live for 25 years[5]. Compared to today, the number of people over 65 will be around 50% higher in 2030 and will have doubled by 2060[6]. As people spend more time in retirement they will need the income to reflect this.

Increasing longevity is also the key driver behind the Government's intentions to increase State Pension Age. In 1955 there were four people of working age to every one person of State Pension Age[7]. This ratio is now three to one and expected to decline further. The decline in the dependency ratio comes at a cost, which falls on the current working generation. To illustrate this, in 2009-10, age-related public spending on health, pensions and gross social care was around 16.5% of Gross Domestic Product (GDP). Treasury figures suggest that this will increase to 20.6% of GDP by 2049-50[8].

Increasing longevity may mean that future generations of pensioners face additional financial pressures, including the need to fund long-term care support. Longevity has been an important factor in employer decisions to close defined benefit schemes.

Sources of workplace retirement income

Pensions

The primary source of retirement income provided through the workplace remains pensions. In 2009, 2.4m employees were actively saving into a defined benefit scheme and a further one million into occupational defined contribution schemes[9]. In 2006-07, there were also 6.9

[4] Pensions Policy Institute, Retirement Income and Assets: outlook for the future (February 2010)
[5] GAD: ONS, Cohort Expectation of Life Tables (2008)
[6] DWP, A Sustainable State Pension: when the state pension will increase to 66 (November 2010)
[7] Age 20 to State Pension Age
[8] DWP, A Sustainable State Pension: when the state pension will increase to 66 (November 2010)
[9] ONS, Occupational Pension Scheme Survey (2010). This excludes individual, group personal or stakeholder pensions

million people contributing to personal pensions[10]. Comparing these figures to the ONS estimate of 9m active members in workplace pensions[11] it can be concluded that a large proportion of personal pensions are provided through the workplace, ie they are group personal pensions or stakeholder arrangements.

Table 1: Active number of members by pension arrangements (millions)

Type of pension arrangement	Number of active members
Defined benefit schemes	2.4
Occupational defined contribution schemes	1
Private pensions (including individual, group personal and stakeholder pensions provided through the employer)	6.9

28% of private sector employers, covering 82% of all employees, provide pensions to their staff[12]. However, employer pension provision varies significantly by firm size. 52% of firms with 20 or more employees offer some sort of pension provision compared to 24% of companies with 5-9 employees and 5% of employers with 2-4 employees. Firms with 20 or more employees are more than twice as likely to contribute to that pension as employers with 5-9 employees[13].

Employers and employees together contribute on average 24% of gross salary to a defined benefit plan. For a defined contribution plan, this figure stands at 11%:

Table 2: Average employer and employee contributions by scheme type[14]

Type of pension scheme	Average employer contribution	Average employee contribution
Defined benefit	17%	7%
Defined contribution	7%	4%

Income and replacement rates will vary according to the type of pension offered:

Table 3: Typical income for a median earner from a lifetime of saving

DC scheme	DB scheme
11,600	23,200

Assumptions: (i) All figures in current prices. 2010 median average earnings (all) = £21,024 (ii) teal earnings growth 2% per year DB: 40 years service, 80[ths] accrual; (iii) DC: AMC = 0.5%, real investment return = 3.5% , annuity rate (65, single life, non-smoker, 3% escalating) = 4.7%;

[10] ONS, Pension Trends Chapter 6 (2009)
[11] ONS, Pensions Trends Chapter 7 (2010)
[12] Department for Work and Pensions, Employer's Pension Provision Survey (2009)
[13] Making automatic enrolment work. A review for the Department for Work and Pensions (2010)
[14] Department for Work and Pensions, Employer's Pension Provision Survey (2009)

Other forms of workplace saving

In addition to pensions, some employers may also offer staff access to other savings arrangements.

- Over the last decade, there was a marked increase in the number of Tax-Advantaged Employee Share Schemes offered. In 2000-01, 5,180 companies offered one or more tax-advantaged employee share schemes. By 2008-09 this figure had more than doubled to 12,140[15].
- Over the same period there was a decline in the popularity of SAYE schemes[16].
- Employers are also starting to offer workplace ISAs.

In addition to benefits designed to help employees save directly, employers offer a wide variety of benefits on top of basic salary.

A survey for the Chartered Institute of Personnel and Development[17] showed that 95% of employers provided a pension in addition to a salary. The top ten employer benefits other than pensions provided to all employees were:

- Training and career development – 71%
- 25 days or more paid leave – 67%
- Free tea/coffee/cold drinks – 62%
- Christmas party/lunch – 60%
- On-site car parking – 60%
- Childcare vouchers – 56%
- Life assurance – 51%
- Eye care vouchers – 46%
- Enhanced maternity/paternity leave – 43%
- Employee assistance programmes – 42%

Non-workplace retirement saving

Outside the workplace there is a considerable amount of saving that may be used for retirement.

- **ISAs:** In 2009/2010, there were 14.9m ISA accounts. The average annual subscription was £2,731 for a cash ISA and £4,155 for a stocks and shares ISA[18]. £172bn is saved through ISA accounts[19].

