ASSOCIATION OF CONSULTING ACTUARIES

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15 December 2017

Resolution Foundation
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BY EMAIL TO: info@intergencommission.org

Dear Sir/ Madam

Intergenerational Commission's Call for Policy

I am writing on behalf of the Association of Consulting Actuaries in response to your call for evidence on potential policy solutions in areas raised by the Commission's work.

You note that responses could cover themes including "pay progression, home ownership, pensions adequacy, welfare and taxation and the provision and financing of social care" and "aims to renew the social contract between the generations".

Our members provide advice to thousands of pension schemes and their sponsors and we have therefore focussed our response on issues relating to pensions adequacy. However we agree that public policy in each of these areas must in future be interlinked and balanced from an intergenerational perspective and we have commented below on several areas of overlap.

Conclusions of Resolution Foundation's report "As good as it gets? The adequacy of retirement income for current and future generations of pensioners".

We agree with observations in the report that two key recent policy measures, the flat-rate State Pension and Auto Enrolment, are likely to have positive effects on retirement outcomes for future generations.

However, in our view the evidence does not support the conclusion that "overall, future pensioners look set to experience similar levels of earnings replacement adequacy to recent retirees". In particular, given competing savings needs and an increasingly exclusive reliance on DC pension provision, we believe many young people risk retiring on materially lower relative incomes than current retirees.

For example, ACA's 2017 pension trends survey indicates that:

- Median employer contributions to Defined Contribution schemes (which younger employees are generally members of) are only 5%, compared to combined contributions of c.30% in open Defined Benefit schemes (which predominantly include older employees); and

- 80% of employers with DB schemes say DB costs have a negative impact on intergenerational fairness. In particular, 53% of employers say their DB costs have a negative impact on pay increases and 42% say there is a negative impact on employer DC contributions.

In relation to auto enrolment, we also believe it is too early to tell how much of the reported "success" of auto enrolment will endure. For example;

- We are yet to observe the potential impact of opt outs (or "opt downs") resulting from step ups in minimum contribution rates in 2018 and 2019; and

- Even as we approach the end of auto enrolment staging, allowing for employees who are "not eligible" (e.g. those aged under 22 and the self-employed) only 60% of the overall workforce is now in a workplace pension scheme. This is no higher than the comparative figure between 1960 and 1980 when most of these employees were in comparatively more generous DB schemes.

We agree that many of the challenges of accumulating adequate retirement savings, such as competing savings needs, are not unique to the current generation and have been building for some time. However, in our view, these pressures have now reached a stage whereby many young employees are unable to save sufficiently or are put off from saving altogether.

For example, a graduate joining the workforce today faces costs from university tuition fee repayments and rapidly rising rental costs. Combined with the challenges of saving for a house deposit and other short and medium term savings needs, it is unsurprising that some young people might "rationally" choose to prioritise other savings needs by either opting out of workplace pension schemes or, more likely, contributing at minimum or low levels.

These pressures will likely increase further if (as we would like to see) automatic enrolment minimum contributions continue to rise. For example, the combined rate of 8% from 2019 is itself unlikely to be sufficient for most people to achieve the Pension Commissions' targeted replacement ratio of two-thirds (we estimate that over a 40 year career and assuming 3% real investment returns, contributions of around 14-16% would likely be needed to reach this benchmark).

Given the significant financial incentives for retirement savings, e.g. tax relief and often generous matching employer contributions, this crowding out of retirement saving by shorter term needs should be a key area of concern for future public policy. In particular, for today's generation to save adequately for retirement, we believe ways must be found to allow young people to save flexibly, for multiple purposes, without disincentivising retirement saving.

From the perspective of renewing the "social contract" between generations, we also believe that increasing flexibility in how traditional "retirement" savings can be used, could be an important part of that settlement.

For example, it has been well publicised (e.g. in debate surrounding last year's Cridland report) that continued longevity improvements mean traditional definitions of "working" and "retirement" ages will likely continue to evolve. For example, for many people retiring today, retirement initially marks merely a step down in economic activity (e.g. to part time work).

If, as we expect, this trend continues for younger generations (perhaps including several periods of reduced economic activity during the working life) traditional concepts of how retirement savings are built up and utilised will need to adapt.

Possible Policy Responses

(i) Flexible Savings

One policy option could be to allow additional flexibility for pensions saving in the early "accumulation" phase (when competing savings needs, in particular saving up for house deposits, often combine with the greatest scarcity of financial resources) and which would complement longstanding flexibilities in the "decumulation" phase.

For example, it has long been the case that a tax free cash sum at retirement (and now also withdrawals under Freedom and Choice) can be used to support necessary one-off spending needs, such as paying off the remaining term of a mortgage.

It seems consistent with this to allow the initial tranche of housing spending, a deposit, or potentially other limited spending needs at an early age, to be funded by similar means.

The Lifetime ISA was a constructive development in this area, but is complex and suffers from not being able to receive employer contributions or be used for automatic enrolment purposes. This means that Lifetime ISA savers still need a separate pension arrangement if they are to benefit from employer contributions. Given limited resources, this means many savers are unable to benefit from the higher levels of employer pension contributions often on offer.

One option would be to redesign the Lifetime ISA to allow employer contributions (perhaps as a National Flexible ISA), but allowing only employee contributions to be withdrawn.

Alternatively, the solution could use existing occupational DC schemes, most of which are now set up to provide members over age 55 with the option to access pension saving under Freedom & Choice. We do not believe it would require extensive legislation to extend this flexibility for the younger generation of savers, perhaps allowing an early withdrawal (or transfer into a Flexible ISA) of up to £30,000 (and taxed consistently with withdrawals under Freedom and Choice).

Care would be needed to ensure that a reasonable level of retirement savings remains after withdrawal and that funds are replaced quickly. Ideally the policy could also be designed with the aim of resulting overall in net cash inflows to the pension system due to behavioural impacts (for example by helping to embed the savings habit at a younger age). For example, one option could be to mandate an additional "step up" in minimum employee pension contribution rates under automatic enrolment after funds have been accessed in this way.

(ii) Pensions tax reform

In 2015/16, £38.2bn was received in pensions tax relief of which some two-thirds went to higher and additional rate tax payers. As these tax payers made up just 17% of the population (and are most likely to be towards the older end of the spectrum), it is likely that any of the major tax reform options (ranging from flat rate relief to pensions ISAs) that have been widely considered in recent years, and which could result in savings to this amount, could have a positive intergenerational impact.

We do not comment here on which, if any, of these options is most appropriate, however we believe that if the aim is to renew the "social contract" between the generations, the intergenerational impact of pensions and wider tax reform should be of key concern.

(iii) Realigning retirement expectations

In our submission to the Cridland Report, we raised a number of policy concerns relating to state pension provision in an era where continued improvements to longevity have begun to challenge the concept of an agreed "retirement age".

We have not sought to reproduce our response to Cridland[1] here but, given this reality, it will be important for policy to respond with appropriate flexibility.

For example, although these macro trends are increasingly understood, at an individual level many young people still expect to retire at traditional ages (e.g. 60 or 65). We believe that retirement outcomes are likely to be improved by helping individuals to make realistic assessments of their expectations for retirement so that they can set appropriate savings targets.

We would be very happy to contribute to further discussion in these or other areas that could impact future pensions policy.

Yours sincerely

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

[1] http://www.aca.org.uk/files/ACA_responds_to_State_Pension_Age_review-22_December_2016-20161222102826.pdf

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.

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