Institute
and Faculty
of Actuaries

Intergenerational Fairness Bulletin

From the Institute and Faculty of Actuaries

Retirement

Ageing population

Informing the debate

Issue 2

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Contents

1. Introduction by our President

How can we ensure a stable, happy and financially sustainable life in retirement for all? For some this question may be of immediate concern; for others it may seem like something daunting and distant, better to be thought about tomorrow. But this question is at the heart of the intergenerational fairness debate, and trying to answer it should be a priority for pensions policy. In this second issue of our Intergenerational Fairness series, our contributors have examined the social, political and economic environment we find ourselves in, and how the current pensions landscape can have positive and negative effects across and between generations.

Be it the State Pension age review commissioned by DWP, the Work and Pension Select Committee's recent examination of the pensions 'triple lock', or the creation of the Resolution Foundation's Intergenerational Commission, there is evidence that the UK policymaking community is beginning to open its eyes to intergenerational fairness, and finding that pensions issues are at the very core. Many of these issues are also central to the work of actuaries, and ensuring that both today's and future pensioners have an adequate retirement income has been a key theme of much of the IFoA's recent work.

At the IFoA we are strongly of the belief that the intergenerational fairness question should not be framed as a war between the generations, nor should we be wedded to a narrative that pits disgruntled Millennials against high-flying Baby Boomers. Rather, we should consider how public policy can help to balance the needs of current generations with those of future generations, without placing an unfair burden on either. And whilst receiving the contributions for this bulletin, it has become clear that there is a healthy debate around what is the most appropriate way to do this. There are convincing cases put forward both for and against the triple lock, articles arguing that generations X and Z have been unfairly disadvantaged by pensions policy while Baby Boomers have benefitted, and others pleading for the debate not to lose sight of *intra*generational issues.

Policymakers now have an important role to play in examining the needs and aspirations of all generations, and designing policies that help to maintain and build upon the improvements in pensioner outcomes seen over the past decade, without placing the future prosperity of younger generations at risk.

We are delighted to bring together some leading voices in the pensions arena from a range of backgrounds and political persuasions to present a perspective on the issue. This bulletin features articles from two former government ministers, voices from parliament, the pensions industry and economics as well as a number of think tanks and members of the actuarial profession.

We hope you enjoy reading.

Colin Wilson
President, Institute and Faculty of Actuaries

If you would like to receive future Intergenerational Fairness Bulletin editions, or hear more about our work on intergenerational fairness or pensions, please email **policy@actuaries.org.uk**.

2. The generational pensions divide

David Willetts, Executive Chair, Resolution Foundation

Fairness between the generations is rapidly becoming one of the most important issues in British politics and public policy. I published a book about it, The Pinch, back in 2010 and have been struck by how the issue has moved from the fringes to the mainstream of politics. Theresa May frequently refers to the "growing divide between a more prosperous older generation and a struggling younger generation." And I am now chairing an Intergenerational Commission based at the Resolution Foundation, made up of senior figures from business, academia and policy making, which is trying to analyse the issue robustly and come up with practical solutions.

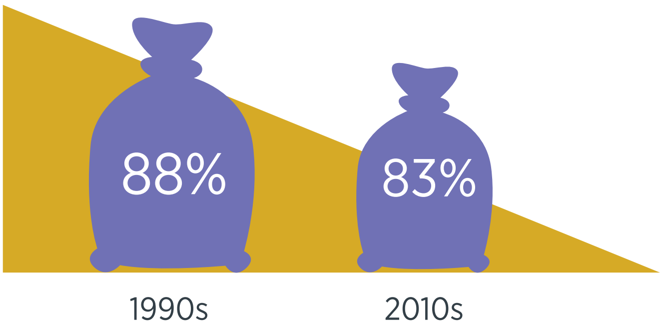
The economic evidence does show that on many measures the younger generations – the millennials (born 1981-2000) and generation X (born 1966-1980) – are not doing as well as the big generation of baby boomers (born 1946-1965) which came before them. Some of the starkest evidence is found in pension provision.

Of course, we must expect the usual life cycle effect in which people build up assets during their working lives and then run them down during their old age. So it is not in and of itself shocking that those in their 50s and 60s have much greater pension claims and assets than those in their 20s and 30s. But it is shocking if they have assets on a scale which their children are never going to be able to match. The fact that nearly all the growth in pension wealth since the financial crisis has been enjoyed by the over-55s suggests this is a very real risk.

Several forces are at work here. First, life expectancy improved faster than companies or policy makers kept up with. With company pension rights and state pension entitlement linked to a fixed chronological age this yielded an unexpected benefit to certain cohorts. But now policy makers and pension schemes have changed the rules to better account for life expectancy so this dividend has ended.

Above all, however, the generational pensions divide has been driven by the trajectory of defined benefit pensions. For thirty years successive governments of all parties legislated to change the pensions promise to make it more generous than most companies intended when they set up their pension schemes. There were improvements to the rights of early leavers and widows and widowers. Inflation protection was enhanced too. This increased the value of the company pension promise for many baby boomers. But as a result companies resolved never to be caught out by such an expensive promise again, by and large closing defined benefit schemes to new members. This very generous pension entitlement has become a once-off special offer for one generation only.

To add insult to injury, some younger workers in established British firms are busy working hard to generate revenues for their employers to plug deficits in these pension schemes which won't accept them as members. The National Accounts show the effects of this.



There has been a decline in wages as a proportion of total compensation to workers – from 88 per cent in the early 1990s to 83 per cent today – with most of the slack picked up by private pension contributions. The intergenerational imbalance underpinning these trends is evidenced by the fact that while older generations were at their peak earnings, many of their employers were taking pension contribution holidays, but now they are taking their pensions there is a shift in the opposite direction.

How far should we go in prioritising pensions rights over the pay of younger generations?

This raises a policy issue for the British Government. How far should we go in prioritising pensions rights over the pay of younger generations? Of course the broad pension promise needs to be honoured. But it is legitimate to ask for example what index should be used to protect them from inflation. The DWP has published a consultation document on the regulation of pension schemes. It regards the issue of whether or not to shift all schemes from RPI (now seen as a less robust measure of inflation which tends to overstate price growth) to CPI as just a matter of whether or not companies can meet the higher RPI measure without going bankrupt.

It is good news that most companies can pass this test. But the policy issue goes wider than this. It is also an issue of fairness between the generations. The pay of workers, many of them younger, in firms carrying defined benefit deficits is being held down as a result of these pension costs. The Government amended the inflation index for the public sector pension promise even though it was not at risk of going bankrupt and should do the same for companies.

Pensions are at the heart of the intergenerational contract and we need to ensure we get the balance between the generations right.

Biography

David Willetts joined the Resolution Foundation as Executive Chair in June 2015. He is a Visiting Professor at King's College London, Governor of the Ditchley Foundation and a member of the Council of the Institute for Fiscal Studies. He was Minister for Universities and Science from 2010-2014 and was the Member of Parliament for Havant from 1992-2015. Before that David worked at HM Treasury and the Number 10 Policy Unit. He also served as Paymaster General in the last Conservative Government. David has written widely on economic and social policy. His most recent book 'The Pinch' was published by Atlantic Books in 2010.

3. The role of the UK pensions system in helping or hindering equity between generations

Steve Webb, Director of Policy, Royal London and UK Pensions Minister 2010-15

There is an increasingly received wisdom in the UK which says that pensioners have 'never had it so good' and that we now need to cut back on the largesse shown to the older generation and focus instead on the young. The argument was powerfully expressed seven years ago in a book by David (now Lord) Willetts called 'the Pinch'. The subtitle of the book says it all: "How the Baby Boomers Took Their Children's Future - And Why They Should Give It Back".

Arguably, the case made in that book has become more powerful in the intervening years, not least because of the actions of the last government. Most notably, since 2010 the rate of the state pension has been uprated according to a generous formula known as the 'triple lock' – increasing by the highest of the growth in earnings, prices or a floor of 2.5%. On top of this, whilst those in work suffered pay freezes and those out of work suffered benefit cuts, the elderly – so the narrative runs -were largely spared the pain of austerity.

However, the truth is – as ever – much more nuanced than this.

Pensioners are not a homogeneous group

First, whilst it is true that some in this 'golden generation' have enjoyed good workplace pensions, the pattern is quite mixed. For example, looking just at single pensioners, the average occupational pension income for a man is one third higher than for a woman. Amongst married couples the difference between men and women is likely to be much greater as many more married women will have had breaks in their career because of caring responsibilities which will have reduced any workplace pension they might receive. Furthermore, it is still the case that for the typical woman retiring this year more than half of her income will come from the state pension. Generalisations about pensioners living in the lap of luxury are likely to be highly misleading.

The present may not be a guide to the future

Second, there is a crucial question about how far the newly retired generation are a good predictor of the future standard of living of pensioners. Whilst it is true that the newly retired have quite a high level of income from occupational pensions, there is some evidence to suggest that this is now nearing a peak. Workplace membership of high quality 'final salary' pension schemes has been in pretty much remorseless decline for the last fifty years and this is now starting to feed through into incomes in retirement.
As each succeeding cohort comes up to retirement they are less and less likely to have long service in a generous workplace pension. Although automatic enrolment is bringing millions of new savers into workplace pensions these are typically far less generous than the pensions of a generation ago. If public policy were to reduce support for pensioners now on the basis of high levels of occupational pension coverage amongst today's newly-retired, such policy might need to be reversed in relatively short order as more poorly-pensioned workers start to reach pension age.