[15] HMRC administrative database, table 6.2
[16] HMRC, Save as You Earn Share Option Schemes
[17] Chartered Institute of Personnel and Development, Annual Survey Report (2009)

- **Equity release:** The value of the equity release market now stands at £205m[20].
- **Property:** The mean value of a property held in addition to the main property was £247,300 in 2006/8[21].
- **Other forms of saving:** Over £1,000bn is saved in building societies, banks and NS&I[22].

Access to workplace retirement saving

Pension coverage varies significantly according to employment status, gender, age, income, and sector. According to the ONS[23]:

- In 2008, 45% of self-employed men working full time belonged to a personal pension. This was down from around two-thirds in the early 1990s.

- Employee pension scheme membership varies by sector, with the highest coverage in public administration, defence and social security (92% for men, 90% for women), followed by electricity, gas, steam and air conditioning for men (79%) and education for women (75%). The lowest pension coverage is found in the hospitality and catering sector (6% for both men and women).

- The higher the weekly earnings of an employee, the more likely they are to belong to an employer-sponsored pension scheme. Where the employee earns over £600 per week pensions coverage for men and women is 75% and 82% respectively. This falls to 18% and 29% for men and women for those earning less than £300 per week.

- Membership of pension schemes varies with age. Men and women in their 40s and 50s have the highest participation in employer sponsored provision (65% men, 62% women) compared to around a third in the 22-39 age group.

- Membership of schemes is closely related to socio-economic status: two-thirds of those who were working for "large employers or in higher managerial positions" were members of pension schemes. This fell to 17% for those belonging to "routine occupations".

---

[18] HMRC, Individual Savings Accounts (2010)

[19] HMRC, (September 2010)

[20] Safe Home Income Plans, Press Release (17 November 2010)

[21] ONS, Wealth in Great Britain. Main Results from the Wealth and Assets Survey (2006/08); this figure needs to be interpreted with caution because it is derived from a survey of people self-reporting (and potentially overestimating) the value of their second home

[22] Building Societies Association (2010)

[23] ONS, Pension Trends, Chapter 7 (May 2010)

And research from the PPI shows that disabled workers are less likely than non-disabled workers to be saving in a private pension: 55% of 45 to 54 year-old disabled people in work are saving for a pension compared to 64% for non-disabled people[24]. The PPI also reveal that ethnic minority workers are less likely than white workers to be saving for a pension: 54% of 45 to 54 year-olds in work from ethnic minorities are saving for a pension, compared to 63% for comparable white people[25].

Workplace pensions under pressure

Despite being the primary source of retirement income provided through the workplace, workplace pensions have come under significant pressure over the last few decades.

Today, just 23% of defined benefit schemes in the private sector are open to new employees and 70% are closed. Ten years ago those proportions were reversed. Further rapid decline of DB is likely: almost 40% of schemes currently open to new members are likely to close over the next five years whilst a further one in three schemes already closed to new members are likely to take the final step of closing to future accruals[26].

In light of these pressures, the Coalition Agreement commits the Government to a programme of action to *"…simplify the rules and regulations relating to pensions to help reinvigorate occupational pensions, encouraging companies to offer high quality pensions to all employees…"* [27].

Notwithstanding this decline, the legacy of DB will remain for some time to come. Those schemes that are not bought out by insurance companies will expect to be paying benefits for decades to come in some cases. And the £800bn of assets under management in those schemes will remain a significant economic force.

As outlined in the introduction to this Chapter, further – significant – changes are on the horizon. From 2012 all employers, irrespective of size, will be required to auto-enrol all employees aged 22 and over and earning more than £7,450 into a workplace pension scheme. Employers and employees will also be required to contribute to the scheme – at least 3% from the employer, 4% from the employee and 1% from tax relief – on a specified band of earnings. This will be a significant change to the way in which workplace pensions currently operate and will mark a shift from a predominantly 'opt in' joining basis to an 'opt out' basis as a means of increasing scheme take-up.

[24] Pensions Policy Institute, Briefing Note 50, The under-pensioned: disabled people and people from ethnic minorities (March 2009)
[25] Pensions Policy Institute, Briefing Note 50, The under-pensioned: disabled people and people from ethnic minorities (March 2009)
[26] NAPF, Annual Survey (2009)
[27] The Coalition: our plans for Government (May 2010).

It is not just auto-enrolment that will change the way pensions are provided over the next few years. The Coalition Government has already signalled an active legislative programme of pension changes:

Box 1: Further changes to pension and saving provision

- The timetable for increasing the State Pension Age has been accelerated, reaching 66 for both men and women by 2020.
- The Government has indicated its intention to publish a Green Paper on state pension reform with the likely objective of making the state pension simpler and more generous.
- The Government will phase out the default retirement age.
- The Government has made significant changes to the tax rules for saving in a pension, reducing the amount that can be saved annually tax free from £245,000 to £50,000.
- The Government has introduced proposals giving people more flexibility to access their pension pot on retirement.
- The Government is consulting on whether to give people the chance to access some of their pension savings before age 55.
- The Government has made the uprating of the basic state pension more generous. It will now be increased in line with the higher of earnings, prices or 2.5%. The maximum savings credit will be frozen for four years from 2011-12.
- From April 2011 the State Second Pension and public sector pensions will be uprated in line with CPI rather than RPI and some private sector pension schemes can also use CPI as their uprating index.
- In its June 2010 Budget, the Government confirmed it would index link the annual ISA subscription level from 2011/12.
- The Government has stopped contributions to the Child Trust Fund and decided not to proceed with the Savings Gateway.
- The Independent Public Service Pensions Commission, chaired by Lord Hutton of Furness, is drawing up recommendations for public sector pension reform.

