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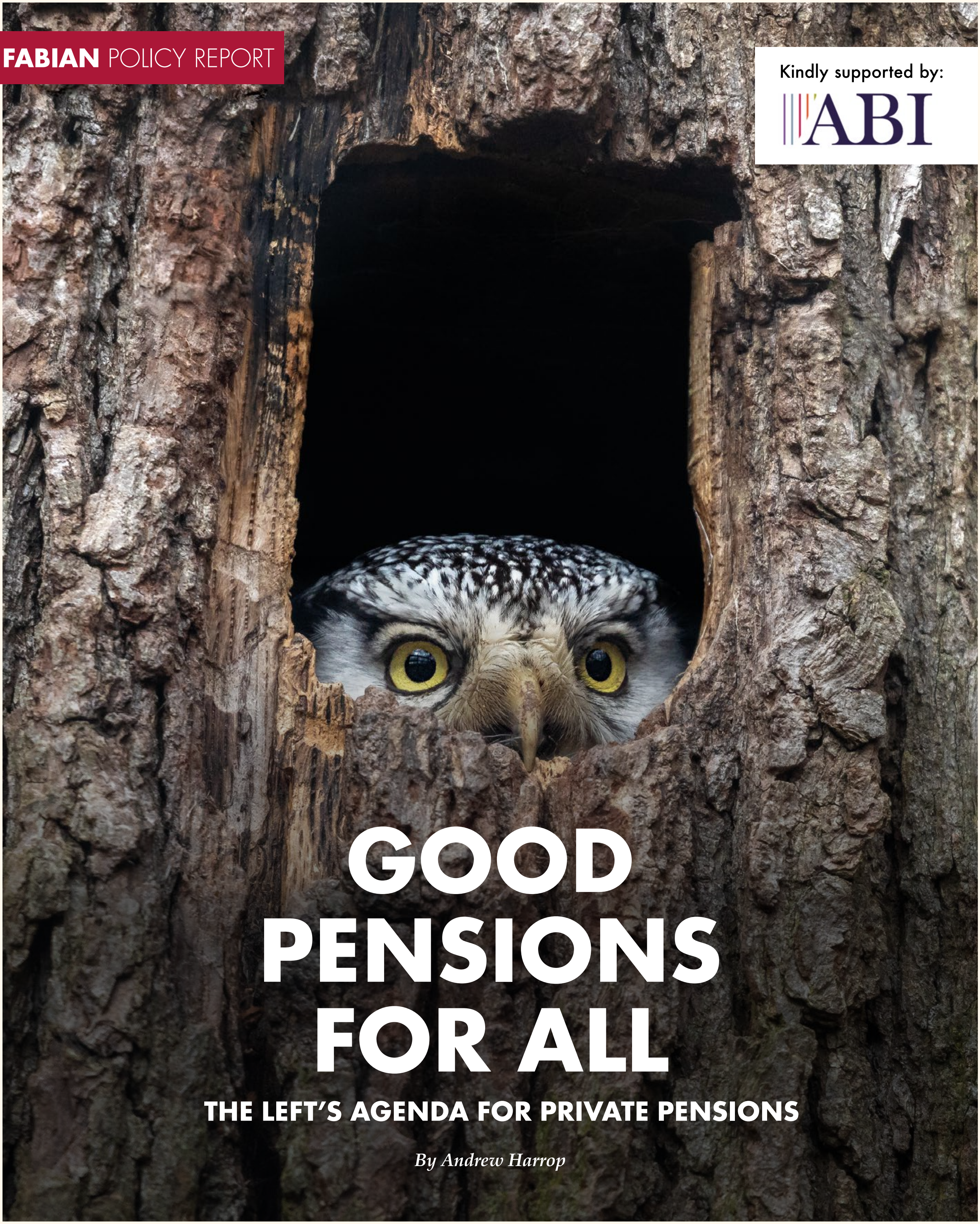

GOOD PENSIONS FOR ALL

THE LEFT'S AGENDA FOR PRIVATE PENSIONS

By Andrew Harrop

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IN MEMORIAM

In memory of Jack Dromey and Sir John Hills, two tireless champions of good pensions for all.

CONTENTS

Glossary

Accumulation The stage of making contributions into a pension ('accumulating') during working life.

Annuity An insurance product that allows you to convert a pension fund into a guaranteed regular income that will last for the rest of your life.

Auto-enrolment The requirement that all employers enrol eligible workers into a pension scheme and make employer contributions. Employees have the right to opt out. The policy was proposed by the 2002–05 pensions commission, legislated for by the last Labour government and introduced by the coalition government in 2012.

Collective defined contribution (CDC) pension A pension which aims to provide a target retirement income, funded by individual and employer contributions. If the scheme's investments under-perform then the amount paid may be lower than the planned target. This is in contrast to DB schemes where employers guarantee the benefits paid by the scheme. The new Royal Mail pension is the first CDC scheme in the UK.

Consolidation The process of combining a number of DC pension pots to create a larger fund to reduce costs and increase simplicity.

Decumulation The stage of accessing money from a pension ('decumulating') across the course of retirement.

Defined benefit (DB) pension A pension that pays you a retirement income based on your previous earnings and the number of years you've worked for an employer. Defined benefit pensions were once commonplace among large private sector employers but are now mainly found in the public sector.

Defined contribution (DC) pension A pension where individuals and employers make cash contributions and the value of the pension at retirement depends on how much has been paid in and the performance of investments. At retirement people need to convert the cash sum into an income. Most private sector workplace pensions and personal pensions are defined contribution pensions.

Drawdown pension An arrangement where a pension fund remains invested once people enter retirement, and people withdraw money in parts to meet needs as they arise or to produce an income. The money investment is subject to market risks. The pension does not pool life expectancy risk with others in order to provide a guaranteed income for life.

Master trust A DC pension provider run by trustees that offers workplace pensions to multiple unrelated employers. Master trusts often offer simple, low-cost pensions to employers to meet their auto-enrolment obligations.

New state pension A single-tier flat-rate state pension launched in 2016 that replaced the former system which consisted of two separate tiers of state pension. It is more generous to people who are self-employed or have low lifetime earnings.

Pension credit The main means-tested benefit for people over pension age with low incomes.

Pensions dashboards Digital services which will show savers information about all their pensions in one place, which are due to launch in the next few years.

Pensions 'freedoms' Reforms initiated by chancellor George Osborne in 2014 that liberalised the way people access pensions once they reach the minimum pension age. People can take their whole pension in cash, following the removal of a previous requirement to buy an annuity or drawdown product.