Housing wealth will benefit future generations

Finally, there is a very interesting question as to whether we are really thinking very clearly about housing wealth. Whilst there is no doubt that the older generation are sitting on a large and growing pile of housing wealth, there is very little evidence that they are actually consuming it. Equity release take-up is low, and those who downsize generally do so for housing reasons rather than to free up cash for current consumption. This means that a significant amount of wealth will – sooner or later – 'cascade' down to younger generations.

Generalisations about pensioners living in the lap of luxury are likely to be highly misleading

There are many in the older generation who would not necessarily regard themselves as winners in the inter-generational lottery

In terms of public policy making, one of the reasons why intergenerational concerns do not get the attention that they deserve is that government models are almost all cross-sectional rather than longitudinal. In other words, they may look at the distributional impact of a policy on today's old and today's young, but they rarely look at individuals over their lifetime. For example, the 'triple lock' policy looks like a simple redistribution from today's working age population to today's pensioners. But, of course, today's workers are tomorrow's pensioners and if the state pension is enhanced then that will also benefit future pensioners. There are government models which adopt a lifetime perspective and these should probably be used more widely, especially in policy areas such as pensions which have such obvious distributional implications over time and not just within the current generation.

Pensioner poverty has been falling and pensioner incomes have been rising and these are two good things. After a prolonged period between 1980 and 2010 when the value of the state pension was steadily eroded relative to average earnings, the triple lock policy has helped to partially reverse that relative decline and has reduced the number of pensioners dependent on means-testing. But there are still more than two million pensioners today who receive means-tested top-ups simply to get to a decent minimum income, and roughly half of all pensioners are too poor to pay income tax. These facts are a reminder that there are many in the older generation who would not necessarily regard themselves as winners in the inter-generational lottery.

Biography

Steve Webb is Director of Policy at Royal London. He was Minister of State for Pensions between 2010 and 2015, the longest-serving holder of the post. During that time he implemented major reforms to the state pension system, oversaw the successful introduction of automatic enrolment and played a key role in the new pension freedoms implemented in April 2015. Steve was a Liberal Democrat MP from 1997 to 2015. Before this he was professor of social policy at Bath University for two years, having previously worked for nine years as an economist at the Institute for Fiscal Studies. He was knighted in the 2016 New Year's Honours list, for political and public service.

4. The changing generosity of pension provision and its differential effects across generations

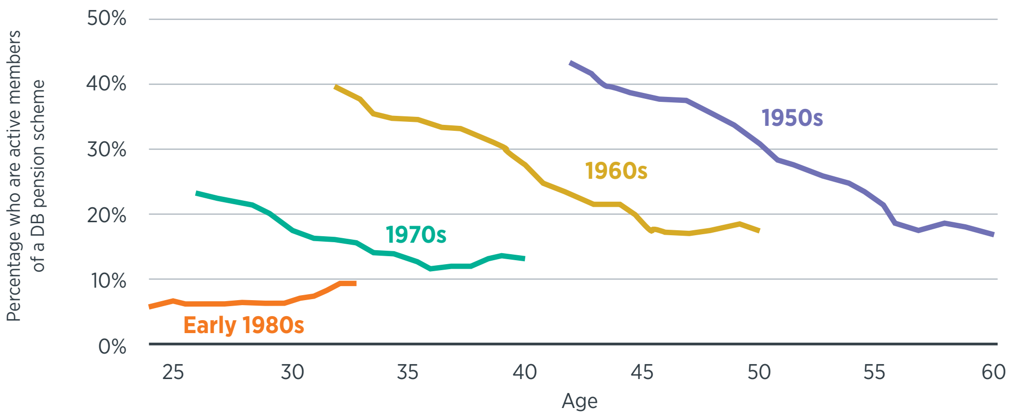
Andrew Hood, Senior Research Economist, Institute for Fiscal Studies

How old were you at the turn of the millennium? It turns out that the answer to that question affects not only the kind of night you might have had, but also the kind of private pension provision you are likely to have had access to. Although the share of private sector employees in a defined benefit (DB) pension schemes had been in decline from the 1980s onwards, it was in the early 2000s that most private sector firms closed their DB schemes to new members. This happened because a combination of increases in expected longevity at older ages and poor stock market performance made it clear that many of these schemes were unaffordable.[1]

Defined contribution (DC) schemes with reduced employer contributions became much more prevalent. The impact of this dramatic shift in the landscape of pension provision among private sector employees in the UK was very different across generations, as shown by Figure 1. For those born in the 1950s and 1960s, the result is a sharp decline in the proportion of private sector employees who were active members of a DB scheme as they moved through working-age life (and in many cases moved employer). But for those born in the 1970s and early 1980s, it means that the vast majority of private sector employees have never had access to a DB pension scheme. In their early 30s, less than 10% of private sector employees born in the early 1980s were active members of a DB scheme, compared with more than 15% of those born in the 1970s and nearly 40% of those born in the 1960s.

There are at least two respects in which this shift away from DB schemes is bad news for younger generations. First, as mentioned above, it has entailed a significant decrease in the generosity of the pensions provided by firms. Of those in DB schemes in 2015, 90% received an employer contribution equivalent to 10% of their earnings or more, compared

Figure 1. Percentage of private sector employees who are active members of a DB pension scheme by age, for people born in different decades



Source: 'The economic circumstances of different generations: the latest picture' **https://www.ifs.org.uk/publications/8583**

1 | Department for Work and Pensions, 'Pensions and growth: a call for evidence', 2013, **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221423/pensions-and-growth-call-for-evidence.pdf**

2| Authors' calculations using the Annual Survey of Hours and Earnings, 2015.

with only 13% of those in DC schemes.[2] Second, the switch also represents a transfer of some risks from employers to employees – as, in DB schemes, firms rather than employees bear, at least by default, risks around investment returns and longevity. The consequence is that whether or not younger generations are able to accumulate the pension wealth of the predecessors, they will certainty face greater uncertainty with regard to their future living standards than those with greater access to DB schemes.

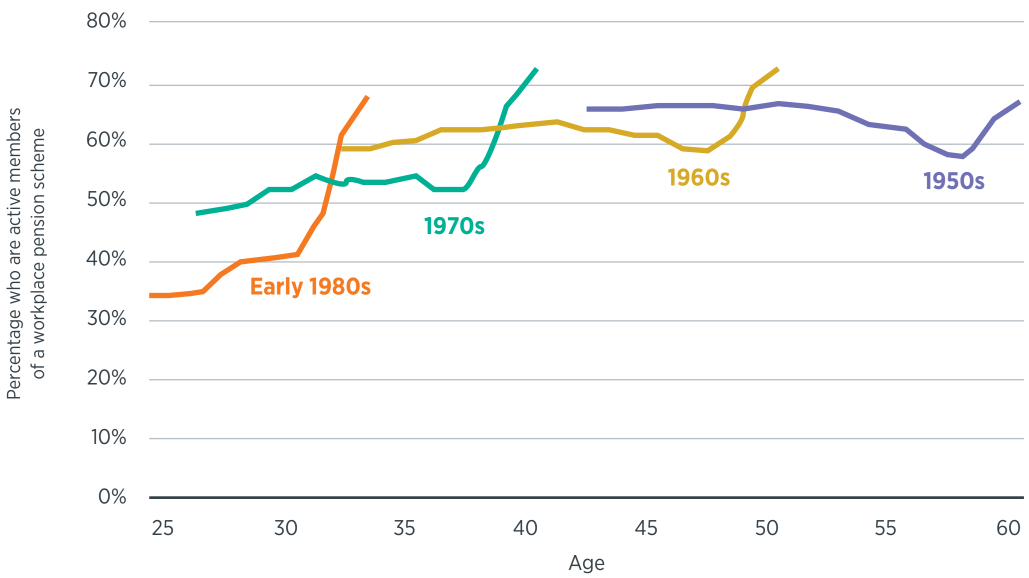
On the other hand, younger generations are now more likely than their predecessors to have at least some access to a workplace pension scheme. As Figure 2 shows, nearly 70% of employees born in the early 1980s are now (in their early 30s) members of a workplace pension scheme (DB or DC), compared with less than 55% of employees born in the 1970s at the same age. Five years ago the picture was completely different: in their late 20s, only 40% of employees born in the 1980s were in a workplace pension scheme, compared with over 50% of the 1970s cohort at the same age. This dramatic reversal of fortunes is entirely down to one of the major success stories of recent pensions policy – 'auto-enrolment'. Rather than having to choose to contribute to a pension, most employees now actively have to choose not to save in one, with dramatic effects on workplace pension membership. The reform is estimated to have increased workplace pension membership by 37 percentage points on average, and by 52 percentage points among those aged 22 to 29 (albeit from a lower base).[3] While the minimum contribution rates required under the policy are currently low, they will rise by 2019, which could help younger generations accumulate pension wealth faster in future (although that may come at the cost of reduced wage growth).

Of course private pensions are not the only part of the pension system that can ameliorate or exacerbate intergenerational inequalities – the state pension matters too. The picture here is clear: in the long term, the single tier pension introduced in April 2016 will be less generous to just about everyone (except the self-employed) than the system it is replacing.[4] This might well be a sensible change – the government should be seeking to move to a state pension system that will remain financially sustainable in the context of an ageing society. But it does put the onus onto increased private pension saving if younger generations are to replace anything like the same share of earnings in retirement as their predecessors. And while the success (so far) of auto-enrolment does provide some hope in that regard, the near-death of DB pensions, at least in the private sector, is likely to make it an uphill struggle.

Biography

Andrew Hood is a Senior Research Economist at the Institute for Fiscal Studies. He joined the IFS in 2012 and works in the Income, Work and Welfare sector. His current work includes analysis of the effect of taxes and benefits on the income distribution, and investigating the role of inheritances in explaining inequalities in consumption and wealth.