Question 1: Is this the right assessment of the state of retirement saving provided through the workplace and elsewhere today – and likely future trends?

Chapter 2 – workplace retirement saving tomorrow

This chapter briefly examines a range of issues affecting workplace retirement saving and retirement income. It looks at the barriers to retirement saving; coverage and adequacy; understanding and engagement; trust and confidence; the balance of employer and employee risk; employers' engagement in pensions and saving; how people save for retirement; governance and regulation; and retirement saving and the economy. These issues are examined from the perspectives of people saving for retirement, employers and the pensions industry.

The Commission seeks views on the questions raised. While the Commission does not anticipate that every respondent will answer every question, it is keen to hear your views on any of the issues raised.

Barriers to retirement saving

There are a number of barriers to people saving for their retirement:

- **Affordability:** One of the main reasons people cite for not saving in a pension is that they cannot afford it. A YouGov Poll for the NAPF shows that 43% of people were not saving for retirement because they said they could not afford to[28]. Research from the Consumer Financial Education Body (CFEB) also reveals that only 20% of adults in the lowest income group put money aside, compared to 60% in the highest income group[29].

- **Lack of foresight/long-term planning:** Individuals take a short-term view and do not take rational decisions about long-term savings:
  - people think they are too young to start saving for retirement – 58% of 18-24 year olds took this view[30]; and
  - people have a high discount rate – they tend to value income today over income tomorrow.

- **Means-tested benefits:** Means-tested benefits (and the Pension Credit in particular), can act as a barrier to save for some people – especially for those on low incomes who are concerned that saving, including saving in a workplace pension, will result in a reduction in Pension Credit. In other words, they cannot be sure it "pays to save".

[28] Poll conducted by YouGov. Total sample size was 4,177 adults. Fieldwork was undertaken between 21-24 January 2011. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+)
[29] Consumer Financial Education Body, Financial capability and saving: Evidence from the BHPS (2010)
[30] Poll conducted by YouGov (21-24 January 2011)

- **Inertia:** People suffer from inertia – they put off decisions about saving for tomorrow. This can be driven by a number of factors including:
    - lack of understanding;
    - complexity of pensions;
    - retirement being too far away;
    - putting off difficult decisions; and
    - lack of trust and confidence.

  Harnessing this inertia to make saving for retirement the norm lies behind the policy decision to introduce auto-enrolment from 2012. Companies that operate auto-enrolment experience take up levels around twice as high as those that use opt in joining methods[31].

Question 2: What are the barriers to getting people to save – and to save more – for their retirement? What further actions might overcome some of these barriers?

Question 3: How far will auto-enrolment address these barriers? How do you think employees and employers will respond to auto-enrolment?

Employers' engagement in pensions and workplace savings

Over the last few decades there has been a significant decline in defined benefit (DB) pensions, the traditional form of workplace pension arrangement in the UK, in favour of defined contribution (DC) pensions. Today, less than a quarter of DB schemes in the private sector remain open to new members[32]. At the same time, DC based pension coverage has grown, from 10% of the workforce in 1997 to 16% in 2009[33]. There have been many reasons for this shift, including: regulatory change, increasing costs (contributions and administration), changes in accounting rules, changing investment conditions and increasing longevity.

Notwithstanding this, many employers still view pensions as an important part of their remuneration policy and this is reflected in the reasons employers give for providing pensions. Research from the CBI reveals that 83% of employers agree that there is usually a good business case for providing pensions to employees; 75% agree that a company pension scheme assists with the recruitment and retention of staff; and 59% agree that a company pension scheme enhances corporate reputation[34].

[31] The power of suggestion: Inertia in 401(k) participation and savings behaviour, B.C. Madrian (The Quarterly Journal of Economics 116:4, 2001)
[32] NAPF, Annual Survey (2009)
[33] ONS, Pension Trends, Chapter 7 (May 2010)
[34] Confederation of British Industry, A View from the Top – CBI/Watson Wyatt Pensions Survey (2009)

However, as shown in Chapter 1, employer engagement with pensions varies significantly by size of employer. A DWP survey of employers[35] found that, among employers with 5-49 employees, 52% said the prime reason for providing a pension was that it is a legal requirement to do so. This contrasts with the largest employers (500 plus staff), where just 7% gave this response, with far more (59%) saying their key motivation was recruitment and retention – a key factor for just 20% of smaller employers.

In considering how they apportion their non-salary benefits budget, employers may consider the value employees place on the benefit provided. The same DWP survey found that, even among employers who provide pensions, 37% said their employees placed 'no value at all' on pension provision, while 27% valued it 'a little'. Just 19% valued it 'a fair amount' and 17% 'a lot'. However, employees continued to value workplace pensions: 39% said that a pension is the most important benefit an employer offers on top of their salary – nearly twice as many who said flexible working (20%) and almost four times as many who said the annual bonus scheme (11%)[36].