Whole-of-retirement pension A proposed new style of pension plan that includes an income for life and other designated features. Plans are likely to combine elements of cash lump-sums, drawdown pensions, annuities or CDC pensions.

Summary

Workplace pensions have come a long way in the last few years. But after two decades of debate and reform, private pensions still do not offer the prospect of an adequate retirement income for most people.

This report asks what a future government of the left should do to address this. It focuses on low to middle-high earners who only engage with pension choices when they have to. The left should prioritise people in this group by building strong defaults that will secure them good outcomes – and it should bring a greater focus on equality and collectivism to private pensions policy.

A new offer from the left should guarantee:

1. **A retirement income for life available to all as the norm.**

2. **Support for everyone to save enough to meet their future financial needs.**

3. **Fair, affordable and effective social security and tax policies.**

The last Labour government made a major contribution to UK pension reform. It established the 2002–2005 pensions commission and adopted its plan to create auto-enrolment workplace pensions with compulsory employer contributions. This policy has been a huge success and the share of private sector employees saving into a pension has increased from 32 per cent in 2012 to 75 per cent in 2021.[1]

However, major challenges remain. Most people with defined contribution pensions are not saving enough to meet their needs in retirement (only a small minority of people are members of traditional defined benefit schemes). And important groups are excluded from automatic pensions altogether, including the self-employed, very low earners, and people not working while caring. This has a disproportionate impact on women, disabled people and people from many minority ethnic backgrounds.

Since 2010, Conservative-led governments have supported auto-enrolment and made the state pension more generous for most people. But they have also recklessly deregulated the way retirement funds can be accessed, ending the principle that pensions should secure people an income for the whole of their retirement.

Politicians of the left should plan a major new round of pensions reform to correct these deficiencies – and also to respond to new developments including the rising number of people renting in retirement, the increase in poverty and worklessness in the years before the state pension age and the re-emergence of high inflation. In taking forward reforms, they should consult and engage with employers, trade unions and pension providers to develop practical solutions that stand the test of time.

The plan should:

- Gradually increase the minimum contribution for auto-enrolment pensions to 12 per cent of total earnings (mainly by raising employer contributions).

- Change how people access defined contribution pensions at retirement, by automatically consolidating small and medium-sized pension funds into a single pot; and by ensuring that most people enter a whole-of-retirement pension plan including an income for life which will normally rise with inflation.

- Create a new self-employment pension collected through the tax system, with the government paying a bonus of 3 per cent of earnings to everyone who saves 5 per cent themselves.

- Encourage large employers who would have once offered defined benefit pensions to adopt new collective pensions which do not involve them having ongoing financial liability (ie 'collective defined contribution' or CDC pensions).

- Support and incentivise individuals and employers to contribute beyond minimum contribution rates – to pensions and also to payroll saving schemes for low earners.

- Develop new measures to reduce the private pensions gender gap – especially by introducing new credits for parents and carers with zero or very low earnings.

- Improve the generosity of social security for people aged 60 to 65 with a pension; and for people over state pension age who rent their home.

Finally, politicians should consider whether to reform pensions tax relief alongside the rest of this package. Tax reform is complex and controversial – but changes would make the system fairer and cheaper. They could also pay for all the proposals in this report that require public expenditure.

The report makes 38 recommendations to deliver on this agenda – see page 36. F

KEY FACTS FROM THE REPORT

- **Undersaving:** only 19 per cent of workers and 1 per cent of low-earning workers are saving enough each year to be on track to achieve what the public thinks is a minimum acceptable retirement income (excluding workers with defined benefit pensions).[2]
- **Required pension contributions:** Low earners in their 20s today need to save at least 11 per cent of earnings across the whole of working life to achieve an acceptable minimum income. Middle and high earners need to save a still greater percentage to achieve a standard of living that reflects their lifetime earnings.[3]
- **Self-employment:** the proportion of self-employed workers saving into a pension fell by two thirds from 1998 to 2018 – from 48 per cent to 16 per cent.[4]
- **Incomes for life:** only around 10 per cent of DC pension funds are currently converted into incomes for life (i.e. annuities) when they are first accessed.[5]
- **Gender equality:** women reaching retirement today have one third of the private pension assets of men.[6]
- **Renting in retirement:** 30 per cent of households headed by a 45 to 64-year-old are renters, compared to 20 per cent of households headed by someone aged 65 and over.[7]
- **Tax relief:** At least 51 per cent of the value of pension tax breaks (£27.6bn per year) go to higher or additional rate taxpayers. They make up just 4 million out of 28 million employees.[8]

1. Introduction and context

This report examines how a future government of the left should reform private pensions to achieve good retirement incomes for everyone in the UK. It asks which policies politicians should consider during the next parliament, which we can expect to run from 2024 to 2029, in order to create a fair and effective pension system for the 2030s.

The focus is on low- and middle-income earners: from people working a few hours a week on the national living wage, to 'middle-high' earners with an annual income above median earnings but below the higher rate income tax threshold. Therefore, this report looks exclusively at the mass consumer market. We do not consider pension issues for high earners and the products and tax rules that mainly affect them.

Most people on low to middle-high earnings rarely think about pensions or take proactive decisions about long-term saving. This is unlikely to change much since growing the number of people who are well-informed and actively engaged with their pension saving is a very difficult endeavour. Achieving good pension outcomes for everyone therefore requires a system that produces acceptable results for people who only act when they have no choice in the matter.

So this report largely sets aside current debates about how to increase voluntary consumer 'engagement'. Seeking to build understanding and active decision-making is a valuable strategy for the minority who engage, but it cannot bring benefits to all. Our focus is on designing a system that will prevent harm and achieve decent outcomes, regardless of how much people get involved.

Pensions policy is reserved to the Westminster parliament, so the proposals in this report apply to the whole of the UK – England, Scotland, Wales and Northern Ireland. We do not discuss small differences between the nations (eg different income tax rates in Scotland).

A centre-left approach to pensions

The Labour party under Keir Starmer says it wants to offer everyone security, prosperity and respect. When it comes to pensions, this should mean helping people from all backgrounds to secure an adequate retirement income suitable to their needs. People should receive support to build a pension, especially those who have traditionally had poor retirement provision. And they should have security and peace of mind regarding their pension in retirement, including the certainty of an income for the rest of their life.