Figure 2. Workplace pension participation rate of employees by age, for people born in different decades



Source: 'The economic circumstances of different generations: the latest picture' **https://www.ifs.org.uk/publications/8583**

3 | J. Cribb and C. Emmerson, 'What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the UK', 2016 **https://www.ifs.org.uk/publications/8733**

4 | For details, see R. Crawford, S. Keynes and G. Tetlow, 'A single-tier pension: what does it really mean?', 2013 **https://www.ifs.org.uk/comms/r82.pdf**

5. Unlocking a state pension that is as fair as possible for all generations

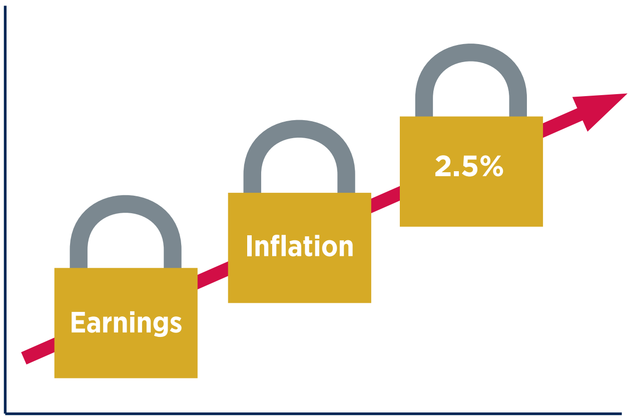
Rt Hon Frank Field, Work and Pensions Select Committee Chair 2015-2017 and Labour General Election Candidate for Birkenhead

Intergenerational fairness is a huge topic with ramifications that extend well beyond the policy remit of any single departmental Select Committee. It encompasses housing, health, social care and even the environment. So why did we in the Work and Pensions Committee choose to take it on? Because nowhere is it more salient than in the question of how our social security system provides for people at different stages of their lifecourse.

Expenditure on 'welfare', defined in the broad sense so as to include the State Pension as well as the full array of benefits and tax credits, accounts for over a tenth of our national income. This expenditure, geared largely and increasingly towards pensioners, is financed by today's workers – and tomorrow's, insofar as it is funded by borrowing. Underlying this dynamic is an implicit social contract between generations. The provision of benefits and public services to the current pensioner population is funded by the taxes of the current working-age population. In turn they expect to receive similar benefits and services when they retire, and so on.

A number of immediate pressures prompted us to examine the increasing strains on the intergenerational contract: the arrival of the large post-war Baby Boomer cohort in retirement age; the associated dramatic improvement in pensioner incomes relative to those of working age; and the severe fiscal stringency imposed on non-pensioner benefits since 2010 at a time when pensioner entitlements have been largely protected.

The debate about pensioner living standards has been transformed over the last two decades. Where once we had a severe crisis of pensioner poverty, the position has since changed markedly for the better, thanks notably to the introduction of Pension Credit and latterly the State Pension triple lock. After adjusting for housing costs and household composition, pensioners are now substantially less likely to be living in poverty, and on some measures even have higher incomes on average, than non-pensioners. This remarkable turnaround provided much of the context for our work.



The triple lock has made a welcome contribution to arresting the decades-long erosion of the value of the State Pension relative to earnings. However, intergenerational fairness requires us to take the long view. Of course, in the happy event that growth in average earnings outstrips inflation and 2.5 per cent, then the triple lock costs no more than an earnings link. But this will not always be the case. As the state pension rises each year by the highest of these three factors, it is structurally more generous than its individual components. The consequent ratchet effect sets the state pension on a permanently divergent – and arbitrary – upward trajectory relative to both earnings and prices, with profound long-term implications for fiscal sustainability and intergenerational fairness. The Office for Budget Responsibility currently projects that by 2060 the triple lock adds 0.8 per cent of GDP to annual State Pension spend compared with an earnings link, or £15 billion in today's terms.

There are four ways in which the Government could seek to sustain this.

1. It could let borrowing rip and rely on the bond markets to continue letting us live beyond our means, thereby deferring the payment of the tab ever further into the future.

2. It could increase taxation.
3. It could try to squeeze expenditure on non-pensioner households ever further, even though recent policy reversals indicate that the limits to this approach have already been reached.
4. Or it could maintain its current approach of using increases in State Pension age as the principal lever to keep expenditure under control.

All of these options have implications for intergenerational fairness, but none more so than the prospect of further State Pension age increases. These necessarily affect the youngest the most and disproportionately hit those socio-economic groups with lower-than-average life expectancies in retirement. Today's young adults are faced with the prospect of an ever longer working life shouldering the mounting fiscal burden of the triple lock, while the finishing line recedes ever further into the distance. The Government Actuary's recent report raised the stark prospect of the State Pension age potentially rising to 70 in the mid-2050s. For many, working to this age will not be an option: many will have died while others will be too knackered to work.

The inherent trade-off between long-term generosity of pension indexation and increases in State Pension age was central to our analysis, and its importance was rightly recognised by John Cridland's Independent Review of the State Pension Age. I very much welcome the fact that his final report has recommended that the triple lock be scrapped in the next parliament and replaced with an earnings link.

Cridland's call for a return to an earnings link echoes our principal recommendation – that during the next parliament the State Pension should track a given percentage of average earnings. When prices rise faster than earnings, price indexation should kick in to protect pensioners against a reduction in purchasing power and should continue when real earnings growth resumes until the pension returns to its benchmark proportion of average earnings. Such a mechanism would enable pensioners to continue to share in the proceeds of economic growth, protect against inflation, ensure a firm foundation for private retirement saving and reduce the fiscal pressure to raise State Pension age ever higher.

I hope that the Cridland report, following on from our own report, will further help to shift the political debate towards a broad acceptance of the need to rethink the triple lock. Whatever course of action is ultimately adopted, we must conserve the progress made in alleviating pensioner poverty and prevent any resurgence of this scourge. I am confident that the alternative that the Committee proposes will achieve the twin goals of securing the gains in pensioner living standards while keeping the system fiscally sustainable and fair to all generations.

Greater awareness of the intergenerational implications of decisions would make for better policy, and the actuarial profession is particularly well-placed to bring the requisite expertise and long-term view. It is therefore welcome that the IFoA has embraced this role in promoting understanding of the intergenerational dimension of policymaking among politicians and the wider public.

Biography

Frank Field was first elected Labour MP for Birkenhead in 1979 and was Chair of the Work and Pensions Select Committee from 2015, having previously served as Chair of the Social Security Select Committee (1990-1997). In 1997-1998 he accepted the position of Minister for Welfare Reform in Tony Blair's first government. Before joining Parliament Frank worked as Director of the Child Poverty Action Group and the Low Pay Unit. In 2010, in recognition of his expertise in the fields of poverty and welfare, Frank was appointed Chair of the Independent Review on Poverty and Life Chances.

Today's young adults are faced with the prospect of an ever longer working life shouldering the mounting fiscal burden of the triple lock, while the finishing line recedes ever further into the distance

6. Smoothing the transition

John Cridland CBE, Independent State Pension Age Reviewer

I believe we have a duty to those who come after us to try and make the future both fair and sustainable. This means ensuring that State Pension costs remain affordable and accessible for future generations. As far as possible, the aim should be to give current and future pensioners roughly the same deal in retirement.

For the State Pension age review, I spent a year gathering and considering evidence on intergenerational fairness. The picture which emerged is complex. Life expectancy is projected to continue to increase. Each generation will enjoy a longer life expectancy than the preceding one, although disparities driven by socioeconomic inequality remain. Thanks to automatic enrolment, more people in younger generations will reach retirement with private pension savings, and the new State Pension means that a higher proportion of people will receive a full State Pension than in the past.

However, the generous defined benefit pension schemes are disappearing. In decades to come, those coming up to State Pension age are more likely to have debt, continuing or higher housing costs, fragmented pension pots and caring responsibilities for elderly relatives.

Public spending must also be seen in the context of intergenerational fairness. The State Pension is a 'pay as you go' system, meaning that today's workers pay for today's pensioners. It is projected by the Office for Budget Responsibility that the cost of the State Pension will grow from 5% of GDP to 7.1% over a 45 year period, even assuming that the State Pension age rises with longevity. This position is made starker by an even bigger projected increase in health spending, with an increase anticipated from 6.9% of GDP in 2021/22 to 12.6% of GDP in 2066/67. Additional spending on pensions is likely to mean a reduction in spending elsewhere, higher taxation, funding through further borrowing or a combination of the three, which will impact on younger generations.

What does this mean for State Pension age?

1. **The proportion of adult life spent in retirement should be capped,** to help constrain future public spending and deliver intergenerational fairness. I consider that the average proportion of adult life spent in retirement over the last decade is an appropriate baseline and we can only maintain this if the rise in State Pension age to 68 is brought forward.

2. **I believe that State Pension age changes should be spread equally across generations.** It is important that the pace of change remains steady and focused on achieving the balance in the long-term. I came to the judgement that an increase of the State Pension age every ten years – and by only one year per decade – represents an appropriate pace of change for the future, on current longevity assumptions. If life expectancy continues to improve at the same rate as it has in the past, then a change of once a decade still allows for the State Pension to remain broadly at the same proportion of adult life as it is today. Only exceptional changes to the data would mean moving from this position, given the impact it would have on those affected.

3. **The longevity link appears close to the limit of what can be saved on State Pension spending through increases in the State Pension age.** Further savings to ensure fiscal sustainability are more appropriately delivered by moving in the future to uprating the pension by earnings, instead of the triple lock. The triple lock uprating mechanism currently used is responsible for an estimated 0.9% of GDP in State Pension spending in 2066/67.

