SMF Social Market Foundation

Pensions policy for the next parliament

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With the Government and all parties announcing fresh reforms over the last six months, pensions policy is set to be one of the dominant themes of the conference season. Drawing on past and current SMF research, we highlight the most important points for discussion.

Access to pension pots

In March 2014, the Chancellor and Pensions Minister removed the restrictions on capital drawdown from pensions from the age of 55, abolishing the requirement for anyone to annuitise. For several reasons this flexibility is to be welcomed. Research suggests that there is a growing trend towards "phased retirement" – whereby more people carry on working after the State Pension age – and that spending patterns often vary during retirement.

To be considered a success, the Budget reforms must stimulate more active, engaged and informed consumers, whilst the market must respond by offering products to meet consumers' needs. Hardly surprising then that much of the policy focus has been on how the new guidance promised for retirees will operate in practice so as to minimise the potential risks for those approaching retirement. Viewing guidance and advice as a process rather than a one-off event and boosting trust through impartiality are important starting points.

More broadly, however, SMF's current research highlights the complexity of decisions that retirees will have to make. The trade-offs and the risks are likely to be balanced not just across an individual's life-course, but across families and across generations. Currently, one in five of 45-65 year olds are relying on inheritances to fund their retirement. In making decisions on how to use their pension pots, retirees are likely to be balancing their own needs, the needs of their children and grandchildren in the immediate future (for instance to make a call on the 'bank of mum and dad' and get on the housing ladder) and their desire to leave an inheritance. What are the new types of products that retirees are likely to need? How can retirees be guided through the complex decisions that they have to make at retirement?

Collective pensions: Each to their own or all together?

Paradoxically, whilst promoting freedom and flexibilities for individuals at retirement, the Government is also seeking to develop 'collective defined contribution' (CDC) pension schemes. This idea has received cross-party support. CDC schemes are a means by which members of a pension scheme save not individually but together. When someone retires, their retirement income is paid out of the asset pool.

Many have extolled the virtues of CDC schemes on the basis that they may provide more retirement income and that they may provide certainty of retirement income. But there are doubts as to how far these would emerge in the UK. CDC schemes can only provide certainty of retirement income at the expense of requiring higher contributions from younger generations. Meanwhile, it is not clear that members will see significantly greater retirement income. Many of the advantages attributed to CDC schemes in comparison to the previous status quo stemmed from the lack of flexibility individuals had in what they could do with pension pots: being steered into lower yielding asset classes ahead of retirement; being forced to annuitise; and, being forced to crystalise assets at a particular moment in time (when the value of the assets may have dipped). But the Budget reforms have changed all this. Previous work by the SMF also suggests the needs and circumstances

of individuals vary significantly on retirement. For instance, people's life expectancy varies significantly: the post-65 life expectancy of a healthy male manual worker in the early 2000s was 14.1 years, while a similar professional could look forward to an 18.3 year retirement. And, peoples' health at the point of retirement also varies significantly. Is it clear the CDC schemes would suit all individuals or just the average? How do collective pensions sit alongside the freedom and flexibility agenda?

Autoenrolment: Encouraging saving

On the surface, auto-enrolment has been a huge success, increasing the number of savers dramatically. But, the headline conceals a very concerning detail: that both existing savers and new savers are putting too little money aside (only about half of what is needed). Boosting this rate should be a major ambition for any party entering Government in 2015.

The current incentives to save into a pension are coming under closer scrutiny than ever before. The Liberal Democrat Party has spoken openly about its desire to even out the distribution of pension tax relief and offer a flat rate relief of 20%. The Labour Party has announced plans to reduce relief for people earning £150,000 a year from 45 to 20 per cent.

Reform certainly seems necessary. Currently, the top 1 per cent of earners receives 30 per cent of all tax relief. Moreover, as the SMF has pointed out before, the distribution of gains across the earnings distribution over the last forty years – with the earnings at the top growing much faster than the earnings in the middle and at the bottom – suggests that higher earners will pocket an increasing share of the tax relief in the future. Disproportionate increases in their income will be exacerbated by the growing marginal propensity to save as people's incomes grow.

But big questions remain: Should we offer incentives on the way in or on the way out? To what extent should we hope to differentiate saving for retirement versus saving in other forms? How do we get the most for each pound spent by the state: via tax relief or via matched savings? And, are there ways in which we could link these incentives to additional nudges such as an auto-escalation policy as previously advocated by the SMF in our publication *Jam Tomorrow? The next 20 years of savings policy* ?

Changing nature of old age, retirement and working later into life

Future UK economic performance and quality of life in older age will be reliant on boosting significantly the number of people working later into life. This must be seen as a twin challenge alongside increasing savings levels. The SMF's on-going research suggests that decisions to retire are extremely intricate and unpredictable. Individuals substantially over-estimate the likelihood of retiring – with a majority of those over 50 saying that they expect to retire in a year, remaining in work one year later. Couples frequently retire in sync to spend time with one another. Meanwhile, the opportunity to work is not consistent across earnings groups or across occupations – as a rule lower earners have fewer opportunities to work later into life and less access to flexible working arrangements.

Traditional policy levers can play a part – but our initial evidence suggests that incremental increases to the state pension age may not have the effect that policymakers hope because individuals tend to think of their retirement age in more broad-brushed terms.

So, how should we seek to boost the opportunities to work later into life across the earnings spectrum? Are there ways to nudge people to remain in work for longer?

Contact the SMF

We will be debating many of these questions at the party conferences and continuing our research into them through the autumn. We look forward to debating them with you. If you wish to hear more about our current and future work in this area, please contact: **nigel@smf.co.uk**.