Some of the things future ministers should prioritise are non-partisan common sense that we should be entitled to expect from political parties of any stripe. Any government should offer competence, clarity and resolve. Over the last few years Conservative pensions policy has been characterised first by purposeful harm, under George Osborne, and since then by drift and inaction. For example, ministers have done nothing to implement plans to expand pensions coverage first announced in 2017.

A future government must turn words into action, set long-term direction, be guided by evidence and act with consistency. It should listen to and work with employers, trade unions and pension providers to build broad agreement and shared purpose. These things matter especially for pensions policy, where it takes decades not years to deliver results.

But ideology and values also matter, and the election of a government of the left should bring a greater focus on equality and collectivism to pensions policy. This will be a matter of evolution not revolution: it was, after all, a Labour government that created most of our current pensions framework. The next government should dial up the egalitarianism and collectivism of our system while keeping its key features – in particular our flat-rate, near universal state pension and our new earnings-related, opt-out workplace system.

It is true that some observers would prefer to see the UK return to a state-led system, where low and mid earners have an earnings-related state pension rather than private provision: other European countries successfully use this model, and it has its advantages; but it would be a complete change in direction for the UK and take decades to achieve, when the same progressive goals can be secured through our mixed-market pension system.

If we don't need a more 'statist' pensions framework, in what ways should the values of the left inform pension reform? First, the priority must be to secure good outcomes for people who have faced inequality and disadvantage over the course of their lives. The focus must be on those with low and middle lifetime earnings, including people with intermittent employment histories.

As part of this, the system must reduce inequalities between women and men, support people from minority ethnic and working-class backgrounds, and be especially mindful of the needs of people with long-term illness or disability and a low life expectancy. Thinking about these groups first will steer the questions that politicians ask and the answers they come up with.

A centre-left approach means thinking differently about 'how' as well as 'who'. A progressive pensions policy should strive to be more collectivist and to move away from excessive emphasis on personal risk, choice and responsibility. The power of the state needs to be used to secure good outcomes for all, whether or not people engage and make choices. This was the approach of the last Labour government, that created the default of a workplace pension (unless employees declined) and mandated employers to make contributions. By contrast, recent Conservative policies have placed the expansion of choice and control for people who wish to engage over the pursuit of good results for everyone, disregarding the risks involved. We need more paternalism in our pensions, using the power of defaults, inertia and regulation.

Politicians of the left should also consider how to expand collective risk pooling and roll back the journey the UK has made towards the personalisation of pension risks. Over time, liability for the uncertainty associated with life expectancy, inflation, interest rates and investment returns has all become more individualised. We should explore how these risks can be better shared. As a top priority, a new government needs to protect people from uncertainty regarding their own life expectancy, so that everyone can have a secure income for their whole retirement no matter how long they live.

A new offer from the left should guarantee:

1. A retirement income for life available to all as the norm (chapter 2).
2. Support for everyone to save enough to meet their future financial needs (chapter 3).
3. Fair, affordable and effective social security and tax policies (chapter 4).

The pensions commission and its implementation

The 1997–2010 Labour government set in train a radical transformation in the UK pensions landscape. It is often described as one of the greatest achievements of the New Labour years. The backdrop was rapid decline in defined benefit (DB) pensions, sluggish take-up of workplace-based defined contribution (DC) pensions, an inadequate state pension and high pension inequalities. Labour's response was to set up the pensions commission. It was announced in December 2002 and, under the leadership of Adair Turner, Jeannie Drake and John Hills, published its recommendations in 2005.

The commission argued that the UK needed to extend working lives and raise pension saving to avoid increased poverty in retirement. With respect to the state pension system, it recommended a gradual increase in the state pension age and a long-term shift to a flat-rate, earnings-indexed, near universal pension. The commission also proposed a revolution in private pensions, with the creation of a new workplace regime that would be opt-out for employees and compulsory for employers. Under this new system of auto-enrolment employees were to pay a minimum of 5 per cent of their earnings and employers were to pay 3 per cent (with an initial portion of pay excluded from the calculation).

The Labour government accepted the commission's key recommendations and introduced landmark legislation to put the new regime in place. After 2010 the coalition and Conservative governments also embraced the reforms and oversaw the staged introduction of auto-enrolment workplace pensions, with the combined employer and employee contribution reaching the planned 8 per cent of eligible earnings in 2019. All employees aged 21 to state pension age with annual earnings above £10,000 are covered by the policy.

Auto-enrolment has been a huge success: the share of private sector employees with a workplace pension has increased from 32 per cent in 2012 to 75 per cent in 2021.[9]

There are however important differences between the pension settlement envisaged by the pensions commission and the system in place today. First, the delivery is more market-based than originally proposed: the commission envisaged one state-run auto-enrolment provider; instead a flourishing market has emerged, with a range of providers offering low-cost pensions for low and middle earners, with employers selecting between them. The state-run Nest is the largest provider, and has helped shape the market, but is by no means dominant. The downside of this approach is that many savers can expect to acquire numerous small pension pots during their working lives, creating complexity for them and higher costs for providers.

The commission also originally expected that auto-enrolment would provide a minimum baseline only and would be supplemented through voluntary pension saving, either by individuals making extra contributions or employers offering more generous pension schemes. For median earners, the commission expected that saving at the minimum level would provide half the amount required for an adequate retirement pot and that additional contributions would make up the other half.[10]

In reality, voluntary contributions have turned out to be far lower. Looking at individuals, there is very little evidence of low and middle earners personally choosing to save above the level at which they are auto-enrolled. Indeed the existence of a government-set default may have led many employees to believe they are doing all they need to do to achieve an adequate pension.

The picture is a bit better when it comes to employers. Many employers have enrolled employees they are not required to: in 2020 31 per cent of private sector employees who were not eligible for auto-enrolment were in a workplace pension.[11] Some employers have also enrolled employees at contribution levels beyond the legal minimum: in 2018 almost 9 million private sector employees were receiving a contribution above the new auto-enrolment minimum (compared to around 5 million who were receiving contributions in excess of the same amount in 2012).[12] However the proportion of people receiving generous employer contributions varies hugely across sectors and occupations, with high earners far more likely to benefit from them.[13]

The improvement in voluntary provision is welcome but it is nothing like enough to ensure that most people achieve an adequate pension. The implementation of auto-enrolment in the last decade has taught us that compulsion and inertia work; that voluntary employer action can play a supportive role; and that proactive saving by low and middle earners will only ever be a small part of the picture. There is broad consensus that, for everyone to achieve a decent pension, a higher minimum is needed, and that voluntarism should play a proportionately smaller role.