Some employers are also looking at different ways of rewarding their employees and supporting their saving. As Chapter 1 shows, there is already a considerable amount of non-pension saving taking place through the workplace. This may increase further. For example, some employers are starting to introduce workplace ISA arrangements to help staff save for shorter-term savings needs, and some financial services companies are looking to develop this area of the market. Following the introduction of auto-enrolment in 2012, some employers may choose to limit their pension contribution to the statutory minimum (currently 3%) but reward their employees with other forms of benefit and saving options.

Question 4: Why do employers provide pensions? What is the role of the employer in providing retirement income, and where does this responsibility end? Does this vary by size of employer?

Question 5: What priority will employers give to pensions compared to other workplace benefits – including other saving vehicles – in their remuneration policy post 2012?

Coverage

The Pensions Commission concluded that average pensioner incomes today compare relatively well with those of previous generations. But it also observed that the distribution of this income was unequal given differences in employment history, coverage of private pension provision, and gaps in entitlement for those who had interrupted working lives

[35] Department for Work and Pensions, Employers' attitudes and likely reactions to the workplace pension reforms 2009: Report of a quantitative survey, H. Bewley and J. Forth (2010)

[36] Poll conducted by YouGov (21-24 January 2011)

(especially women and carers). Data in Chapter 1 provides information on groups where coverage is weakest.

The changes introduced following the Pension Commission's report (improving the state pensions system and the introduction of auto-enrolment and NEST) will go some way to addressing this. By 2025 it is expected that reforms to the state pension system will mean that around 90% of men and women will receive a full basic state pension in retirement and the introduction of auto-enrolment and NEST will see an estimated 5-8m people start saving for their retirement[37]. However, even with these reforms it is estimated that 6-9m people will not be saving for their retirement through a workplace pension due to not being eligible for auto-enrolment (4-5m individuals) or opting out (2-4m individuals) [38].

In terms of remaining gaps in coverage, one area of concern is the self-employed, where pensions coverage remains poor[39]. Some sectors, such as manufacturing and finance, already have relatively good pensions coverage – the ONS shows workplace pension coverage in these sectors at 55% and 76% respectively[40]. However, the survey also shows that there are other sectors, particularly retail and hospitality that do not, with coverage at 29% and 6% respectively. These sectors typically see more casual or part-time working. While auto-enrolment should improve coverage, sector differences will remain.

Question 6: Where are the remaining gaps in coverage both in terms of types of worker who will be at risk of undersaving for retirement and sectors of the labour market? What are the potential policy solutions?

Adequacy

Different individuals will have different income needs in retirement. These are often expressed as replacement rates (ie setting out retirement income as a proportion of working income). For some individuals on lower earnings throughout their lives it may not make sense for them to save as benefits from the State will provide an adequate replacement rate. However, as set out in the Making auto-enrolment work review, there are very few people in this position.[41] In thinking about their proposals for reform of the state and private pensions system, the Pensions Commission considered policy options against achieving a minimum replacement rate of 45% for a median earner – broadly 30% from the State and 15% deriving from (quasi) compulsory private pension saving.

[37] DWP, Pensions Bill 2011 Impacts, (January 2011)
[38] DWP, Pensions Bill 2011 Impacts, (January 2011)
[39] ONS, Pension Trends, Chapter 7 (May 2010)
[40] ONS, Pensions Trends Chapter 7 (May 2010), figures refer to men only
[41] Making automatic enrolment work. A review for the Department for Work and Pensions (2010)

This was very much seen as a starting point. The Commission noted that people might need to save more – for example, lower earners might need a replacement rate closer to 80%.

The introduction of auto-enrolment and NEST should meet the Commission's initial vision. The key question will be whether, over the longer term, this delivers adequate incomes in retirement and the outcomes that individuals want.

Question 7: What level of income should individuals be targeting in retirement?

Question 8: Is an 8% total contribution enough to achieve the desired outcomes? If not, what are the potential policy responses and how might these be delivered?

Trust and confidence

The introduction of auto-enrolment takes place against the backdrop of falling confidence in financial services including pensions. Maxwell, Equitable Life, personal pensions mis-selling and the financial crisis have combined to dent public confidence. In February 2010, at the depth of the recession, just 34% of people surveyed said they were confident or very confident that their pension would give them enough money to live on in retirement. Twelve months on, that number has risen only slightly to 36%[42].

However, when asked "who do you trust to provide a pension?" confidence tends to be highest in employers. In early 2010, 28% of employees said that they trusted employers most to provide them with a pension. This compared to 17% saying they trusted Government the most and 9% for insurance companies and banks[43].

It is not only the institutions providing pensions in which individuals lack confidence. They also lack confidence about the pension outcome: 55% of people are not confident that they will have enough money to live on in retirement[44].

Question 9: What effect has the financial crisis had on confidence in saving for retirement?

Questions 10: What can be done to improve trust and confidence in pensions?

Understanding and engagement

Consumer understanding of pensions is poor. A survey by Aon Hewitt[45] found that 85% of people do not fully understand what retirement income they are entitled to from the State.

[42] NAPF Workplace Pensions Survey, (Q1 2010 and Q1 2011)
[43] NAPF Workplace Pensions Survey (Q1 2010)
[44] Poll conducted by YouGov (21-24 January 2011)
[45] Aon Hewitt, Survey on attitudes towards saving for retirement in the UK (2010)

54% of non-retired people who have a pension fund have limited or no understanding of what income they are entitled to receive from their private pension.

