Consultation Response

Reshaping workplace pensions for future generations

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This consultation considers the scope for a new category of defined ambition (DA) pensions to complement the defined benefit (DB) and defined contribution (DC) models that currently predominate and proposals for a new regulatory framework for future pension provision.

About Age UK

Age UK is a charity and a social enterprise driven by the needs and aspirations of people in later life. Our vision is a world in which older people flourish. Our mission is to improve the lives of older people, wherever they live.

We are a registered charity in the United Kingdom, formed in April 2010 as the new force combining Help the Aged and Age Concern. We have almost 120 years of combined history to draw on, bringing together talents, services and solutions to enrich the lives of people in later life.

Age UK provides information and advice to around 6 million people each year, runs public and parliamentary campaigns, provides training, and funds research exclusively focused on later life. We support and assist a network of around 170 local Age UKs throughout England; the Age UK family also includes Age Scotland, Age Cymru and Age NI. We run just over 450 Age UK charity shops throughout the UK and also offer a range of commercial products tailored to older people.

Key points and recommendations

- We welcome the Government's commitment to encouraging innovation in pension saving – but this should not distract from the key priority of ensuring good quality standards in DC pensions being used now for automatic enrolment.
- Overall the potential models presented in the paper for DC and CDC are far more attractive than the proposals for flexible DB about which we have significant concerns.
- The most striking feature that emerges from the paper is just how essential good governance is in ensuring any model of DA develops in the interests of pension savers.
- Current governance issues, especially within contract based schemes need to be resolved before DA can develop further

1. Introduction

Age UK are pleased to respond to this consultation and welcome the Government's commitment to encouraging innovation within pensions saving models to improve member outcomes and increase consumer confidence in saving for retirement.

We are generally supportive of any moves that will improve pensions for future generations but are mindful of the significant changes that are already being made to pensions. We would not want any debate about the shape of future pensions to detract from the key priorities of the moment in terms of ensuring the success of automatic enrolment; improving scheme governance; establishing quality standards and a charge cap for DC schemes; and, achieving a successful way of consolidating small pension pots.

The short time allowed for this formal consultation has prohibited us from making detailed comments on the many questions raised within the consultation document but we do have some overarching comments about what needs to be put in place before defined ambition can move from being an aspiration to something that actually becomes a reality that will work for consumers. We also have some observations on the three broad models set out within the paper and raise some issues that we can foresee in relation to how well DA models might 'fit' with other elements of the Government's pension reform agenda.

2. Comments The conditions needed before DA can develop in the interests of pension savers

Whilst innovation is desirable in principle, in practice – particularly for workplace pensions where the employer is the purchaser and the end user of the pension has no control over choice - it is possible for innovation to go wrong. Whilst some of the models presented in the consultation paper have potential for improving outcomes and providing certainty we are less certain as to whether the conditions exist currently for DA to develop to the benefit of pension savers.

The models around DC and Collective Defined Contribution (CDC) clearly need to be developed at scale to provide adequate value for money for consumers and to manage the intergenerational risks highlighted within the paper. More important is the need for good governance.

In order to develop DA further in the interests of scheme members robust governance arrangements need to be in place for both trust and contract based schemes. As we highlighted within our recent consultation response on the charge cap we remain to be convinced that the ABI's approach towards independent governance committees will deliver truly independent bodies that will be sufficiently robust in pursuing member's interests.

Principles for the development of DA

In general we think that you have identified the right principles, as set out on page 11 of consultation document for the development of defined ambition schemes. We would argue that there are additional aspects to the principles outlined.

We absolutely agree that a DA scheme needs to address consumer needs – but the difference in influence between employers and scheme members must be acknowledged. Scheme members rarely have any choice over the scheme used for workplace pensions, and where they are consulted the technical complexities are likely to put them at a disadvantage. While there are many excellent employers who do their utmost to balance their needs with those of their employees, the work of the Pensions Regulator has shown that there are segments of the market that do not work so well in members' interests. All schemes should have a mechanism for ensuring the interests of pension savers are represented. It also needs to be spelt out that this needs to explicitly cover both the accumulation and decumulation phases.

Clearly risk-sharing is an important principle but we would argue that the most catastrophic and/or long-tail risks should remain with those parties who are most equipped to deal with them and this principle should be applied to the further development of DA. For example, reducing compulsory indexation of pensions might not be a problem if there were adequate ways in which a retired individual could create their own form of index-linking. However, there are very few index-linked products now available, except for annuities, which someone retiring from a DB scheme is unlikely to buy.

We absolutely agree with the principle of transparency and need for high governance standards. We are concerned over the complexity of the models presented and if a raft of different DA schemes develop how (given that employees now have on average eleven jobs during their working lives) you effectively communicate with pension savers as they move between a variety of different scheme designs.

Transparency is also important in terms of the trade-offs between the complexity of such schemes and the possibility of better value for consumers and how to explain this to individual consumers. Individuals facing greater risk will need to take this into account in their own financial planning.