Policy developments since the pensions commission

Pensions policy over the last 15 years has stretched well beyond just implementing the Turner report. The commission's plan for accumulating a private pension has been seen through, but policy on state pensions and accessing private pensions in retirement have taken a different turn. Some of these developments have gone with the grain of the commission's plans, but others have been disruptive departures.

State pensions: Today's state pension system differs from the model the pensions commission proposed in a number of important ways. First, the 'triple lock', introduced in 2011, provides a more generous basis for annually increasing the value of state pensions than the earnings link recommended by the commission. By 2022 the state pension was 9 per cent higher than it would have been with just the earnings link, and this gap will continue to grow.[14]

Second, the government decided to significantly accelerate the journey to a flat-rate state system. The pensions commission had wanted a long-term evolution, with the earnings-related state second pension gradually becoming flat-rate. Instead the coalition government chose to replace the basic and second state pension with a single 'new' state pension, for people reaching state pension age from April 2016. Broadly this benefits people with low lifetime earnings and the self-employed, but will be less generous than the previous system for younger generations with above median lifetime earnings.[15]

Together these two changes have reversed decades of decline in the state pension and helped to create a far more adequate state system than in recent decades. This has reduced the need for means-tested pension credit and provides a stronger platform for private saving. In 2022/23 the new state pension is worth around £9,600 per person per year (which is 31 per cent of average earnings).[16] This is just higher than the poverty line for a single person without housing costs, but lower than the amount the public thinks is a minimum acceptable retirement income for a single adult (around £12,800 excluding housing costs).[17] As a result of these changes the state pension will make up a higher share of new retirees' incomes than the last Labour government envisaged. This is just as well given the limited progress made on voluntary private saving.

Another change to the state pension system has been much less positive. The women's state pension age (and hence the pension credit age for women and men) was due to rise from 60 to 65 between 2010 and 2020, as a gender equality measure enacted in 1995. The coalition government chose to accelerate this timescale, so that the pension age for women reached 65 in 2018, and the state pension age for both sexes increased to 66 in 2020. Many people had less than 10 years' notice of their new retirement age. Looking ahead, Labour had previously legislated to raise the pension age to 66 in 2026, but the coalition instead decided it should reach 67 by 2028. These rapid changes have led to high levels of pre-retirement worklessness and poverty (see box on page 10).

Accessing private pensions: The changes to state pensions since 2010 built on the system Labour had created in office. By contrast George Osborne's major reform to private pensions represented a radical change in direction. At the 2014 budget the then chancellor stunned observers by announcing a complete liberalisation of the rules and restrictions governing how pensions could be accessed once people reached retirement. These pension 'freedoms' allowed anyone aged 55 and over to access their entire pension pot in one go, removing the requirement to buy an annuity or alternative drawdown product. Osborne promised that the freedoms would be accompanied by an offer of financial guidance. The Pension Wise service was created to meet this need: it is well-regarded but has low levels of take-up.

The new policy was a major retreat from the state's vital role in helping people to smooth their lifetime income and consumption, and secure good living standards for the whole of retirement. Many observers said that Osborne's pension freedoms called into question the very point of a pension, especially from the perspective of employers and taxpayers: the employer contributions and government tax reliefs that make up a high proportion of the value of most pensions were intended to create an income for life.

When this new policy was unveiled the principal concern initially raised by critics was that people might take out all their money and use it up too soon, depriving themselves of a long-term retirement income. The pensions minister Steve Webb glibly responded that he did not mind if people bought Lamborghini cars with their life savings, because the recent state pension reforms meant they would not then need to claim means-tested benefits.

Other issues with the policy also emerged. There was a high risk of people losing out to scams, high-pressure selling and poor advice. Cases of people giving up generous DB promises for cash lump sums prompted particular concern.[18] Experts also raised the alarm over people converting their whole pension into cash and depositing it into low-interest savings accounts, without protection from inflation. The government and regulators have slowly sought to address these issues, but this is only after significant harm has already been done.

So what was the point of these reforms? Their rationale was to give people greater flexibility and control (even though savers had always been able to access a quarter of their pension as a lump sum, or the complete amount in the case of small pots). This complete freedom might make sense for someone who also has another private pension – eg a DB plan to provide a long-term income. However, many people accessing a DC fund have turned out to have no other private pension: a 2020/21 Department for Work and Pensions survey found that only 54 per cent of those who had accessed their pot before state pension age had another private pension (with just 21 per cent belonging to a DB scheme).[19] This issue will only grow in future years, as fewer and fewer people have significant DB entitlements.

For people who only have DC pensions there is a significant risk that they will spend their money too fast and run out. The DWP survey found high numbers who had taken pension cash using it to meet immediate needs or pay off debts. But there is also a countervailing threat that people will draw down their pension too slowly and spend less than they could to fund their retirement. This is the experience in the UK for other types of assets (eg housing, cash savings and investments) which typically do not get run down during retirements.[20] It has also been seen in overseas DC pension regimes with fully flexible decumulation, like the United States.[21] The underspending of pension assets leads to reduced consumption and wellbeing in retirement, in exchange for larger bequests when people die (something that pension saving is not designed to pay for).

George Osborne's decumulation reforms were best suited to a fairly small segment of financially confident consumers, with incomes well above the average willing and able to make active choices. They fit very poorly with the emerging UK system of mass-market auto-enrolment, which seeks to create default pathways for passive savers. As things stand, when these low- and middle-income savers reach the pre-retirement stage they will suddenly be expected to make complex, high-stakes decisions. A new approach is needed so they are not faced with a plethora of confusing options – some of them bad. People need a straightforward process for converting their pension savings into a regular income stream designed to last the whole of retirement.

ECONOMIC AND SOCIAL TRENDS SINCE THE PENSIONS COMMISSION

Earnings growth has been very weak since the financial crisis of 2007/08. This has made it much harder to implement reforms that require increases to payroll contributions for employees or employers. Any reforms by a future government will need to take careful account of ability to pay in a period of sustained economic weakness. Slow earnings growth has also given rise to concerns about intergenerational fairness because median living standards are now higher for people in retirement than those of working age.[22] This weighs on the debate about improving pension provision, although it is an unhelpful distraction when it comes to long-term pensions policy because most potential reforms will only affect future generations of pensioners.