This may reflect the fact that, as the Pensions Commission said in 2004[46], the UK has one of the most complex pensions systems in the world due to:

- a state pension system which is a mix of a contributory basic state pension, a means-tested Pension Credit and an additional earnings-related tier;
- a private pension system embedded in a myriad of laws and tax rules; and
- the interplay between the two systems, particularly the contracting-out option.

In a DC environment individuals are faced with more choice, and more risk if the choices they make turn out to be the wrong ones. An NAPF report looking at employer communications[47] found that 57% of employers had concerns about discussing pensions with their employees. It also found pensions are the employee benefit that employers felt most constrained in discussing. Specific problems included employees treating guidance as individual financial advice, concerns about FSA regulations, and difficulties in addressing investment outcomes and investment risk. But employees want engagement – a recent poll by YouGov showed that 75% agreed or strongly agreed that an employer should help their staff to save for retirement[48] and an NAPF Workplace Pensions Survey identified a strong demand for employer-led communication on pensions of various types[49].

Question 11: What are the respective roles of government, employers, individuals, employees and other groups (eg trade unions) in helping to improve understanding about the need to save for retirement?

Question 12: Are there barriers that prevent or discourage employers from providing support to their employees when it comes to saving for their retirement?

The balance of risk between the employee and employer

There are a number of risks associated with saving for retirement, for example:

- longevity risk – people living longer than expected;
- inflation risk – inflation eroding the value of individuals' savings;
- investment risk – investments not performing as anticipated or poor investment choices being made;

[46] Pensions Commission, Pensions: Challenges and choices. The first report of the Pension Commission (2004)
[47] NAPF, Talking pensions: employer concerns and options for reform (October 2009)
[48] Poll conducted by YouGov (21-24 January 2011)
[49] NAPF, Workplace Pensions Survey (Q3 2009)

- salary inflation risk – wage rises increasing the cost of providing pensions; and
- the risk of not saving enough and falling back on means-tested benefits.

These risks fall in different measure on employers, employees and the government. For example, in a defined benefit scheme the employer bears the investment and longevity risk. But the employee may face some risk if the employer becomes insolvent. And there is a risk to government of having to compensate for regulatory failure.

In a DC scheme the employee bears the investment and longevity risk, but employers may be at risk if pensions do not perform as the employee anticipated and the employer is held responsible by the employee.

An additional risk to government from both DB and DC is that of people not saving enough and having to rely on means-tested benefits. This risk has been exacerbated with the shift from DB to DC and the historical uprating of the basic state pension in line with prices not earnings.

Some of these risks can be managed by having a robust regulatory and pension protection framework, but there will always be a division of risk between the employee and the employer.

Question 13: In saving for retirement, how much risk is it appropriate for the employee to bear, and how much is appropriate for the employer to bear? Could risks be shared differently or more equitably? Does the capacity for risk alter with firm size?

Question 14: To what extent does the regulatory system push risk disproportionately to the employer or disproportionately to the scheme member? If this is a problem, what are the solutions?

The changing labour market and how people save for retirement

There is a question about whether today's saving and pension products match employment and retirement patterns today and tomorrow. Traditionally, pensions have lacked flexibility: an individual joined a pension scheme knowing their money would be locked away for the long-term and at retirement they would secure an income for life. However, the needs of today's savers and retirees may be different from those of previous generations. For example, more people in higher education mean that people are entering the labour market later and individuals may have more debt on leaving university.

This raises questions about how people will want to save for retirement in future.

- **Early to mid pension saving:** People who are starting to think about saving are more likely to have debt, be looking to buy a house and to have more flexibility around their employment patterns. So saving in a pension could seem a bit daunting and short-term needs may be the priority. Auto-enrolment (and re-enrolment) is designed in part to overcome this problem and to kick-start the savings habit earlier by requiring people aged 22 and over to join a pension. However, it cannot yet be known how many younger people will opt out of pensions.

  One proposed solution to tackling the perceived lack of flexibility in pensions is early access. Proponents suggest that the possibility of access to some part of the pension before retirement could encourage greater take up and/or higher saving levels. However, according to a report from the PPI, the evidence of the extent to which early access would positively affect take up and overall net saving is mixed[50]. HM Treasury is currently running a call for evidence on early access to pension saving[51].

- **At retirement:** One of the trends over the last decade has been more people remaining in the labour market for longer. Today, 870,000 people over 65 are still in work[52]. This trend is likely to continue as people live longer and have less put aside for their retirement. The Government has recently introduced changes to the way in which pensions may be taken[53]. Whilst this addresses some consumers' concerns, there remain issues as to how people convert their pension into an income and whether there is sufficient flexibility. For example, do occupational pensions, annuities or drawdown products match well enough pensioners' expenditure patterns? How well do they work for those in partial retirement or those who rejoin the workforce? Also, is there enough flexibility for individuals to combine small pots to maximise their annuity value? Are people maximising their pension income, eg by using the Open Market Option?

