ASSOCIATION OF CONSULTING ACTUARIES

Association of Consulting Actuaries Limited · Second Floor (203) · 40 Gracechurch Street · London · EC3V 0BT
Tel: +44 (0)20 3102 6761 · Email: acahelp@aca.org.uk · Web: www.aca.org.uk

Call for evidence – Intergenerational Fairness and Provision

This document sets out the response by the Association of Consulting Actuaries to the call for evidence issued by the House of Lords Select Committee on Intergenerational Fairness and Provision on 23 July 2018. Submission was made electronically on 10 September 2018.

Members of the ACA provide advice to thousands of pension schemes and their sponsors, and we have therefore focussed our response to issues relating to pensions adequacy. However, we recognise that public policy in the range of areas included in the call for evidence must in future be interlinked and balanced from an intergenerational perspective, and so we have commented below on some areas of overlap.

General

1. **Is the intergenerational settlement in the UK currently fair? Which generations are better off or worse off, and in which ways?**

2. **What are the future prospects for different generations in the light of current economic forecasting?**

From a pensions perspective, we believe typical savers in younger generations risk being materially worse off than today's generation of retirees. A key reason for this is the decline in recent years of employer sponsored defined benefit pension schemes (outside of the public sector). This has led to increasingly exclusive reliance on defined contribution (DC) pension schemes - with generally lower contribution levels - for most young employees.

The impact of this trend has been a significant transfer of cost and risk to younger people as they save for their retirement. For example, ACA's 2018 Pension Trends Survey (full results of which will be published in coming months) found that median employer contributions to DC pension schemes (which younger employees are generally members of) were only 6% of salaries. This compares to combined contributions of c. 30% of salaries to open defined benefit pension schemes (which predominantly include older employees).

Whilst arguments can be formed that a combination of future investment returns, improved state pension provision and increased participation from auto enrolment will help bridge this gap, we believe that significantly higher contributions would be needed in order for younger DC savers to expect a similar overall retirement income to DB savers in the current generation of retirees. For example, assuming 40 years of contributions, and 3% p.a. real investment returns, we estimate contributions of c. 16% would be needed to reach the Pension Commission's targeted replacement income of two-thirds of pre-retirement income.

Further, whilst in DB schemes key risks such as around investment returns and longevity are borne by employers, in DC schemes these fall exclusively on employees, further increasing the risk of poor retirement outcomes for younger savers.

In seeking to meet these challenges, for example by paying high employee contributions into DC schemes, younger generations also face challenges from competing savings needs in a way many in older generations did not. For example, those joining the workforce today face significant university or further education and training fee repayments / loans, and rapidly rising rents. They may also have difficulty getting onto the property ladder due to the need to simultaneously save significant deposits.

As a result, we believe that in many cases younger people choose to make lower than optimal contributions into their pension schemes as they seek to manage these competing savings needs, thereby further damaging their retirement prospects. In particular, if choosing to pay contributions at low levels they forgo significant financial incentives in the form of (often matching) employer contributions as well as the government tax relief.

To the extent these decisions are taken “rationally”, e.g. due to greater priority consciously being given to saving for a house deposit, in spite of the financial opportunity cost, we believe this “crowding-out” of retirements savings is of concern and could warrant a policy response. We have set out several of our own suggestions below in response to question 4.

The switch towards DC schemes has to a degree come hand in hand with wider changes to the working environment, which has generally become significantly more flexible. For example, in contrast to older generations for whom a 'job for life' was often seen as typical, those entering the workforce today will likely work for a significant number of employers during their lifetime – perhaps with various career breaks along the way, and periods of self-employment, possibly culminating in a longer “partially retired” state towards the end of their career.

For savers over age 55, Freedom and Choice has provided much needed pension flexibility to recognise these changes. However, for younger employees grappling with competing savings needs at an earlier age, there have not been significant changes. While Lifetime ISAs have been a step in the right direction, there is no interaction with employer contributions, and there are relatively few providers which appears to limit competition. Significantly more flexibility could be provided for younger savers.

In addition, evolving trends towards multiple career employers mean that at some point younger employees run the risk of losing track of where their pension savings are. If they have, say, 10 or more pension pots built up over their working life, we believe the Pensions Dashboard concept is vital in supporting them to keep track of their retirement savings. Without this, how can they make informed decisions about how much they will need to retire on, and how much more they might need to save in order to retire?