Homeownership among under-65s has fallen fast. Among under-65s, the number of owner-occupiers declined from 71 per cent of households in 2002–03 to 59 per cent in 2019–20. This development has hit many people aged 45 to 64 who will retire in the next two decades – and are also at an age where they are fairly unlikely to buy a home for the first time. This means the number of retired renters could climb by a half as future cohorts retire (20 per cent of households headed by someone aged 65 or over currently rent, compared to 34 per cent of households headed by a 45 to 54-year-old). The proportion of social tenants is likely to rise slightly, and the number of private tenants to shoot up (figure 1 shows private renting is three times higher among 45 to 54-year-olds as over-65s).[23] This all matters because pensions policy has been designed around the assumption that people are either homeowners or will have a sufficiently low income that their rental costs will be fully supported by housing benefit. In the future private renters with a modest private pension could fall between these stools (see page 30 for discussion of housing benefit).

Figure 1: Percentage of households renting, by age of head of household, 2019/20

Age	Social renter	Private renter	All renters
45–54	18	15	34
55–64	16	10	26
65 and over	15	5	20

Source: English housing survey, 2019/20

Poverty and worklessness in the years before state pension age has emerged as a major issue, following the rapid increase in the age of eligibility for pension credit from 60 to 66. Although employment rates for older workers increased quite quickly until the pandemic, by 2020 far fewer 65-year-olds were working compared to 59-year-olds in 2010 – and in 2021 just 52 per cent of 60 to 65-year-olds were in work.[24] High rates of ill health are one of the main causes of this low employment – 31 per cent of 60 to 64-year-olds were disabled in 2019/20.[25] As a result many people are unable to continue working and saving until the new state pension age. Some fall back on state benefits which have become much less generous over the last 12 years. Others start to use their savings, depleting what they will have available after pension age. All told, the raising of the pension age led poverty among 60 to 64-year-olds to rise from 16 per cent in 2009/10 to 23 per cent in 2019/20.[26]

Inflation has re-emerged as an economic risk in the last year, with the consumer prices index exceeding 10 per cent in the summer of 2022. This has reminded policy makers of the risks of creating pensions that pay a level amount rather than rising in relation to inflation. The pensions commission flagged inflation risks as an issue but said it should be up to people to decide what to do. It expected most workplace pensions to be converted into annuities which are usually flat-rate payments. Since the pension freedoms, increasing numbers are just taking their pensions as cash. In thinking about future reforms, politicians need to consider how to establish better protection from inflation.

Unfinished business and new debates

The Labour government's policies were never meant to be the last word on pension reform. Even at the time it was acknowledged that the pensions commission had skirted round a number of issues that remained unfinished business. On top of that, important questions have emerged in the intervening years which were barely on the radars of policymakers before 2010.

Accessing pensions in retirement: The first of these questions is how to 'decumulate' pensions, an issue discussed earlier in this chapter in the context of George Osborne's surprise pension freedom reforms of 2014. Osborne's liberalisation was an extreme and reckless intervention, but it was also a recognition that the UK's approach to the decumulation of DC pensions needed to change. Back in 2005 decumulation was barely mentioned by the pensions commission, which assumed that DC savers would continue to buy an annuity upon their retirement (alongside taking a tax-free lump sum). But the annuities used by most people with a DC pension were clearly inferior to the lifetime promises made by occupational DB schemes, because they usually lacked inflation protection or pensions for surviving partners.

Annuities oblige financial firms to pay people a guaranteed regular income, usually until they die, so they need to be invested in very secure low-yield investments. In a climate of low interest rates and rising longevity, they have come to look increasingly expensive. They are also inflexible and irrevocable: the guaranteed lifetime income has to be purchased at a particular moment in time, even though rates might be better in the future, and it comes with no scope for variation in the future to reflect changing needs.

Since buying an annuity is a fixed-point transaction, pension providers need to de-risk people's savings more in the years leading up to retirement than they would if funds will remain invested in financial markets (this is to avoid a sudden fall in the value of a pension pot just before buying an annuity). In advance of buying an annuity portfolios should be gradually transferred from equities to cash and bonds, which deprives savers of the likelihood of higher returns.

The one important advantage annuities have is that they can offer a more generous deal to people with impaired health, who can access personally underwritten policies that provide more income because of their shorter life expectancy.

Chapter 2 considers what future form of lifetime income is needed. The complete flexibility of the pension freedoms will serve most people badly. But out of those reforms could emerge a new framework for lifelong pension incomes that improves on the annuity-based framework envisaged by the pensions commission. Pension providers, regulators and policy makers are starting to develop ideas for new lifetime income solutions that provide more flexibility, and hopefully higher incomes, than guaranteed annuities. An incoming 2024 government could turbo-charge this agenda.

The idea is that CDC schemes, which pool the investments of large groups of savers, can invest in riskier assets and secure higher returns

Collective pensions: Another important debate to grow in prominence over the last decade is the question of whether the UK should develop collective defined contribution (CDC) pensions based on the experience of the Netherlands. At present the UK has individual defined contribution (DC) pensions, where each saver takes all the risk personally, or collective defined benefit (DB) pensions, where the employer or scheme sponsor takes all the risk. CDC schemes are intended to sit between these extremes as pensions where the risks are shared collectively by all the members of the scheme, but not by the employer.

The idea is that CDC schemes, which pool the investments of large groups of savers, can invest in riskier assets and secure higher returns. First, they do not need to de-risk the investments of individual savers approaching retirement, ready to buy an annuity or similar source of income. Second, CDC schemes can invest in equities and other investments with higher risks and returns because they do not make a guarantee about the precise level of income they will pay. In bad times they can increase pensions in payment by less than inflation or implement a modest cut. This flexibility creates the opportunity to potentially achieve higher average incomes for members, when compared to the cast-iron promises of annuities or DB pensions that require ultra-low risk investing.

These advantages also apply to drawdown-style pensions which remain invested in financial markets. The difference is that the latter do not pool life expectancy risks between savers in order to provide the certainty of an income for life.

The new Royal Mail pension is the first CDC scheme in the UK. To the company's employees it will resemble a DB pension while they are making contributions, with members accruing a percentage of their earnings for each year they serve. The difference is that the employer will have no liability if the scheme underperforms: the members collectively will pay the price through a reduction in planned annual increases or potentially even a cut in the retirement benefits. Proponents of CDC schemes like the Royal Society of Arts point to modelling using historic market data which indicates that cuts would be extremely rare.[27]

There are other potential CDC models. For example, schemes can be designed for decumulation only, rather than as workplace pensions provided by employers. In this scenario, providers would pool the longevity risks of a large group of members in retirement. They would offer them an income for life that would be expected to rise to reflect inflation, but without a cast-iron guarantee of its future value (unlike with a DB pension or an annuity). This flexibility would enable providers to buy riskier investments which would normally secure higher returns and so deliver better income growth over time on average.