4. **We must not forget about the differential impacts on certain groups and intragenerational fairness.** Without the right support, some individuals will struggle to cope with changes to State Pension age. This is why we need a package of mitigation measures which must go alongside the increase to 68. These measures are designed to smooth the transition into retirement for those who work, while supporting those with multiple barriers to work.

In decades to come, those coming up to State Pension age are more likely to have debt, continuing or higher housing costs, fragmented pension pots and caring responsibilities for elderly relatives

Carers suffer disadvantage in the labour market and my Review calls for all employers to adopt eldercare policies and for the Government to directly support a Statutory Carers' Leave programme. To support the gradual transition to retirement a Mid-Life MOT should be introduced to provide workers with holistic advice to prepare for the transition. Older workers should have a more prominent role as mentors and trainers in the Government's apprenticeship strategy.

For older workers, the conditionality in Universal Credit could be flexed to allow part-time working. Importantly, long-term carers and people with ill-health or disabilities should have access to a means-tested pensioner benefit a year before State Pension age from the rise to 68.

We must raise State Pension age to ensure that the cost burden on tomorrow's young people does not become unsustainable and we maintain intergenerational fairness in the system. We must not do that without the mitigations that will smooth the transition into retirement for the most vulnerable pensioners of tomorrow.

Biography

John Cridland was appointed as independent reviewer of State Pension age in March 2016 and published his findings in March 2017. John was most recently Director General of the Confederation of British Industry (CBI) from 2011 to 2015. He joined the CBI as a policy adviser in 1982 and became its youngest ever director in 1991, when he took over the environmental affairs brief. He later helped negotiate the UK's first national minimum wage and entry into the European Union's "social chapter" on employment conditions. John is currently Chair of Transport for the North. He spent 10 years on the Low Pay Commission and was a member of the ACAS council from 1997-2007.

7. Fair pensions for all generations

Sally West, Policy Manager - Income and Poverty, Age UK

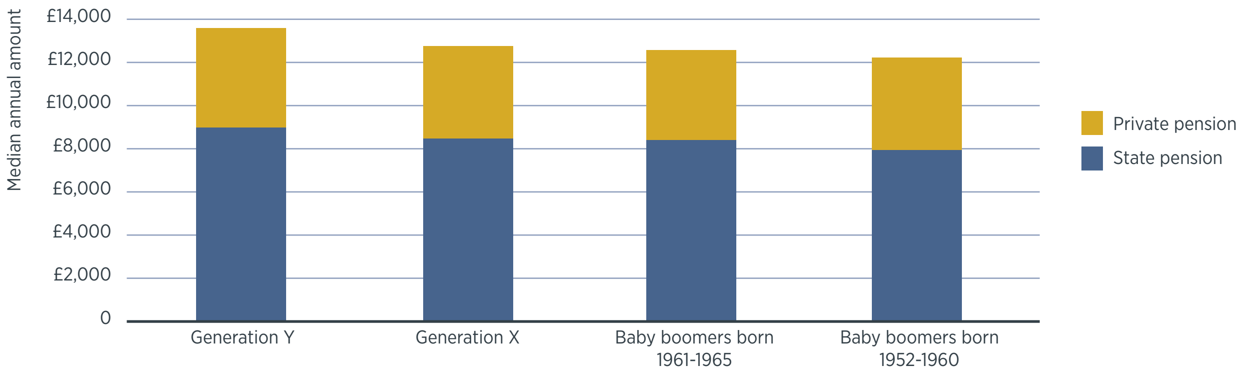
Pensions policy is often likened to a supertanker that takes years to turn around and decades to reach its destination – and that's why at Age UK we are keenly committed to fair pension systems that work for all generations, keeping both current and future pensioners out of poverty in later life and providing a decent income in retirement for us all. If we are to achieve this aim, however, we need to consider the differences within generations as well as between them.

While it's tempting to characterise the Baby Boomers as the 'lucky generation', with defined benefit schemes and now a triple locked State Pension, analysis of future incomes overall does not necessarily bear this view out. There are clearly some who have benefited from very generous provision but projections in the Cridland State Pension age Review Report looking at different generations show increases in median incomes in the first year or retirement over time. Median State Pension income is projected to be higher (assuming the triple lock stays in place) and while median private pension income is lower for generation X (born 1966-1979) than for the Baby Boomers it is the youngest generation Y (born 1980-2000) who are expected to have the highest median private pension income.[5] The report notes that while younger generations are less likely to have high levels of defined benefit pensions, there will be wider membership of defined contribution pensions following automatic enrolment.

Analysis by the Pensions and Lifetime Savings Association looked at prospects for different cohorts. Among Baby Boomers aged 55-64, for example, some with defined pension entitlement have 'very good retirement income prospects' but around half are expected to have 'quite poor ones' with not enough time for automatic enrolment to boost incomes substantially. In contrast most Millennials (aged 22-34) have the opportunity to achieve adequate pension incomes - but this depends on a rise in automatic enrolment contributions and possibly, longer working lives.[6] This is an important reminder of the uncertainties around projections, especially when considering the likely future income of people many years from retirement.

What is clear is that, for all generations, the State Pension has an important role, particularly for women and lower income groups. Currently around 60 per cent of pensioners receive the majority of their income from State Pensions and benefits and the Cridland report shows that the State Pension is likely to continue to be the most important element of income for middle and lower income groups. That is why Age UK places

Figure 1. Projected median average amounts of State Pension and private pension in 1st year of retirement by generation



Source: Smoothing the transition, Independent Review of the State Pension age, Final Report, 2017

5 | Smoothing the transition, Independent Review of the State Pension age, Final Report, 2017.
https://www.gov.uk/government/publications/state-pension-age-independent-review-final-report

6 | Retirement income adequacy generation by generation PLSA, 2016.
http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/0605-Retirement-income-adequacy-Generation-by-Generation.aspx

While it's tempting to characterise the Baby Boomers as the 'lucky generation', with defined benefit schemes and now a triple locked State Pension, analysis of future incomes overall does not necessarily bear this view out

such importance on protections such as the triple lock. In our view, questions such as that posed by the Institute of Fiscal Studies paper *'Would you rather? Further increases in the state pension age v abandoning the triple lock'* [7] are a false dichotomy - the difficulty is that both options would particularly affect more disadvantaged groups. A rising State Pension age is already having an impact on women in their early sixties who are finding it difficult or impossible to carry on working due to reasons such as caring responsibilities or ill health. And further increases in State Pension age will affect both men and women in this position. On the other hand, a change in the uprating policy would, over time, reduce the level of the pension and particularly affect younger people. For example, the Pensions Policy Institute (PPI) has calculated that a younger person with lower earnings has a 63 per cent chance of achieving an adequate retirement income if the new State Pension is increased by the triple lock, but just a 36 per cent chance if it is linked to earnings.[8]

Alongside the need for an adequate State Pension as a platform for saving, we should build on the success of automatic enrolment. It is good news that an increasing proportion of employees are paying into a private pension, but we are concerned that around half of the UK population aged 16 to 64 are not eligible for automatic enrolment, because they are self-employed or not working, or employed but not eligible for automatic enrolment – mainly because they earn below the threshold.[9] The current automatic enrolment review offers an important opportunity to ensure more people are brought into the system and to consider the next steps in terms of increasing contribution levels.

However, ensuring a comfortable income in later life is not just about building up pension savings, but turning these into a retirement income. Older generations had little choice about this. Younger people, with defined contribution provision and more options at retirement, will have some complex decisions to make, and may also find it harder to ensure savings will last throughout retirement. A missing part of the jigsaw is proper consideration of how 'default pathways' at retirement, combined with greater take up of Pension Wise, could help people avoid poor choices and maximise their savings.

In conclusion, while looking at pensions through the 'intergenerational' lens can be informative, this provides just part of the picture. In our view, the focus should be on ensuring that everyone including those with low and modest incomes of all ages can look forward to a future income that is sufficient to enable them to make the most of their retirement.

Biography

Sally West is the Policy Manager for Income and Poverty at Age UK. She has worked there for over 20 years and leads the organisation's policy work on income issues including: poverty, state pensions and benefits, and taxation. She is part of the Policy Team which is responsible for analysing the needs of older people, developing evidence-based policy proposals, and carrying out influencing work to bring about policy change. Before working for Age UK she was a nurse and gained a PhD from Kings College London based on research around psychological and social influences on recovery from heart surgery. She has also worked as an adviser for a local Citizens Advice Bureau.

7 | **https://www.ifs.org.uk/publications/8942**

8 | What level of pension contribution is required to obtain an adequate retirement income? PPI, 2013.
https://www.pensionspolicyinstitute.org.uk/default.asp?p=12&publication=0349&

9 | **http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-75---who-is-ineligible-for-automatic-enrolment**

8. Public Sector Pension Schemes

Allan Martin, independent pension scheme trustee

Most public sector pension schemes are unfunded including those in the civil service, the NHS, teachers, police and fire services. Employee and employer contributions and benefits are calculated using the SCAPE discount rate (Superannuation Contributions Adjusted for Past Experience). This discount rate is arguably the most important assumption in UK defined benefit (DB) pensions, because of its potential to affect the public finances as well as retirees now and in the future. It is also arguably the least appreciated.