We would also argue for an addition to the principles listed – that consideration should also be given to ensuring that DA 'fits' appropriately with other elements of pension reform and that any transitional issues are dealt with and don't give rise to any unintended consequences.

Flexible defined benefit

We are unconvinced that the proposals around defined benefit schemes will make it any more likely that the relatively small number of employers who still have open schemes will continue to offer them. We note that page 18 of the consultation document highlights the changes that employers can already make to reduce their potential liabilities and that these are rarely used. Simply providing a wider range of options may not necessarily mean that they will be used.

In terms of whether they offer anything at all for a scheme member it is difficult to make any global judgement as it would only be on a case by case basis that you could weigh up the risk of losing the scheme altogether for future accruals against the possibility of retaining some of the benefits through greater risk-sharing.

There are a few aspects of the proposals that are particularly concerning.

The proposal to switch a DB pension into a DC pot in our view could act as a significant incentive for an employer to get rid of staff prior to their scheme retirement date in order to reduce their pension liabilities. Such an approach potentially undermines the Government's extending working lives agenda and also does not fit well with the reality of people's working lives in the lead up to retirement. It is disproportionately unfair to workers who have to leave or change their employment prior to their anticipated retirement date due to ill-health, disability or caring responsibilities.

Whilst we can see the attraction of increasing the ability to change the scheme pension age the proposals suggest employers can choose to use the GAD index on longevity or be free to use their own mechanism to reflect their workforce. Given the great inequalities in life expectancy and healthy life expectancy we believe it is important than in choosing an index employers justify why it is the most appropriate one to reflect the overall life expectancy of the workforce. We would agree that employers should not be able to adjust the normal pension age of somebody within 10 years of the existing age to allow people to plan appropriately. We also believe that even if people are more than 10 years away there needs to be limits on how often and by how much their NPA can be raised.

We are also concerned about removing the statutory requirement for indexation of pensions in payment. Increasing longevity makes indexation more rather than less important and the removal of indexation may simply serve to shore up problems for the future as members see the value of their pensions diminish over time. It also makes it absolutely imperative that there is a long-term requirement in legislation to triple lock the state pension to provide a solid underpinning against inflation.

We accept that the majority of proposals relate to future accruals but note the Government's desire to protect members where a transfer of past accruals is made. Whilst we would support the requirement to provide independent financial advice in these circumstances it should be made clear that the cost of this should be borne by the scheme and not the member. Advice on such matters is also very complex and so consideration should be given to how to ensure that members get advice only from suitably experienced and qualified advisers.

Introducing greater certainty to defined contribution

The proposals around improving DC schemes are interesting and potentially attractive to both employers and consumers – although it is important to recognise that even under these proposals the majority of the risk continues to be borne by the scheme members and any guarantees paid for by them.

As we have stated in previous consultation responses we need to strive for continual improvement in DC pensions since they are likely to continue to be the predominate model for pension saving for the foreseeable future. All the models contained in this consultation document have some merit. Whilst we acknowledge the strong demand for guarantees amongst consumers we are also aware of the trade-off between this certainty and a potentially greater level of growth. This is particularly acute given the relatively low level of contributions being made under automatic enrolment and also arguably places a greater burden of care on scheme trustees. The need for good governance to strike the right balance for this trade-off in the interests of scheme members cannot be under-estimated.

Despite the potential merits that these models may hold we are concerned about how the development of these types of DC schemes will fit with the Government's commitment to a pot follows member approach to the consolidation of small pension pots – given that any pot with any form of guarantee will be excluded.

Collective defined contribution schemes

We would agree with the conclusion drawn in the consultation document that CDC schemes offer an alternative approach to risk sharing and so we are pleased to see them included within consideration of DA. Similar issues arise for us as under DC schemes in relation to the need for good governance and how such schemes would fit within a pot follows member consolidation approach. There are some additional issues, over and above those raised in the previous section, in relation to CD that we think bear further consideration.

We would also agree that one of the main challenges in terms of developing this approach would be how to achieve the scale necessary to run them successfully, especially initially. This will be particularly important in terms of mitigating the very real risk of intergenerational fairness.

We agree that one of the attractions of the CDC model is the potential for more stable outcomes and risk-sharing at the decumulation phase. Given the continued decline in annuity rates and the fact that the current market does not appear to work in consumers' best interests and is difficult to navigate this option appears highly appealing. It does however beg the question of whether there needs to be a fundamental review of annuity provision and the annuity market. We would not want to see a return to the days when pension savers effectively had to buy a poor value annuity from their pension provider – some mechanism is needed to ensure whatever the mechanism used to provide the income, pension savers get the best possible value.

The clear downside of CDC for pension savers is the fact that pensions in payment can be reduced, as the recent experience in the Netherlands demonstrates. This highlights the need for a far greater degree of communication and engagement with members in order to ensure they are aware of this possibility and that any changes in benefit levels are flagged up in good time and explained coherently. Given the poor level of trust that consumers have in financial services it would not take very much to undermine confidence in this form of pension provision. Excellence in communication and governance would go a long way to help mitigate these risks.