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PENSIONS WATCH – ISSUE 8: WHAT'S BEEN HAPPENING AND WHAT'S ON THE HORIZON IN THE WORLD OF PENSIONS

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In this edition we focus on the latest, and one of the most illuminating, industry reports to warn of the imminent deterioration of retirement outcomes, principally as a consequence of wholly inadequate Defined Contribution (DC) saving.

The Ski-Slope of Doom

When former Pensions Minister (and the UK's longest serving) Sir Steve Webb publishes a report as evocatively entitled as *The Ski-Slope of Doom*,[1] you tend to sit up and take notice. Even more so, when the report's central tenet suggests that we're almost at the point of peak pensions, after which the state pension will increasingly become the mainstay of most retirement outcomes. This, despite the UK state pension equating to less than 30% of pre-retirement income for the average UK earner,[2] having been designed to provide no more than a basic standard of living in retirement.

What exactly do the numbers tell us?

The bottom line of this revealing report, which really gets behind the high-level numbers, is one with which most pensions practitioners are all too familiar. Over the next 25 years, in the absence of a dramatic increase in contribution rates and stellar long-term investment performance, DC simply won't substitute for the abrupt decline of *private sector* Defined Benefit (DB) pension rights,[3] notwithstanding the undoubted success of automatic enrolment and the roughly 10.5 million people who have been brought into pension saving since 2012.[4] This will be especially true for men who have, to date, been the main beneficiaries of private sector (although not public sector) DB pensions – at least those of a certain age. Indeed, excepting those men who will be newly retired over the next couple of years and "will probably have the highest incomes of any generation before or since", the real income at retirement of newly retired men over the next two decades (who will be largely, if not exclusively, reliant on their DC pension pots and the increasingly central role of the state pension) looks set to fall by around 20%.[5] By contrast women, on average, should fare a little better by virtue of their ever greater participation in the labour force, their take up of auto enrolled pensions and the recent equalisation of State Pension age (SPa).[6]

By implication, one of the few positives to surface from this seemingly inexorable trend is that the chasm between women's and men's pensions should halve by 2040.[7] However, this upturn in women's relative fortunes is just that, given that women's real incomes in *absolute* terms at retirement are likely to do no better than stagnate, rather than decline, over the next 25 years. Indeed, over 80% of women's retirement income is likely, on average, to derive from the new single-tier state pension[8] and the continuation of the generous uplifting of the state pension each year by the "triple lock".[9]

[1] The Ski-Slope of Doom – Is this the most worrying chart in pensions? Sir Steve Webb. LCP. April 2021.
[2] The UK state pension has a post-tax replacement ratio for the average earner of 28.4%. OECD (2019), *Pensions at a Glance 2019: OECD and G20 Indicators*, OECD Publishing, Paris.p.155.
[3] The report pinpoints the dichotomy between the 6.6m public sector workers who are still accruing DB pension rights against a mere 0.9m in the private sector doing so. In the context of a 32.7m working population, less than a quarter of the workforce remain active members of DB pension schemes. See: ONS Occupational Pension Schemes in the UK Survey 2019 and TPR Auto Enrolment declaration of compliance monthly report, March 2021. Although the generosity of public sector DB pensions has been somewhat diluted over the past decade, most public sector workers and a number of these private sector employees should avoid this likely widespread decline in the standard of living in retirement.
[4] See: TPR Auto Enrolment declaration of compliance monthly report, March 2021.
[5] Webb (2021). op.cit.p.22.
[6] Longer working lives mean women have more time to build up a private sector pension.
[7] The, so-called, gender pensions gap which, in the UK, stands at 35%, against an OECD average of 25%, is the difference between the pensions of men and women at age 65 as a percentage of men's pensions. Please see Pensions Watch edition 3 for a more detailed analysis of how the equalisation of SPa and the new single-tier state pension have already begun to narrow the gender pensions gap. See: https://www.columbiathreadneedle.co.uk/en/inst/insights/pensions-watch-issue-3/
[8] The new single-tier state pension, which replaced a typically less generous and more complex predecessor, was introduced in 2016 for those reaching SPa on or after 6 April 2016. It is paid in full, at £9,339.20 per annum for 2021/22, for those accruing a 35 year NICs record and pro-rated for those with at least a 10-year NICs record. This has seen the gender pension gap relating specifically to the state pension reduce from 17.2% to 4.8%. See: Benefits statistical summary. DWP. February 2020.
[9] The triple lock applies the *highest* of Consumer Price Inflation, average earnings growth or 2.5% as an uplift to the state pension annually.