- **Non-pension ways of saving for retirement:** As set out in Chapter 1, there is a considerable amount of saving taking place outside pensions. A YouGov survey showed that while 49% said they were planning on funding their retirement through a workplace or private pension, 21% were saving through an ISA, 18%

[50] Pensions Policy Institute, Would allowing early access to pension savings increase retirement incomes?, by D. Silcock, S. James and A. Steventon (2008)
[51] HM Treasury, Call for evidence on early access to pension savings (2010)
[52] ONS, Labour Market Status by Age Group
[53] HM Treasury, Removing the requirement to annuitise by age 75: a summary of the consultation responses and the Government's response (December 2010)

were saving in a bank account and 17% were using property[54]. As people's preference for how they save for retirement evolves, there is a question for employers as to the shape of the optimal remuneration package.

- **Working longer:** The boundary between work and retirement is becoming increasingly blurred. In 1992 5.5% of those aged 65 and over were in employment, in 2010 this had risen to 8.8%[55]. This is likely to accelerate with the abolition of the default retirement age and people saving less for their retirement. The Government has also announced plans to accelerate the increase in the State Pension Age to 66. Models of retirement that were based on working one day and leisure the next are becoming less relevant. According to the DWP, people make the decision to extend their working lives based on health, job security, caring for others and financial security[56]. However, this raises issues about whether there will be the employment opportunities for older workers and whether there are any remaining barriers (legal or cultural) to older workers remaining in the labour force. It also raises questions about how employers will deal with these issues and about the mix, timing and shape of individuals' income in retirement.

Question 15: Will additional flexibility lead to an increase in saving? What would it mean for the balance between long-term and short-term saving? What issues might any additional flexibility raise for employees and employers?

Question 16: Are there additional issues that need to be addressed in the 'at retirement market' that have not been addressed so far in the Government's legislative programme?

Question 17: What impact will the increase in the State Pension Age and the abolition of the default retirement age have on a) employee behaviour and b) employer behaviour?

Supply side issues – the question of cost and scale

The UK's workplace pension landscape is characterised by a long tail of small schemes. 94% of DC schemes have fewer than 1,000 member. Under than 1% have more than 10,000 members[57]. The picture is similar for DB schemes: over 80% of schemes have fewer than 1,000 members, and only 3% have more than 10,000 members[58]. Average scheme size in the UK stands at 2,600 compared to 10,500 in the Netherlands and 27,000 in Australia[59].

[54] Poll conducted by YouGov (21-24 January 2011)
[55] ONS, Labour market status by age group
[56] Department for Work and Pensions, Factors affecting the labour market participation of older workers (2005)
[57] The Pensions Regulator, DC Trust (October 2010)
[58] Pension Protection Fund, The Purple Book (2010)
[59] NAPF, UK Pension Regulation Compared (2008)

Data from Capita Hartshead's Pensions Administration Survey shows that smaller schemes are relatively more expensive to run than larger schemes. Schemes with more than 50,000 members report costs of between £10 and £30 per member compared to costs of around £200 per member for schemes with fewer than 1,000 members[60]. And research from Spence Johnson shows that scale can be a powerful tool in ensuring effective member communications, not least because larger funds have the resources for creative and personalised campaigns[61].

Question 18: What are the pros and cons of having a long tail of small schemes? Are any new policy initiatives needed? What lessons can be learned from abroad?

Question 19: Are pensions in the UK too expensive to the consumer? Is this perception or reality?

Fiscal incentives to save for retirement

Tax relief is granted on pension contributions made by employees and employers as a way of encouraging individuals to save into a pension.

Pensions are taxed as deferred income and follow the EET model of tax relief – contributions are exempt from tax, investment growth is exempt from tax, withdrawal is subject to income tax with the ability to take 25% of the fund as a tax free lump sum. This contrasts with ISAs that follow the TEE model of tax relief – where contributions are made from taxed income, but investment growth and withdrawal are tax free. IFS figures show that if an individual is a basic rate taxpayer in work and in retirement, then contributing 94p to a pension delivers the same outcome as contributing £1 to an ISA. For a higher rate taxpayer in work who is a basic rate taxpayer in retirement, contributing 71p in a pension delivers the same as contributing £1 to an ISA[62].

The Pensions Commission found that while tax relief and employers' national insurance relief significantly improved employers' incentives to provide pensions, the benefits of tax relief are poorly understood, are unevenly distributed and comes at a significant cost.[63] Recent research from Aegon also suggests that the current system of savings incentives suffers from low awareness and understanding, complexity, and low trust[64]. The gross cost of tax relief was £28.1bn in 2009-10. The net cost of tax relief, taking into account income tax on pensions in payment, is £19.7bn[65].

[60] Capita Hartshead, 17th Annual Pension Scheme Administration Survey (2010)
[61] Spence Johnson, The Pension Communications Project 2010, Getting personal: Excellent DC communications from around the world (2010)
[62] Making automatic enrolment work. A review for the Department for Work and Pensions (2010)
[63] Pensions Commission, A New Pension Settlement for the Twenty-First Century (2005)
[64] Towards More effective Savings Incentives (2011)
[65] HMRC, table 7.9 cost of tax relief in registered pension schemes (updated September 2010)

The pensions tax regime has recently seen significant change. The 2006 'A-day' reforms simplified the system by bringing together eight separate systems for granting tax relief into a single regime for all types of tax-relieved pension saving. And the Government will limit the amount of tax relief individuals can receive as part of its deficit reduction programme[66]. These changes come into affect from April 2011.

Question 20: Does the current structure of tax relief incentivise the right people? If not, what would a more effective structure look like?