The SCAPE discount rate was significantly reduced in 2011 from RPI+3.5% to CPI+3%, this lower rate meaning higher contributions and/or lower benefits. It was further reduced to CPI+2.8% in March 2016. In setting the rate HM Treasury, with a public consultation[10] and advice from the Government Actuary's Department[11,12], considered that the rate should represent a fair assessment of costs and protect Government income, i.e. its tax base, which in turn is largely dictated by GDP growth. The rationale for this change was set out in the Government's response to the 2010 consultation 'The discount rate used to set unfunded public service pension contributions'[13].

Why is this an issue for intergenerational fairness?

The interaction between UK GDP growth and the SCAPE discount rate will have a significant effect on the sustainability of the contributions paid for and benefits secured by millions of public sector employees over the generations.

GDP growth has been somewhat challenged after the financial crisis and that looks set to continue once the UK leaves the European Union. Net migration, real wage growth and productivity all affect GDP. The March 2016 SCAPE adjustment reflected input on GDP growth from the Office of Budgetary Responsibility (OBR). Downgrades of assumed growth have followed from the OBR and indeed across the developed world.

Figure 1. GDP: Year on Year Growth, % above CPI

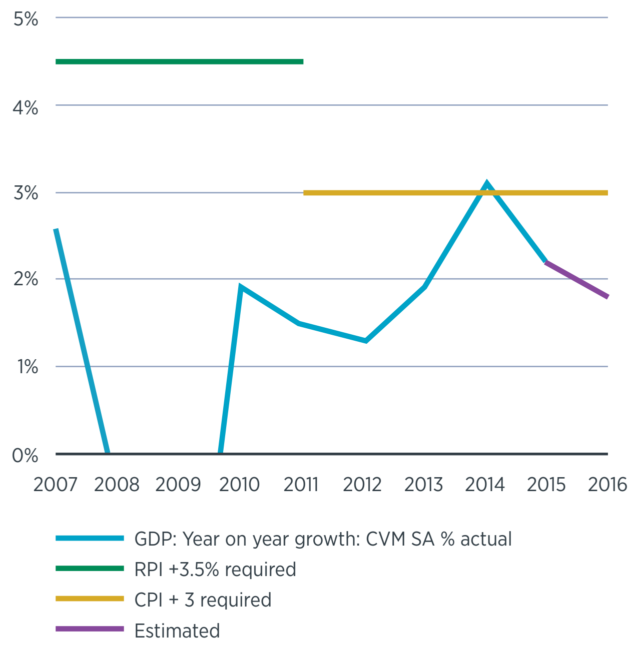


Figure 1 shows how the last 10 years of GDP figures compare with the prescribed SCAPE discount rates. These coupled with the projected figures for the next 5 years would suggest that significant public interest challenges will continue.

Noting that the UK has £1.5tn of unfunded public sector pension promises[14], a 1% funding or GDP growth assumption shortfall in any year might be valued at £15bn - quite a worrying inheritance for generation Z and their children and grandchildren. The consequence of not properly managing today's pension promises could include increased future taxes and/or budget pressure with the obvious consequences for public sector employment numbers and pay and services.

10 | **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81610/consult_unfunded_pension_condoc.pdf**

11 | Freedom of Information Request; Correspondence dated 23rd March 2011 between The Government Actuary and H M Treasury

12 | Freedom of Information Request; Correspondence dated 14th March 2016 between The Government Actuary and H M Treasury

13 | HM Treasury, December 2010, Consultation outcome: The discount rate used to set unfunded public service pension contributions **https://www.gov.uk/government/consultations/the-discount-rate-used-to-set-unfunded-public-service-pension-contributions**

14 | Whole of Government Accounts 2014-15; **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525617/WEB_whole_of_gov_accounts_2015.pdf**

Additionally, the March 2016 Budget[15] suggested that from 2019 the impact of the 0.2% adjustment to SCAPE would be £2bn per annum on employer contributions. This money will likely be met from Departmental budgets, which would otherwise go on salaries and services.

Another issue for intergenerational fairness - the new 2015 Scheme structures

Lord Hutton's 2011 public sector pension reforms introduced career average revaluation of earnings or CARE benefits, and the switchover from traditional defined benefit schemes came into effect in April 2015. The changes involved a negotiated range of pension fractions and revaluation rates as described in Figure 2.

Figure 3 shows the relative value of benefits earned over a career at retirement, based on a number of different revaluation rates[16].

The flat top line is my suggestion of intergenerational equality with revaluation in line with national average earnings (NAE). In this example a future retiree's pension entitlement will be rising at the same rate as the average earnings of the working population. When they reach retirement, this cohort's pension value will therefore have risen broadly in line with their earnings.

The purple line shows the effect of revaluation in line with CPI at 2.5% pa less than NAE. The other lines show the adjusted revaluations at CPI plus a fixed amount.

The potential intergeneration inequality or balance between old and young jumps out from the grid. Over time, with a revaluation at CPI, or even CPI +1.6%, a future retiree's pension pot looks like growing significantly less quickly than their possible earnings whilst in work.

Figure 3. Revaluation where National Average Earnings equal CPI + 2.5%

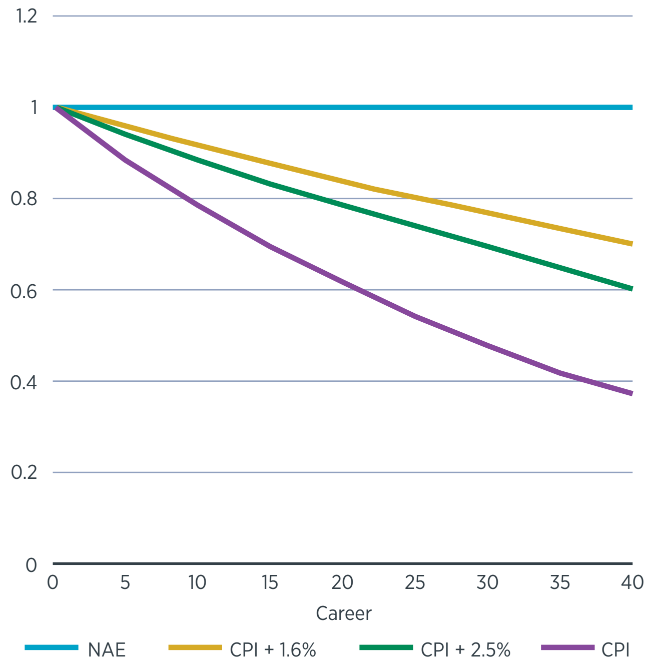


Figure 2.

The fraction of an employee's salary they will be entitled to for each year of service (e.g. someone working for the NHS for 27 years would be entitled to 27/54 of their salary as a pension i.e. one half)

The percentage used each year to calculate the size of the pot an individual will have at retirement (e.g. a civil servant's expected retirement pot between now and retirement will be increased by the CPI rate)

What this calculation means for a public sector pension in 2017

Scheme	Pension Fraction	In Service Revaluation	Actual revaluation in 2017
Local Government	1/49	CPI	1.0%
NHS	1/54	CPI+1.5%	2.5%
Police	1/56.1	CPI+1.25%	2.25%
Teachers	1/57	CPI+1.6%	2.6%
Firefighters (Scot/Eng.)	1/61.6 / 1/59.7	NAE	2.6%
Civil Service (alpha)	2.32% (~1/43)	CPI	1.0%

15 | 2016 Budget **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508193/HMT_Budget_2016_Web_Accessible.pdf**

16 | Using the expected 2016 actuarial valuation assumptions

But what if earnings don't increase at 2.5% above CPI long term?

In a scenario where earnings increase at an average of CPI + 1% per annum, the shortfall of just CPI revaluation (the purple line) reduces, but the fixed additions to CPI (the red and green lines) become much more significant, giving benefits higher than with NAE revaluation. In this scenario, CARE benefits would therefore be more expensive than the old and abandoned final salary benefits! (The final salary link however continues in respect of pre April 2015 service.)

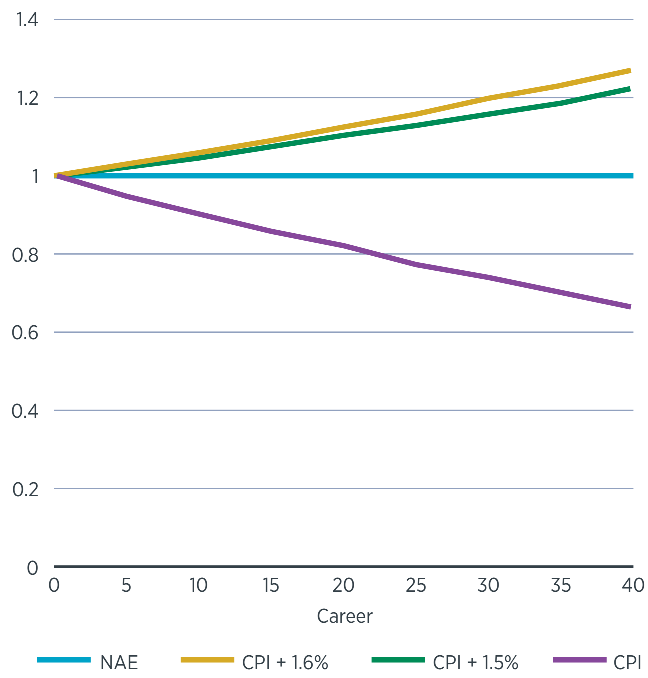
Conclusion

In a world of negative real interest rates for private sector pensions and very positive pension funding growth assumptions for public sector pensions, it is difficult to envisage how both can be sustained long term. The implications for future retirees could be challenging, as current generations and the UK economy become increasingly indebted by propping up a system which is unlikely to be as generous to them in the future. This, as with many other aspects of pensions, is likely to have consequences for how soon and how comfortably different generations can expect to retire in the future.