We recognise that some of the intergenerational imbalance may well be restored in future through a possible inheritance windfall for the current younger generation. However, such windfalls will impact only a fortunate proportion of society. Further, with an ageing population, many Millennials in particular may not benefit from such a windfall until they themselves get close to retirement. This may come too late to help them to live a longer and fuller working life and, in any event, they may find much of that wealth has skipped a generation.

Jobs and the workplace

3. To what extent do different generations have a better or worse experience of the labour market?

The ACA's 2018 Pension Trends Survey (full results of which will be published in the coming months) indicates that:

- Median employer contributions to defined contribution pension schemes (which younger employees are generally members of) are only around 6% of salaries, compared to combined contributions of c. 30% of salaries to open defined benefit pension schemes (which predominantly include older employees);

- 86% of employers with defined benefit schemes say DB costs have a negative impact on intergenerational fairness; and

- In particular, 89% of employers say their DB costs have an impact on pay increases, while 80% say there is a negative impact on employer DC contributions.

Based on these findings there is evidence that, overall, young employees see far fewer resources directed into their pensions compared with their older counterparts. There is also evidence that the cost of managing the pension promises for the older generations (many of whom no longer work for their employers) risks directly damaging the retirement prospects of younger generations by having an impact on both pay and DC pension contributions.

4. What needs to change to enable longer and fuller working lives for all? What role should employers play in providing solutions? What role can technology play?

Flexibility

It has been well publicised (e.g. in the debate surrounding the 2017 Cridland report) that continued longevity improvements mean that traditional definitions of 'working' and 'retirement ages will continue to evolve. Gone are the days of people 'working for 40 years, retiring for 20'.

For example, today's younger employees are much more likely than current retirees to have periods of reduced economic activity during their working life – perhaps taking some 'time out' in the form of career breaks or to re-train – and have a significantly more flexible outlook to semi-retirement than generations before.

Given that younger generations will both work and retire more flexibly than in the past, we believe it is important to evolve consistent flexibility across the pensions system, instead of at present where flexibility is only available to those aged 55 and over.

For example, under Freedom and Choice, anyone over the age of 55 can use their pension pot tax efficiently for multiple legitimate purposes such as paying off their mortgage. However for savers under 55 (who might for example want to save for a deposit – i.e. the first part of the same property transaction), access to pensions saving is currently only possible at the expense of a penal tax charge of 55%.

Given the increased flexibility anticipated in the working lives of younger generations, and to encourage, rather than crowd out pensions savings, we believe that it would be helpful to provide some limited, but consistent, tax efficient flexibility around the use of DC pension savings during the accumulation phase.

Specifically, to encourage younger employees to commence meaningful pensions savings earlier and at higher levels than at present, the ACA calls for extending pension flexibility to reflect their competing savings needs, and to reflect the evolving lines between working and retirement. We believe this can be achieved as follows:

- Allow a single, limited, one-off pension withdrawal at any time in the “accumulation” phase, to be used in certain specified circumstances. This could include funding a property deposit or other very specific lifetime events such as providing income during an extended period of parental leave; and

- Tax the withdrawal (in headline terms) in a consistent way to existing withdrawals under the pension freedoms.

While further discussion needs to take place on specifically how much can be withdrawn, and on taxation of such withdrawals, we believe extending pension flexibility to younger generations will help remove many of the barriers associated with significant pension saving, while allowing younger employees to efficiently accumulate their employer's matching contributions and access an 'investment strategy' geared towards delivering better outcomes over time than a strategy of simply holding cash.

While we do not propose a specific limit, we note that a sum of £30,000 is regarded as 'trivial' for those withdrawing their pension pots at older ages. It could be argued that access to a sum of similar quantum should be made available for younger savers, subject to adequate safeguards and incentives, given they have more time to replace any amount withdrawn.

We believe the above proposal will help augment a culture of saving. Ultimately we believe younger people would be significantly more inclined to put money away if they know a proportion of it can be accessed flexibly (consistent with their flexible working lives), rather than it being tied away for the next 40 years.

Because of these behavioural factors, we believe that the overall impact of the change due to behavioural effects would be to increase rather than reduce long term retirement savings accumulation.

Clearly, detailed consideration would need to be given to regulation surrounding this change, investment consideration (such as the appropriate default funds available to younger members intending to withdraw funds) and obtaining buy in from employer sponsors of DC schemes. However, from an employer perspective, with much current focus on employee financial wellbeing, and the risk in future of having an ageing workforce that can't afford to retire, we believe industry would likely be supportive of developments in this area.