Question 21: Should pensions be more (or less) tax favoured than other forms of saving?

Governance and regulation

Having the right regulation and consumer protection is an essential ingredient to a successful retirement savings framework. But it needs to be the right level of protection at the right cost. And with any type of regulation, government and the regulator must strike the right balance between protecting the consumer and burdens on business.

There is different regulation for trust and contract-based pension schemes, two regulators cover pensions and there are two protection schemes for pensions. There is an EU-wide Directive (which is shortly to be reviewed) and different governance arrangements relating to different types of pension arrangement:

- DB schemes are established under an irrevocable trust;
- occupational DC schemes are established under trust; and
- contract-based DC schemes are not required to have trustees. However, a number have established management committees which play a similar role to trustees.

Some of the differences between trust and contract-based schemes were highlighted in the Making automatic enrolment work review[67]. The Government has issued a call for evidence on this with the aim of better understanding the issue[68]. The Pensions Regulator has also launched a consultation on the future of DC regulation[69].

The Pensions Commission concluded that scheme running costs have doubled since many schemes were first established. Regulation has contributed to this rise in cost. The NAPF Annual Survey 2009 shows that the median cost of fund management increased by 18%, the

66 HM Treasury, Emergency Budget (June 2010)
67 Making automatic enrolment work. A review for the Department for Work and Pensions (2010)
68 DWP (January 2011)
69 The Pensions Regulator, Enabling good member outcomes in work-based pension provision (January 2011)

median costs of professional fees increased by 15% and administration fees by 11%[70]. These and other additional running costs have caused employers to re-evaluate their pension arrangements. A recent survey by the Association of Consulting Actuaries showed that 34% of respondents were reviewing their DB scheme: of these schemes, 39% were considering changing future accrual, 35% a move to career average and 22% considering moving to a DC scheme[71]. Accounting standards have also influenced employer attitudes towards pensions.

Attempts have been made to improve the regulatory framework for occupational pensions. The previous Government established a 'Deregulatory Review' which examined pension regulation item by item.

Question 22: Do we have the right balance of risk and regulation in UK pensions and the right regulatory architecture? If not, what policy solution would deliver the right mix? Is there a case for an alternative, principles-based, approach?

Question 23: Does the way in which pensions are currently regulated act as a barrier to employer-provided pension provision or determine the form of that provision, and to what extent is it a barrier to innovation?

Question 24: What is the optimal form of governance for pension schemes, whether DB or DC?

Retirement savings and the economy

Pension funds and savings institutions play a significant role in the economy, as investors, shareholders and purchasers of government debt. This role is changing and the Commission is keen to understand the latest trends.

- The mix of assets in which savings are invested is moving away from equities towards bonds and other fixed income products. The proportion of UK pension fund assets invested in UK equities fell from 51% in 1999 to 24% in 2009. At the same time, the proportion in UK fixed income and index-linked gilts rose from 13% to 31%.[72]

- The shift from defined benefit to defined contribution will have consequences for pension investment. Defined benefit schemes are increasingly looking to 'de-risk' as they close to new members and/or future accruals.

[70] NAPF, Annual Survey (2009)
[71] Association of Consulting Actuaries, Pension Trend Survey Results (2009)
[72] UBS, Pension Fund Indicators, p.75 (2010)

- Institutional investors are taking an increasingly active role as shareholders. Pension funds, for example, are more closely involved in influencing and questioning company decisions on strategy, appointments and remuneration.

- Pension funds are increasingly looking for larger numbers of long-term, index-linked bonds to match their liabilities.

Question 25: What are the trends in the role that pensions and savings institutions play in the wider economy? How might this change in the future?

Conclusion

The Commission welcomes views on the issues and questions raised as well as any other issues respondents feel are relevant. In particular, the Commission is keen to learn from international experience and hear examples of good practice. One of the key reasons this Commission has been set up is to help the Government meet its commitment to "reinvigorate occupational pensions".

Question 26: What steps need to be taken to meet the Government's Coalition Agreement commitment to "reinvigorate occupational pensions"?

Chapter 3 – how the Commission will work

The Workplace Retirement Income Commission is an independent body chaired by Lord McFall of Alcluith. Its purpose is to "undertake a review of pensions as well as other forms of saving, principally but not exclusively delivered through the workplace, to evaluate current public policy and industry/employer practice, and to make recommendations to ensure that all UK citizens can retire in security and dignity". The Terms of Reference for the Commission can be found in Annex 1.