Biography

Alan Martin is an actuary and independent pension scheme trustee. After a traditional career in established consultancy firms he set up his own consultancy business in 2002. He now proudly claims to be North Ayrshire's leading (= only) independent trustee, overseeing nearly £5bn's worth of public and private sector pension promises.

Figure 3: Revaluation where National Average Earnings equal CPI + 1%



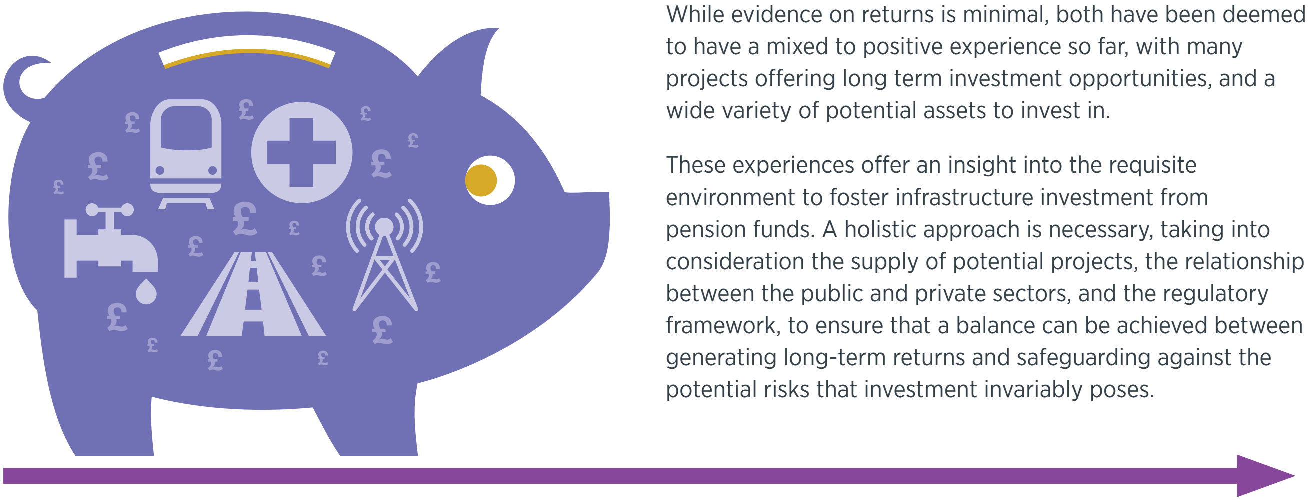
9. Fuelling the future: Infrastructure and pensions

Dean Hochlaf, Assistant Economist, International Longevity Centre-UK

The golden age of economic expansion is a distant memory. Almost a decade has passed since the financial crisis, and many industrialised economies are continuing to experience sluggish economic, productivity and wage growth. Many theories have attempted to explain the current economic malaise: secular stagnation, the savings glut hypothesis, liquidity traps, but the economic conditions which many of the current generation of retirees enjoyed while saving towards pensions are no longer available for the workforce of today. Pensions policy must adapt to reflect a changing economic landscape and may also provide much needed capital to help boost economic performance.

Across the developed world, low fertility rates and improved longevity have resulted in ageing population structures, with the potential to influence economic performance. Reductions in the labour force can hinder growth, while "institutional welfare systems" divert government resources to the older population.

It would be easy to characterise this as an intergenerational struggle. Poor economic performance attributed to population ageing would likely have an impact on saving returns, while the workforce is deprived of economic resources. However, the economy is dynamic and heavily inter-connected. Intergenerational co-operation may prove the route to escaping the prolonged economic stupor, and at its heart would be a reformed approach to the institutional investment of pension wealth, transforming both behaviour and the regulatory environment.



Economics has several prominent theories which attempt to explain growth. Accumulation of physical capital, improvements in technology and the quality of the skills and abilities of the labour force are the over-arching determinants of growth. With a growing population of older workers, saving towards retirement, UK pension wealth is estimated to be above £4.5 trillion. This represents a huge sum which could be more proactively invested into infrastructure.

Trends have shown that as the appetite for risk diminished, UK pension asset allocation moved away from volatile equities, towards fixed income assets, such as government bonds. Unfortunately, the yield on fixed income bonds in the UK and across the industrialised world have been in decline since before the 2008 financial crisis. As demand for government bonds increases, prices rise, which in turn pushes down the yield on government bonds. Ultimately, this is responsible for the creation of an environment of persistently low returns, which will harm the incomes of future retirees.

Infrastructure investment offers scope for greater returns, while simultaneously helping to lay the foundations necessary for stronger economic performance. UK spending on infrastructure is less than other OECD nations, and while assets in the UK are perceived to be of a quality close to the OECD average, they are consistently ranked below other G7 countries.

Australia and Canada are two examples of countries where pension funds have ready access to infrastructure investment, allowing them to diversify beyond traditional asset classes. While evidence on returns is minimal, both have been deemed to have a mixed to positive experience so far, with many projects offering long term investment opportunities, and a wide variety of potential assets to invest in.

These experiences offer an insight into the requisite environment to foster infrastructure investment from pension funds. A holistic approach is necessary, taking into consideration the supply of potential projects, the relationship between the public and private sectors, and the regulatory framework, to ensure that a balance can be achieved between generating long-term returns and safeguarding against the potential risks that investment invariably poses.

Infrastructure investment offers scope for greater returns, while simultaneously helping to lay the foundations necessary for stronger economic performance

More evidence is required to establish whether infrastructure offers a viable investment opportunity and to encourage funds to take risks and make informed choices. This will require an improvement in the collection of statistics on such projects. Both government and the private sector will need to ensure stability when embarking on projects. Education surrounding infrastructure assets and knowledge sharing among pension fund managers and stakeholders will also be crucial if they are expected to invest. Above all, having access to projects with reasonable levels of risk will allow funds to invest appropriately, diversifying their portfolios and developing a steady stream of long-term investment returns.

Infrastructure investment is not a silver bullet, but it is a potential avenue to explore for pensions to generate sufficient returns to improve the productive capacity of the economy resulting in higher growth and hopefully higher retirement incomes for future pensioners. Wider and more inclusive growth could help to secure future prosperity and move the conversation away from talk of an intergenerational war.
So, let's take a new approach to pension fund investment, to help unlock the abundance of pension wealth for the benefit of future generations, and the domestic and global economy.

Biography

Dean Hochlaf is Assistant Economist at ILC-UK. His interests include the macro-economic consequences of demographic change and the political environment in which policy is created. Dean has worked on a number of high-profile reports for ILC-UK including work on immigration and pensions and has recently returned from Washington D.C. where he presented and discussed his work on the retirement savings gap.

10. Updating the taxation of retirement savings

Tim Keogh, Chair, IFoA Taxation of Retirement Savings Working Party

The design of the tax system underlying the UK's retirement savings framework provides opportunities to help or hinder inter-generational fairness. The recent introduction of the Lifetime ISA (LISA) could be the first sign of a shift in approach away from traditional pension saving, offering an alternative way for individuals, particularly those in younger generations, to save for their retirement, and also offering an alternative way for the Government to tax these savings. The IFoA's Taxation of Pensions Working Party has been exploring the fundamentals of the current approach to taxation of all forms of retirement savings, whether they are labelled pensions or not. Two themes of relevance to the inter-generational fairness debate are emerging from this work:

1. Systems where tax is deferred from the point of earning to the point of spending (as in traditional pensions) allow the opportunity to adjust the final tax rate for outcomes which have unexpectedly favoured one generation or the other, thus sharing risk more fairly between generations.
2. Differentiation of income tax rates between current pensions and current earnings presents a possible way to offset apparent bias to the existing retired generation.

The traditional approach to pensions tax can better adjust for inter-generational risk than the ISA model

A key inter-generational fairness issue is the transfer of risk between generations. The classic example is the defined benefit (DB) pension, where commitments are made on the economy 20-30 years hence. Whether the economy proves more or less able to meet these commitments when they are delivered is inevitably unknown and the margin of uncertainty is substantial.

The present system offers the average UK taxpayer a choice between pensions and ISAs for retirement savings. This decision is often influenced by what employers will help with, but employer provision in turn should reflect what is cost-effective/tax attractive.

The main difference is that pension savings are 'gross' – with income tax relief at the point of saving but, broadly, income tax to be paid when the money is spent – whereas an ISA must be funded from post-tax income but with no tax when the money is drawn upon in retirement.

Under the pension model the final level of tax can be adjusted to achieve results which reflect the needs of the time and an assessment of what constitutes fair treatment of that generation relevant to then current workers. This contrasts with the ISA, where the tax is taken up front and it is difficult to make later adjustments.

This is not to say that changing tax rates when pensions are drawn is easy - fairness is not easy to define or agree politically, and retirement planning is hard in the presence of uncertain taxes. However, tweaking subsequent pension tax rates seems less likely to break the bond of trust between savers and the Chancellor than introducing post-saving taxation on ISAs. The existence of some level of trust is essential to a successful long term savings system.

A fairer rate of tax on drawing existing pension savings?

There is no reason why income tax rates on current pension income have to be the same as those on current earned income. When National Insurance (NI) contributions are taken into account the overall level of tax is already unequal.