There are downsides to the CDC concept and a lively debate is underway as to its suitability and prospects. Strong and consistent regulation and governance will be needed to ensure CDC schemes are well run and work in savers' interests. Critics point to other complicated financial products that have not lived up to expectations regarding performance in the past. Alongside this, there is a concern that 'targets' for incomes can morph over time into implied or actual guarantees: unless the communication is incredibly clear people may misunderstand products and believe they will deliver certain outcomes; and future policy-makers can actually convert aspirations into obligations by changing regulations. In the UK both these things have happened in the last 50 years – first in the case of DB pensions from the 1970s onwards (where the rules were tightened) and second in the case of 'with profits' insurance policies in the 1990s and 2000s (where public perceptions were at odds with the contractual promises). Sceptics also suggest that pension providers will be reluctant to ever cut pensions in payment. Such caution would privilege older over younger members within schemes, risking intergenerational fairness.

Questions over the inter-generational fairness of CDC pensions in the Netherlands have led the Dutch to move away from them in recent years. Some of these concerns also apply to DB models which have always treated members in different age cohorts unequally (people of all ages make the same contributions as a percentage of their earnings, but there is a cross-subsidy because it is cheaper to buy the associated pension entitlement when people are in their 20s than their 60s since the money will be invested for longer). Another hangover from the DB era is that collective employer schemes are not very personalised and don't offer different benefits or levels of payment depending on individual circumstances (eg whether people are single or in a couple, or have impaired health).

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Self-employment: Over the last 30 years, the number of self-employed workers has not changed by as much as is often thought – 14 per cent of workers were self-employed in the mid-1990s compared to 15 per cent on the eve of the pandemic and just 13 per cent now following the impact of Covid-19.[28] But the pension habits of those who are self-employed have changed rapidly and for the worse: between 1998 and 2018 the proportion of the self-employed saving into a pension collapsed from 48 per cent to 16 per cent. The cause of this decline is unclear, with the IFS finding that very little of the fall can be explained by a change in the economic or demographic profile of self-employed workers.[29] But few disagree that action is needed if we are to secure good pension incomes for the self-employed.

The creation of the new state pension in 2016 was an important first step towards improving the pension prospects of the self-employed. Previously self-employed people had only received the first of two tiers of state pension, so the new single state pension represented a big increase in their entitlement (with no corresponding rise in self-employment national insurance contributions). The new state pension will be especially important for low-income self-employed workers. However, many mid-income self-employed workers will still face very poor retirement outcomes on the basis of their current private pension saving.

Securing better retirement incomes for self-employed workers should therefore be a top priority for pensions policy. This covers both 'traditional' freelancers and business owners, and also insecure gig economy workers who are often deemed self-employed. Many in the latter category are actually contracted 'workers' who should be treated as employees for pension purposes, so better education and enforcement is part of the picture. But a stronger pension offer is also needed for the genuinely self-employed. Pensions should be at the heart of a broad offer from a new government to improve the rights, protections and benefits of the self-employed.

Gender equality: the pensions commission placed significant emphasis on narrowing the gap in pension provision between women and men, and reforms introduced since the mid-2000s will make a big difference to gender equality over time.

Today the gender pensions gap still remains far worse than the gender pay gap. Looking across state and private pensions the trade union Prospect calculated that in 2019 average women's pensions were 38 per cent smaller than those of men (compared to an hourly pay gap of 17 per cent).[30] The gulf is even greater when it comes to private pensions: women reaching retirement today have only one third of the private pension assets of men.[31]

Some of this inequality is the product of history: pensions take decades to accumulate so outcomes are determined by policy choices and labour market conditions stretching back in time. The position of retired women will improve in the future. The labour market is slowly becoming more equal with respect to women's participation, hours of work and hourly pay. And inequalities will also be reduced by recent pension reforms – including the new state pension, the creation of auto-enrolment and gender-neutral annuities (which prevent women being penalised for their longer life expectancies).

But women still face disadvantage when it comes to private pension saving. Labour market inequality remains the main cause. Women are more likely to take time out of work and to work part time; they earn less per hour; and they also retire a year earlier than men on average.[32] The only upside is that women are more likely to have entitlement to a public sector occupational pension.

Pensions policy also contributes, with women disadvantaged during both saving and decumulation. In retirement, the current shift away from the pooling of longevity risks disadvantages women because they live longer on average than men. And it is now extremely unusual for DC savers to opt for a plan that includes a pension for a bereaved partner (in 2020/21 only 17,000 couples bought a so-called 'joint life' annuity at retirement, whereas widow and widower pensions were traditionally a core element of DB pensions).[33] Couples may benefit from drawdown-style schemes, which can be inherited by the surviving partner. For some bereaved partners this will be financially advantageous but these plans do not provide a guarantee that the money will not run out.

While they are saving, women are also disadvantaged by the way workplace pensions treat low earners. Women are much more likely than men to earn under £10,000 per year and so to be left out from auto-enrolment; and as their pay is lower on average they are more affected by the exclusion of the first portion of earnings from employer and employee pension contributions. These rules also disproportionately impact other groups likely to have low earnings or to work restricted hours, including disabled people and people from many minority ethnic backgrounds.

Women are also disadvantaged by having inadequate pension contributions during maternity leave and no pension contributions at all during other periods out of work when they are caring for children or for older or disabled relatives. Finally, pensions are rarely split during divorce or separation, creating yet another source of inequality. Although a lot has been achieved on gender equality in pensions, there's still a long way to go.

> Our system of tax relief on pensions is complex and poorly understood. It is also highly unequal

Tax relief: our system of tax relief on pensions is complex and poorly understood. It is also highly unequal, with high earners receiving far more tax relief than low earners (this is true whether or not account is taken of the tax they will eventually pay on their pension income). The pensions commission provided a detailed analysis of the inconsistencies and inequalities of tax relief, but it did not make any proposals for system-wide reform. It was said at the time that the Treasury had told the commission that tax relief was 'off limits'. But the commission's plausible justification for backing the status quo was that any reform would entail complexity and potentially harmful consequences, especially for DB pension schemes.

In power, Labour simplified the tax relief system and introduced annual and lifetime limits on the amount of saving permitted into pensions. But these reforms did not change the reality that higher and additional rate taxpayers are eligible for far more tax relief than low earners, whether expressed in cash terms or as a percentage of their incomes. In 2015 Conservative ministers consulted on a comprehensive reform to pension tax relief but the following year abandoned their plans following a backlash from their own backbenches.