Finally, in noting the Department of Work and Pensions' reluctance, at least until the mid-2020s, to widen the automatic enrolment eligibility criteria and raise minimum employee and employer contributions, the report suggests three sensible policy choices, which largely draw on good behavioural science, to arrest this ostensibly imminent decline in retirement living standards. These comprise: increasing the employer – not the employee – minimum contribution, to prevent triggering widespread auto enrolment opt outs; starting employees on higher minimum contributions but allowing them to opt *down* their contribution rate; and introducing the automatic escalation of contributions for when the employee receives a pay rise. In addition, the report suggests enhancing outcomes by improving members' value for money, principally through accelerating DC consolidation and encouraging the greater take-up of Collective Defined Contribution Schemes. Combined, the report notes that these measures could yet see the DC cavalry arrive.

Why does all of this matter?

The report perceptively notes, in a plea to policymakers, that "without a greater sense of urgency, a whole generation of people will experience a worsening retirement outlook."[10] Although not explicitly mentioned, this includes many of the nation's 4.3 million self-employed,[11] who increasingly operate in the gig economy, with its meagre pensions uptake[12] and, of course, those roughly 10 million employees likewise excluded from automatic enrolment by virtue of their age and/or their salary not meeting the £10K minimum.[13] As we observed in Pensions Watch edition 6, even those who do meet the auto enrolment criteria or who participate in other qualifying pension schemes simply do not, on average, save enough to generate a moderate, let alone a comfortable, standard of living in retirement.[14] And therein lies the problem.

Of course, while the disproportionately central role to be played by the state pension should prevent a deepening of the UK's above average old age poverty rate,[15] a lack of policymaker action means far too many people, on current trajectories, are set to unwittingly sleepwalk into retirement penury and endure, rather than enjoy, a retirement after a lifetime of work. While the motivation and means exists to generate better retirement outcomes for today's 20-, 30-, 40- and even 50-somethings, what appears to be missing is the will to develop a better framework. Given this, the report, perhaps inevitably, concludes on a sombre note, suggesting that, "unless we act quickly we will indeed be condemning future generations of retirees to an unattractive future."[16] In other words, whether a basic, moderate or comfortable retirement becomes the norm, is largely contingent on timely policymaker action or continued inaction.

[10] Webb (2021). op.cit. p.4.
[11] See: Number of self-employed workers in the UK 1992-2021. Statistica. 21 April 2021.
[12] According to Pensions Bee, "the self-employed in the UK are the least well-prepared for retirement, and risk being left dangerously exposed to poverty in later life." See: How does the gig economy affect pensions? Laura Miller. Pensions Bee. 10 December 2019.
[13] TPR (March 2021). op.cit.
[14] See: https://www.columbiathreadneedle.co.uk/en/inst/insights/pensions-watch-issue-6/
[15] The old age poverty rate defines the percentage of those aged over- 65 who live on an income below the national median income. The UK's old age poverty rate stands at 15.3%, against an OECD average of 13.5% and a poverty rate of 11.9% for the UK as a whole. Moreover, a gender pensions gap also exists in this metric with 17.7% of women aged over 65, versus 12.5% for men, caught in the old age poverty trap. The OECD average of 13.5% is split 15.7% for women and 10.3% for men. See: OECD (2019). op.cit.p.187.
[16] Webb (2021). op.cit. p.25.

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