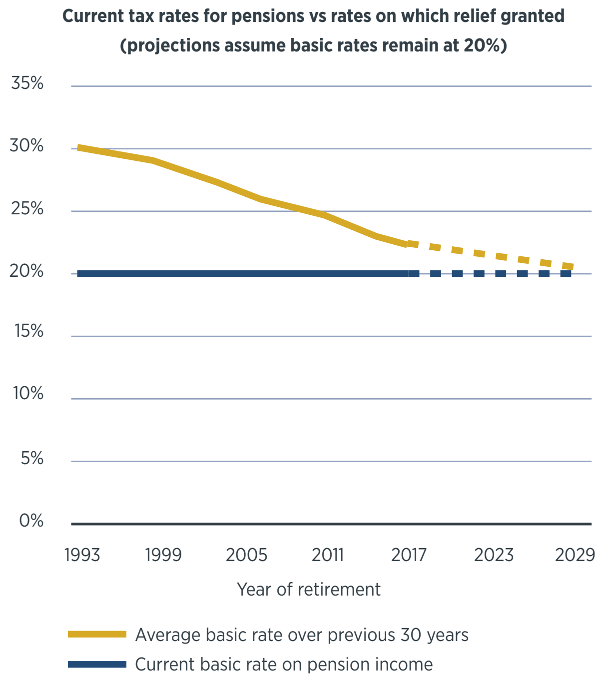
The ability to charge a higher rate of income tax when existing accrued pensions are drawn down (or give current workers a lower tax rate) exists as a potential way to offset perceived unfairness in the favour of the existing retired/retiring generation. An alternative approach could be to introduce a limited level of NI contributions on pension payments, or to increase the basic rate of income tax at the same time as reducing NI contributions.

A key inter-generational fairness issue is the transfer of risk between generations

Regardless of the exact approach any change to the taxation of pension savings should recognise that:

1. Generally these pensions received tax relief when set up at significantly higher rates than currently.

Figure 1. Tax relief obtained on existing pension savings for a basic rate taxpayer.



Source: HMRC/National Archives and Working Party calculations

Figure 1 shows the effect of historically higher basic rates; the effect is even stronger for those who benefitted from higher rate tax relief at the time but now pay only basic rate on their pensions.

2. The bulk of existing pension savings have benefitted from substantial National Insurance relief. Figure 2 shows that exemption from National Insurance on employer contributions adds around one half to the current gross cost of pension tax relief; the proportion is much higher if allowance is made for subsequent income tax expected to be paid on the pensions

   Figure 3 shows that National Insurance relief is arguably the main tax break for pensions – for a basic rate taxpayer, the benefit of a pension instead of an ISA is only about £6 per £100 saved, but this becomes £42 if employer and employee agree to a reduced salary with the resulting National Insurance savings ploughed back into pension.

3. The proportion of tax-funded services drawn by the retired, especially healthcare, is seen as increasing, and many observers believe that some fundamental change in the approach to the funding of these services will be needed in the near future.

4. With the reduction in the general level of occupational pensions, many in the younger generations are unable to benefit from the relief on offer to the same degree as their parents.

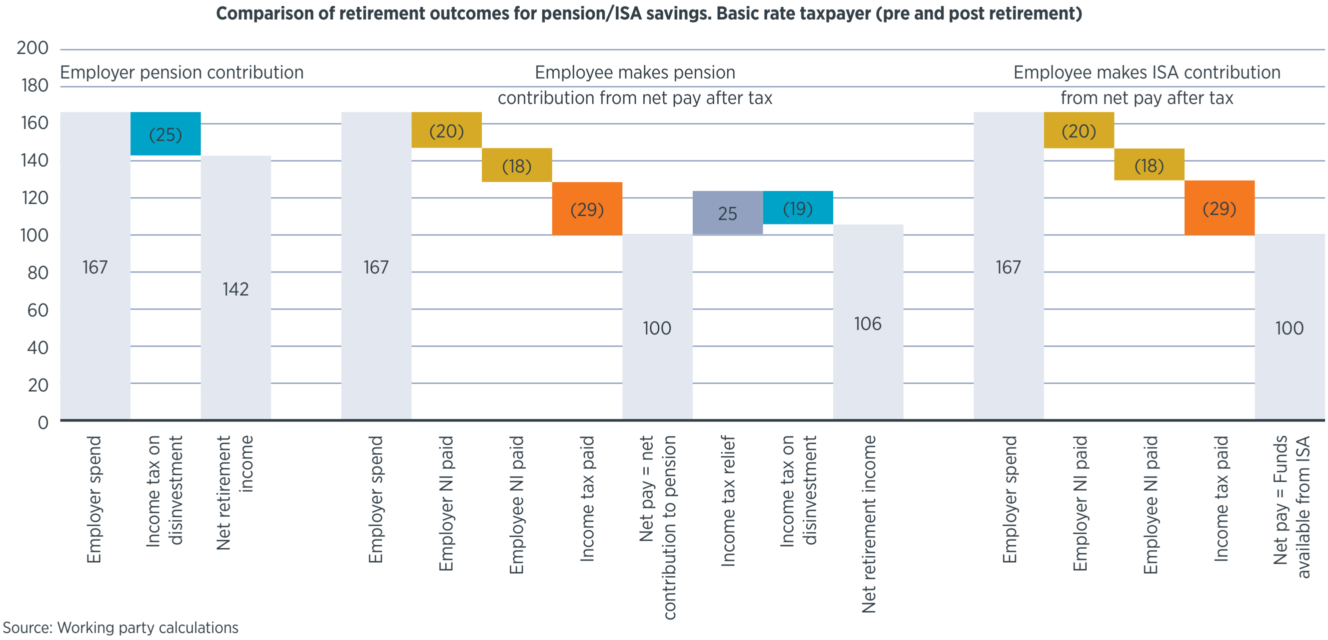
Biography

Tim Keogh FIA is an expert on pension scheme design and finance who spent 20 years at international consultants Mercer, latterly as a research partner dealing with issues including the 2004 pension tax reforms. He subsequently worked as a case specialist and strategy adviser at the Pensions Regulator. He serves on IFoA working parties dealing with DB scheme risk management and the operation of DB schemes in run-off, as well as chairing its Taxation of Retirement Savings Working Party.

Figure 2. Aggregate pension tax reliefs at the contribution stage 2002-2015.

Source: HMRC

Figure 3. Effect of taxes on £100 of savings through pensions with and without employer support compared to ISA savings. Ignoring investment returns, which are treated the same in all 3 cases.



Source: Working party calculations

The existence of some level of trust is essential to a successful long term savings system

11. The role of responsible investment in maintaining intergenerational fairness

Janice Turner, Co-Chair, Association of Member Nominated Trustees

The Association of Member Nominated Trustees (AMNT) believes that responsible investment can and should play a very important role in delivering a better outcome for members in the future.

Intergenerational fairness has been the subject of major and ongoing debate within pensions. Pension scheme trustees must be concerned about the interests of all categories of members, whether retired, deferred or active, and future members: the millennials who will work for the company in the future. Pension schemes are by their nature multi-generational and so are inherently aligned with the long term aims of responsible investment (RI).

AMNT has approximately 700 members from 500 pension schemes with collective assets of £700-billion. We concur with the definition of RI set out by UN-backed Principles of Responsible Investment, that *"it is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors, and the long-term health and stability of the market as a whole … It is driven by a growing recognition in the financial community that effective research, analysis and evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term."*[17]

Pension scheme trustees have rightly been under growing pressure to be more proactive, long-term stewards of their investments. The Kay Review for example in 2012 concluded that short-termism is a problem in UK equity markets, *"and that the principal causes are the decline of trust and the misalignment of incentives throughout the equity investment chain."* [18]

The Law Commission followed this up in 2014 with its review of fiduciary duty and declared that pension trustees should take into account environmental and social issues that are financially material to their investments, as well as corporate governance matters. This was reflected in the Pensions Regulator's new investment guidance to both DC and DB trustees with stronger expectations on responsible investment. It stated: *"Most investments in pension schemes are long-term and are therefore exposed to long-term financial risks … such as climate change, unsustainable business practices, and unsound corporate governance. Despite the long-term nature of investments, these risks could be financially significant, both over the short and longer term. You should therefore decide how relevant these factors are to inform your investment strategy."* [19]

So how can responsible investment maintain intergenerational fairness? By far the most important challenge is winning the race against time with global warming. Failure to stem the rise in global temperatures through prudent consideration of climate change risks and opportunities in investment decision making will leave future generations with an unmitigated disaster from which there may no longer be a way back. Asset owners' RI policies should encourage companies to play their part in this by developing active and stretching environment policies, and penalise those that don't.

There is a substantial and growing body of research showing that the better-run companies outperform their competitors. Having regard to how our investee companies address social issues within their own workforce could have an immediate impact in improving the lot of the millennial generation. While workers heading for retirement may be in a more secure

Pension schemes are by their nature multi-generational and so are inherently aligned with the long term aims of responsible investment

17 | How Asset Owners can drive Responsible Investment, PRI

18 | **https://www.gov.uk/government/consultations/the-kay-review-of-uk-equity-markets-and-long-term-decision-making**

19 | **http://www.thepensionsregulator.gov.uk/guidance/db-investment-two-strategy.aspx#s24049**

situation, those entering the workforce now and in the near future are most at risk of insecure work – the ‘gig’ economy where they may be at the beck and call of unscrupulous employers – and be in receipt of low or no pay and uncertain working hours. Companies with a poor record on this can have a negative impact on returns to shareholders – Sports Direct’s rapid exit from the FTSE 100 when its employment practices were exposed demonstrates the necessity for shareholders to have a strong focus on social issues. Medium to long term returns can be damaged by companies with ongoing problems in this area if their license to operate is called into question. ESG policies should expect companies to treat their workforce fairly, pay or work towards paying the ‘real’ Living Wage and London Living Wage, and fulfil globally endorsed commitments to recognition of trade unions. And again, fund managers should incorporate these risks into their company valuations.