Technology

From a pensions perspective, technology in the form of the Pensions Dashboard has the potential to improve outcomes and effective decision making for younger generations, and we

are pleased to see the Government recently reinforcing its support for this initiative, given recent press articles noting some practical difficulties in reconciling and obtaining data not held electronically for those approaching retirement.

Rather than focussing on these difficulties, we believe it is correct to prioritise the key longer term prize of enabling swift access for the current younger generation of savers who will, on average, work for several different employers and likely have several different pension pots (where data is readily available). In particular we believe that for this "tech-enabled" generation the Pensions Dashboard will be a key part of driving the behavioural changes needed to ensure adequate future pension provision.

In particular, without the ability to see all their pension and long-term saving pots in a single place, how can future retirees make informed decisions on how much they need to save, when they can retire, and how they will need to manage their money in retirement? One of the significant benefits of defined contribution systems (which younger members are generally members of) is that most of the data is already held electronically – so the industry, with Government support, should move to design a solution which captures the longer-term benefit for the younger generations.

The Dashboard may also be the first step towards pension pots following members – i.e. facilitating DC pension pots of younger generations to be efficiently consolidated as they move through their careers, potentially improving outcomes through scale. This may also lead to improvements in the governance of DC provision, including greater transparency of investment options, default funds, and charges.

Housing

6. To what extent is intergenerational fairness impaired by the UK housing market?

7. What has driven the increase in the size of the private rented sector? Which generations are most affected by this and how?

In recent years, developments in the UK property market have seemingly further skewed the intergenerational imbalance in favour of older generations. In particular, the contrast in fortunes between the generation of those who 'own' and 'buy to let' (typically older people) who have benefited from significant house price growth and those who rent (typically young people) – has been widely publicised.

In particular, it appears that the proportion of younger people renting homes has grown significantly over the past decade, with many of the homes rented by this group owned by a generation approaching, or in, retirement, and using this source of wealth to supplement their retirement income.

This represents a transfer of wealth 'up' the generations – a feature which has the potential to adversely impact intra-generational fairness as those young people turning to the private rented sector are the ones who have been unable to access a helping hand from their parents or grandparents in getting on the property ladder. Their rental outgo, which is crowding out other short-term needs including savings for their own property deposit and their retirement, is being transferred to those who may already be likely to transfer some wealth to their children and grandchildren.

Communities

12. To what extent are new technologies and social media isolating different generations from each other? How can technology be harnessed to promote active communities working to redress imbalances between generations?

With the rise in younger employees being employed in the economy or through self-employment, technology has a prominent role to play to promoting pension saving.

For example, those employed in the gig economy are typically managed by and remunerated through an agent, which we believe could act as an auto-enrolment 'employer' and divert an element of pay to an auto-enrolment pension provider.

Similarly, online tax returns could be amended such that a proportion of revenue is, by default, directed to an auto-enrolment pension provider.

Taxation

13. To what extent does the tax system take account of fairness between the generations? What changes, if any, should be made to the tax system to achieve a fair intergenerational settlement?

The government reports the cost of pensions tax relief (income tax and NI) to be around £41bn in 2018/19 with some two-thirds appearing to go to higher and additional rate tax payers.

Major pensions tax reforms have been widely considered in recent years and, based on the above, it appears there is scope to promote intergenerational fairness in the design of any such change.

We do not comment here on which of these candidate reforms could be most beneficial from an intergenerational perspective. However, we believe any such reform should be made thoughtfully (and holistically with other tax reliefs) to consider how best to fit with a positive intergenerational impact.

Chintan Gandhi
Steven Taylor
Main Committee Members
On behalf of the Association of Consulting Actuaries Limited

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

Disclaimer

This document is intended to provide general information and guidance only. It does not constitute legal or business advice and should not be relied upon as such. Responding to or acting upon information or guidance in this document does not constitute or imply any client /advisor relationship between the Association of Consulting Actuaries and/or the Association of Consulting Actuaries Limited and any party, nor does the Association accept any liability to any person or organisation relating to the use of such information or guidance.

Association of Consulting Actuaries Limited · Second Floor (203) · 40 Gracechurch Street · London · EC3V 0BT
Tel: +44 (0)20 3102 6761 · Email: acahelp@aca.org.uk · Web: www.aca.org.uk
Privacy Statement: https://aca.org.uk/privacy-accessibility-statement/