As discussed in chapter 4, the arguments in favour of reform have grown since Labour was last in power for three reasons:

- **More money than ever is being spent on pension tax relief:** the latest HMRC numbers show that savers benefited from £61bn of tax and national insurance relief in 2019/20, which was offset by only £19bn of tax paid on private pension incomes.[34] These figures will be even higher now, following recent increases in national insurance.
- **Tax relief overwhelmingly benefits high earners even after recent policy changes:** over half of all income tax relief on DC pensions goes to people with earnings over £60,000 per year.[35] This is despite the introduction of annual and lifetime limits, and the expansion of pension saving among low and middle earners. Looking across all types of pensions, and including national insurance as well as income tax, new Fabian Society analysis finds that at least half of tax relief benefits higher or additional rate taxpayers (see page 32).
- **DB pensions are a much smaller part of the landscape:** the main reason for not reforming pension tax relief in the past has been fear for the impact on DB pensions. But DB schemes taking accruals now cover only a very small number of private sector employees: in 2021 only 910,000 were benefiting from new accruals, down from 2.1m in 2012.[36] This opens up the possibility of a targeted exemption for remaining DB savers.

If a future government embarks on reform of pension tax relief, there will still be significant operational complexities and important questions of fairness and sustainability to grapple with (see chapter 4). But major reform should not be ruled out without careful thought. F

2. A retirement income for life

Pensions are there to give people in retirement a secure income for the rest of their lives. In recent times the UK has achieved this in three ways. First through the state pension system, second through employers' defined benefit pension schemes, and third through annuities bought using a DC pension pot.

The state pension is on a stronger footing than at any time since the 1970s. Public sector DB pension coverage is also healthy. But private sector DB pensions and personal annuities have declined:

- **Private DB pensions:** in 2019 there were 6 million private sector DB pension scheme members yet to reach pension age. By 2030 this number will have dropped to around 3.5 million out of more than 40 million working-age adults.[37]

- **Annuities:** in 2013, before the pension 'freedoms', over 350,000 annuities were purchased each year.[38] In 2020/21 only around 60,000 DC pots were converted into an annuity when the pension was first accessed (10 per cent of all newly accessed DC pensions).[39] Annuity sales have been stable in recent years.

For DC pension-holders who don't take an annuity there are now two options, neither of which offers a secure income for life. The first is to **take the pension as cash**. This is what happens to most DC pots today, with more than half of pensions being fully encashed the first time they are accessed. Admittedly, many of these are small pension pots, worth less than £10,000, which would not produce much in the way of a regular income. But even once you strip out pots of under £10,000 taken in one go, a third of the remaining funds are still taken as one cash payment.[40] Some people will have good reasons to convert their DC pension into cash at the time of their retirement (eg to pay off a mortgage or loan, make home improvements, or bridge the gap between stopping work and reaching state pension age). But as we move to a mainly DC world, people who cash in their pension savings will be depriving themselves of the certain, long-term income that pensions are there to provide.

The second option is to **gradually access a DC pension pot**, by taking a regular income or a series of lump sum payments – the most common way of doing this is a drawdown pension. Around one third of DC pots first accessed each year make use of these staged withdrawals (or half if you strip out those pots worth under £10,000 taken in one go). Many people enter drawdown simply to draw a tax-free lump sum and take no further money for the time being. The primacy of the lump-sum in this decision raises concerns that considerations about the long-term are being ignored. On the other hand, among those who are making withdrawals, most are accessing their money too quickly to maintain a sustainable income across their retirement. This is particularly true in the case of pots worth less than £100,000. In 2020/21, 59 per cent of these saw withdrawals of at least 8 per cent per year (enough for funds to be rapidly exhausted).[41] In the context of the cost of living crisis, we can expect large numbers of savers to continue to draw from their pensions to meet short-term needs in a way that will leave little left for the future.

There are two problems with drawdown pensions and equivalent arrangements. One can be fixed and the other can not. The fixable problem is that most of these pensions have the wrong investment strategies and rates of withdrawal to act as long-term sources of income. With stronger regulation and guidance this problem can be solved, by creating defaults and constraints to guide what people can do. So far officials have only taken baby steps in this direction. The government has

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ROYAL MAIL'S NEW CDC PENSION

To its future members, the Royal Mail pension will feel very like a DB scheme while they are making contributions. Members will earn a pension from the age of 67 that will have a target income of 1/80th of earnings for each year of service. They will also build entitlement to a lump sum of 3/80ths of earnings each year. The employee contribution will be 6 per cent of earnings and the employer contribution 13.6 per cent. Employees will be automatically enrolled into the scheme, with the right to opt-out or 'opt-down' to a Nest DC pension.[42] The aim is for benefits to rise annually at least with inflation but, as this is a CDC scheme, this is not guaranteed. Planned annual increases could be reduced, or payments cut in value. The company will not be responsible for topping-up the scheme if it is failing to meet expectations.

Politicians have played a supportive, facilitating role in the development of Royal Mail's CDC pension. The plan was developed through social partnership, involving years of constructive dialogue between the company and the CWU trade union. This process was supported by both Conservative ministers and Labour shadow ministers, particularly the late Jack Dromey, a leading trade unionist who served as shadow pensions minister from 2018 to 2021. Legislation to enable the scheme to launch was passed as part of the Pension Schemes Act 2021 (this followed a decision by ministers that previous 2015 legislation, that also aimed to create a framework for CDC schemes, was deficient).

set up the Pension Wise guidance service and is testing ways to increase use of the service. Meanwhile the financial conduct authority has created four clear investment strategies for the drawdown schemes it regulates, with investment choice being determined by what people say they want to do with the money. The DWP is consulting on developing a similar system for trust-based pensions supervised by the pensions regulator. However, these interventions are designed to facilitate personal choice, not to steer or compel people towards what's most likely to be in their long-term interests. Achieving this will require politicians or regulators to create recommended or required maximum and minimum rates of withdrawal to act as 'guide rails' or defaults.

The unfixable problem with the drawdown-only approach is that it individualises life expectancy risk. With the right design a drawdown-style pension can successfully produce a regular income for, say, 20 years of retirement. But none of us can know if this will be too little or too much. As people grow older, they can use remaining funds in drawdown to buy a guaranteed income for life via an annuity, but as yet there is no evidence of how many people will have the funds or financial understanding to do this.