Governance policies covering the issues contained in the UK Corporate Governance Code also serve to improve generational fairness, by ensuring companies are run in the long-term interests of the asset owners rather than the short-term interests of executive directors, thereby addressing the principal-agent problem.

So there is every reason for asset owners to adopt challenging ESG policies and expect their fund managers to implement them within the context of all aspects of the investment process. With respect to shareholder voting, while there are template policies on governance there has been no equivalent set of policies covering environmental and social issues. So the AMNT introduced Red Line Voting – the UK’s first ever set of voting policies covering the range of ESG issues. It is extremely important for pension schemes to adopt an in-house policy not least because they usually have multiple fund managers and it is necessary to ensure consistency across their assets. Our policy is on a ‘comply or explain’ basis: if a fund manager believes that it is in the asset owner’s interests that they vote contrary to a Red Line with regard to a particular company, they may do so but must explain to the client why. We do not accept blanket rejection of entire policies.

But trustees attempting to adopt and implement these policies have met several obstacles. One reported by some of our members is the lack of support from scheme advisers, particularly investment advisers. Some don’t believe that small pension schemes should have their own ESG policies and should simply delegate everything to their fund managers. These trustees, critical of fund managers’ voting record and failure to engage on issues that they consider important, expect better. And new investment guidance from The Pensions Regulator makes clear that investment advisers will have to raise their game if they are to ensure that their clients are fulfilling TPR’s expectations of them with regard to consideration of long-term ESG risks.

An even bigger problem is the attitude of many fund managers to the idea of pension scheme trustees setting the policies that are now expected of them. Most pension schemes invest in pooled funds – which comprise nearly half the assets under management in the UK - and fund managers are reluctant to accept asset owner voting policies with regard to their pooled fund assets. AMNT insists on the right of asset owners to direct the ESG policy governing their assets.

We are continuing to encourage adoption of Red Line Voting and urge scheme advisers to take advantage of them as an easy to understand, off-the-shelf policy, downloadable from redlinevoting.org. We have recently recruited Leanne Clements as our Red Line Campaign Manager and are keen to discuss adoption and implementation of Red Line Voting with all advisers who wish to utilise it with regard to supporting the interests of their pension scheme clients.

And finally, we recognise that actuaries have an important role to play. We are aware of the work being undertaken on the consideration of ESG issues, particularly climate change, within the context of risk. Actuaries would be doing a great service if they communicated to their clients as clearly as they can how they are considering climate change and other ESG factors, no matter where they might be on that journey. There are still many in the pensions industry, including both trustees and professional advisers, who do not recognise the inherent risks in not addressing ESG issues and the opportunities and benefits – including intergenerational fairness – in pushing forward with them. Having their actuary point this out in the context of risk and liability will concentrate minds.

Environmental
Social and
Governance

Biography

Janice Turner is founding co-chair of the Association of Member Nominated Trustees. She helped to found the AMNT. Janice is a member of the Department for Work and Pensions Trustees Panel and until 2017 was a member of on the Actuarial Users’ Committee of the Financial Reporting Council. She has been a guest speaker at Harvard Law School’s international pensions and capital stewardship conference and was named by Pensions Insight as one of the top 50 most influential people in the pensions industry. Janice’s pensions background has been in the defined benefit sphere, having been a member-nominated trustee of the BECTU Staff Retirement Scheme for about 16 years.

12. Australian retirement income system reform

The Honourable Nick Sherry, former Australian Minister for Superannuation and Corporate law and Assistant Treasurer Minister

Over the past 35 years Australia has adopted a radical (in some cases unique) mix of policy changes to reform its retirement income system. The changes have, in the main, been ad hoc but have acted as a reasonable response to relieving the underlying cost pressure on government budgets as a consequence of the ageing population. There has been significant focus on fairness-protecting and improving the circumstances of lower and middle income earners - as well as strengthening the economy by building a larger savings pool via compulsory defined contribution (DC) superannuation.

In all advanced economies and some developing, there is an automatic cost pressure on government budgets via the set operational rules of a retirement income system. There are two interacting cost pressures beyond the immediate control of government: increasing longevity, at the rate of approximately 2 years every decade since the 1860s in advanced economies, and the declining birth rate, now well below the replacement rate of 2.1 in most advanced economies and many developing since the 1960s. The dependency ratio is increasing, placing a rising burden on younger generations. These escalating cost factors and their consequences, whilst receiving widespread debate, are still not well understood by the broader community, or by government decision-makers, particularly given the electoral strength of the over 50s who fear either a reduction in the benefit promise and/or a pushing back of the retirement age. Hence the political challenge of reform.

Australia, whilst sharing these characteristics (with a life expectancy of 82.8 years - fourth oldest in the world), is an interesting example in that its dependency ratio is still relatively low at 13% of the population. This is an outcome of a relatively high birth rate of 1.9 and the fastest growing population of any advanced economy – a consequence of high migration.

Over time, owing in large part to the aforementioned demographic changes and the associated cost pressures, a number of reforms have been introduced in order to help ensure sustainability in the Australian pension system for current and future generations.

A summary of the major reforms as follows:

1983 - indexing the government pension to 25% of male total average earnings and introduction of a means test to the pension of private assets and income (including any super benefit but excluding the family home).

The effect today is that 25% of retired persons receive no government pension, -25% a part pension and 50% a full pension.

1987 - introduction of a 3% DC super payment for all employees earning more than A$450 per month who had no superannuation. Part of a broader economic effort to constrain wage increases, reduce inflation and budget deficits but increase the “social wage”.

DC was seen as the most sustainable form of benefit and the DB super was under significant pressure due to economic restructuring, the decline of manufacturing, the end of life-long employment, and increase in part time/casual and women in the work force. Like we are seeing in the UK, at this time many Australian employers were closing their DB schemes.

1992 - an increase in the compulsory super contribution from 3% to 9% from 1992 to 2002. This was a phased policy in an attempt not to divert too much increase in real wages from consumption to long term saving. At this time there was tacit acceptance between the government and unions of the need to close public sector DB schemes and despite initial opposition the move was eventually accepted.

Australia has the 3rd largest pension system in the world for a country of 24 million persons. The economic by-product has been significant

1983 - a minimum age for receiving the super benefit of age 55 was introduced, together with full vesting of all employer contributions.

1995 - the female pension age was increased from 60 to 65 over 15 years.

1998 - the access age for super was increased from 55 to 60 if born after 1960.

2005 - a new transition to retirement provision allowing a person to part withdraw at age 55 from super if working part-time. Over 500,000 Australians use this provision today. A further provision was also introduced allowing additional pensions payment if retirement is voluntarily extended beyond age 65. This provision has had little uptake.

2007 - a raising of the means testing threshold and a government commitment to preserve tax-free superannuation payments for the over 60s.

2012 - increase in the government pension to 27.7% of male total average weekly earnings, an increase in the pension age from 65 to 67 by 2024, additional 15% tax on super contributions for higher income earners and an increase in compulsory super contributions from 9% to 12% from 2013 to 2019.

2017 – an effective reversal of many 2007 reforms, a tightening of the pension means test and the introduction of a new A$1.6million maximum benefit limit and a higher contributions tax on a greater number of higher income earners. The current government has also foreshadowed increasing the pension age to 70.

Whilst these reforms have been mostly ad hoc in nature, they represent a number of key shifts in the system which can be summarised as follows;

- a modest increase in the minimum government pension (still low by advanced economy standards)
- increases the pension age and means testing in order to contain rising costs
- a increase in benefit to lower/middle income earners via compulsory superannuation in DC schemes
- caps on total savings allowed in the super system and higher taxation of higher income earners to limit their benefit
- the closure of almost all DB schemes in both the public and private sectors.

It is worth noting that the total savings in super today are A$2.2 trillion up from A$150 billion in 1987 and stand at some 126% of GDP. Australia has the 3rd largest pension system in the world for a country of 24 million persons. The economic by-product has been significant.

Not withstanding these significant reforms, which started earlier than most countries, and Australia's comparative advantages from a demographic and dependency perspective, like other countries including the UK, Australia still faces a significant increase in retirement systems costs. The forward estimates for the budget forecast a A$2 billion a year (4.6%) increase in the age pension and A$1.7 billion a year increase (5.5%) in the cost of the super system.

The Australian system is not without its challenges, and it is facing many of the problems associated with the demographic shift and ageing population that much of the developed world, including the UK, also faces. But Australia is clearly an example of a country much further down the road in terms of DC policy than the UK. Citizens have been handed responsibility for their savings as the pensions environment has shifted away from DB arrangements, a move which occurred much before the UK's more recent transition to a primarily DC environment. This shift has helped to set Australia on the path to a sustainable system that goes some way to tackling the potential economic difficulties associated with demographic change.

The reforms to both superannuation and the government pension have gone some way to creating a more balanced and intergenerationally fair system and combatting an increasing dependency ratio. As such, Australia's government pension and superannuation reforms since the 1980s could help to provide a number of policy lessons to the UK and other developed nations about how to mould a retirement system that is fair and sustainable for current and future generations.

Biography

The Honourable Nick Sherry BA FAIST, was a Senator for Tasmania for 22 years. During that period he served as Chairman of the Superannuation Committee overseeing the Superannuation Guarantee (the compulsory contribution system) and Superannuation Industry Supervision Acts, the foundations for the modern Australian system. He was Australia's first Minister for Superannuation, the Assistant Treasurer and Minister for Small Business from 2007 to 2011. After retiring from politics in 2012 he became a Senior Superannuation Advisor to Citibank and EY working in some 22 countries on pension reform. Prior to entering politics he was a manager of a super fund and also a trustee.

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