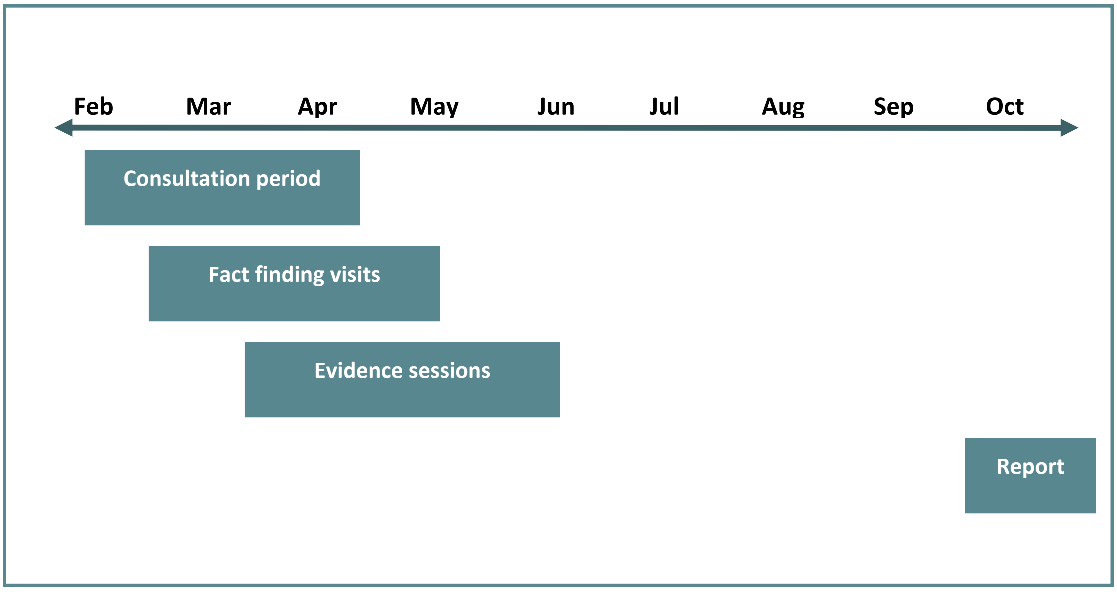
The Commission will make its own decisions on its working methods, avenues of enquiry and its conclusions and recommendations. It will be supported by a Secretariat provided by the National Association of Pension Funds (NAPF).

The Commission welcomes responses to the issues raised in this Call for Evidence. Details of how to respond and engage in the Commission's work can be found in Chapter 4.

As well as seeking views in response to this Call for Evidence, the Commissioners will be holding a series of events to explore the issues further. These will include:

- fact-finding visits across the country, including meetings with employers, working people and pension schemes;
- a citizens' jury and consumer forums; and
- roundtable evidence sessions (for example with employers, trade unions, pension schemes, consumer groups, Government, and regulators).

An indicative timetable for the Commission's work is set out below:



Chapter 4 – how to respond

The Commission welcomes responses from anyone with an interest in the issues raised in this consultation, particularly employers, the pensions and savings industry, trade unions, consumer groups and the Government. The Commission is particularly keen to hear the views of individuals saving for their retirement or those recently retired.

Responses should be sent to Shiona Charlery at wric@wricommission.org.uk or you can write to us at:

Shiona Charlery
Workplace Retirement Income Commission
6th floor
138 Cheapside
London
EC2V 6AE

For any questions regarding this consultation, please contact Shiona Charlery on 020 7601 1777.

The deadline for responses is 26 April 2011.

The Commission website (www.wricommission.org.uk) also has a discussion forum where individuals and organisations can submit views and comments. As well as receiving formal responses to the consultation, the Commission will take a flexible approach to receiving views and wants to encourage active debate. You can follow the Commission on Facebook, Twitter and LinkedIn. The Commission would like to hear from anyone with an interest in the issues raised by this inquiry, whether by responding to the Call for Evidence or raising an issue for the Commission to consider.

The Commission will assume that respondents are content for their submissions to be published unless otherwise indicated.

Next steps

The Commission will evaluate the responses to this consultation and use them as a basis for evaluating the current state of retirement savings in the UK. It will report on its findings at the NAPF Annual Conference and Exhibition from 19-21 October 2011. Regular updates on the Commission's work will be posted on the website.

Workplace Retirement Income Commission

Annex 1: Terms of Reference

To undertake a review of pensions as well as other forms of saving, principally but not exclusively delivered through the workplace, to evaluate current public policy and industry/employer practice, and to make recommendations to ensure that all UK citizens can retire in security and dignity.

In reaching its recommendations the Commission will examine:

- The barriers to workplace retirement saving for both employees and their employers and how these can be overcome. It will pay particular attention to the barriers faced by small and medium sized enterprises and the self-employed.
- The most efficient ways of providing retirement income that meet the needs and demands of today's workforce and employers, that optimise opportunity, efficiency and adequacy, in which employees have confidence and which employers are encouraged to run.
- The role of retirement savings in the wider economy.

The Commission will seek evidence from a wide range of stakeholders and individuals and aim to build a consensus around solutions for strengthening workplace retirement saving. In doing so, the Commission aims to raise knowledge and awareness of the importance of providing for old age.

The Commission will build on the recommendations of the Pensions Commission chaired by Lord Turner, including auto-enrolment and the introduction of NEST.

The Commission's role does not extend to a consideration of public sector pensions reform, which is being considered by the Independent Public Sector Pensions Commission under the Chairmanship of Lord Hutton of Furness. However, the Commission will consider how Lord Hutton's recommendations may affect private sector schemes.

The Commission will report in October 2011 at the NAPF Annual Conference and Exhibition. Its report will set out a series of recommendations around which consensus can be built and which can be used by government, regulators, other policymakers, employers and the industry and which will help meet the Government's commitment to "reinvigorate occupational pensions".

Workplace Retirement Income Commission

6th Floor · Cheapside House · 138 Cheapside · London EC2V 6AE
T: 020 7601 1777 · F: 020 7601 1799 · E: wric@wricommission.org.uk
www.wricommission.org.uk