As we have seen, most people are currently taking money too fast. But in the future, as DC pensions come to dominate, it is likely that many will draw their pension too slowly, and live too frugally, because they do not know how long the money will need to last. This may be a particular problem for women who will start with smaller pension pots and can expect to live longer than men. The only solution is to return to the collective sharing of longevity risks by re-creating more certain incomes for life.

There are two routes back to pensions that provide incomes for life. The first is to build a new generation of workplace collective pensions to replace the DB schemes that have all but vanished from the private sector. The second is to introduce new flexible ways of decumulating DC pension pots that steer everyone towards products that include incomes for life unless they actively choose otherwise. The two routes can work in tandem, although for now the second is likely to be a much larger part of the pensions landscape given the UK's current focus on DC saving.

Route 1: Employer collective pensions

Route one entails promoting employer collective pensions using the CDC model as an alternative to traditional DB schemes (see page 11). We have seen how Royal Mail is setting up the UK's first CDC scheme (see box). A number of large employers are considering following suit. But we do not yet know whether such CDC schemes will turn out to be interesting outliers or become the template for a new generation of whole-life occupational pension schemes.

This will ultimately be for employers to choose, not politicians, but future ministers need to decide whether to adopt a neutral stance on employer collective schemes, or to actively promote them. Politicians should at least challenge large employers who would have once offered defined benefit schemes: 'If this model is right for Royal Mail, why not you?'

Beyond individual employers, the next step in the development of CDC pensions would be to authorise and legislate for multi-employer schemes. These could follow the 'master trust' model, so that any employer could select for their employees a collective pension plan instead of choosing a DC scheme, if they were prepared to make higher employer contributions. Employers would know that, in choosing this option, they would be delivering for their workers the certainty of an income for life, and also potentially securing a higher average income in retirement for each pound of pension contribution (according to studies on the relative performance of CDC and DC pensions).

Another multi-employer scenario would be for business sectors to develop joint pension plans. Politicians might see this as particularly attractive for low paying occupations, such as retail or social care. There would however be significant costs as CDC schemes are much more expensive than typical DC schemes: whole industries might need to move together and the government would need to adequately compensate employers in sectors like social care that rely on public funding. Nevertheless, access to a sector-wide collective pension could become part of the expected terms and conditions in particular industries. The government might also use its power of procurement to require that firms delivering public contracts join such schemes (bearing in mind that equivalent workers employed directly by the public sector are entitled to costly DB entitlements).

Route 2: Converting DC funds into pensions that include incomes for life

The second route to securing lifetime retirement incomes is to create a new framework for decumulating DC pensions, that results in almost everyone converting their money into a whole-of-retirement product which includes an income for life.

This should take the form of a new generation of retirement decumulation products – not a return to compulsory annuities. With careful product design, providers can deliver more flexibility and higher average incomes than annuities offer, while still providing a pension to the end of life. The pensions industry is in the process of developing models, including Nest's retirement income blueprint and the Pension and Lifetime Saving Association (PLSA)'s guided retirement income choices. These are based on combinations of products that blend features of cash lump-sums, drawdown schemes and annuities (for the later stages of retirement). So far only a handful of providers are offering customers choices along these lines.[43]

Another approach being discussed is to create CDC decumulation-only pensions that would pool the investment, inflation and longevity risks of a cohort of retirees. These policies would offer an income for life but (as with workplace CDC pensions) the payment level would be a target not a guarantee. In an ordinary year, payments would rise at least by inflation (unlike with most annuities today). But the increase would not be certain and occasionally payments might have to rise by less than inflation or even be frozen or cut. This flexibility would enable schemes to invest in risk-bearing assets that would be likely to produce higher average incomes than those required to fund the cast-iron guarantees of an annuity. Future CDC decumulation-only pensions could comprise an entire product or form one part of a hybrid pension, for example the element people draw on when they enter late old age.

In taking this agenda forward, British politicians should look to developments in Australia, which has just introduced a new 'retirement income covenant' that requires pension schemes to adopt strategies for their members' retirement incomes. Each provider's strategy must assist beneficiaries to achieve and balance three objectives: maximising their expected retirement income; managing expected risks to the sustainability and stability of their expected retirement income; and having flexible access to expected funds during retirement.[44] This requirement is weaker than initial proposals which would have mandated schemes to offer a core 'comprehensive income product for retirement' (a flexible pension that was to include an income for life). It also set out a detailed set of principles pension funds would have been expected to adhere to.[45] If the new legislation does not lead to providers developing such products there is likely to be pressure for further reform.[46]

Conservative ministers are encouraging innovation in the decumulation of pensions. But they seem reluctant to go down the path of directing people towards solutions. Perhaps they feel this outcome-focused approach conflicts with the carte blanche philosophy of the pension freedoms. This creates an opportunity for opposition politicians to seize the initiative and promise a new approach that pushes everyone towards arrangements that offer income security across the whole of retirement.

Reform of the decumulation process should include the following elements:

A requirement that DC providers offer at least one whole-of-retirement pension that includes an income for life. From the mid-2020s DC providers would either need to offer their own pension including an income for life or (if they did not wish to offer decumulation products) to transfer savers to other providers. Individual pension providers would decide how to discharge this requirement. For example, they could choose whether a CDC decumulation-only pension or a hybrid solution (based on a combination of investment funds and annuities) would be the best option for their savers. Politicians would need to provide support by developing the regulatory framework and introducing the legislation needed for CDC decumulation-only pensions. As an illustration, Nest has recently launched a guided retirement fund which includes three portions – one providing money for regular spending, one for emergency withdrawals, and one designed to buy an annuity when people reach 85.[47]

A requirement to promote a choice of whole-of-retirement products, with other options only available if people first take guidance or advice. Ensuring that all pension providers have a whole-retirement product on offer will be an important first step, but it will not translate into good outcomes for everyone. Under current arrangements – where converting pensions into cash is so easy and commonplace – few people are likely to commit to these long-term products. As DC pensions become most people's main source of retirement income, providers should be required to push people towards lifetime incomes not just provide this as one option.

From the late 2020s, a new system should require that people are offered a choice from a range of whole-of-retirement products as they approach their planned pension age. Providers would be expected to offer several options suited to different circumstances, and also to promote the alternative of shopping-around for similar schemes from other companies. Products should have to comply with a set of core features (see box) in order for people to be able to access them without taking guidance or advice.

Pension providers should also be expected to take action to educate and engage with savers to inform them about whole-of-retirement products and help them make active choices about which option would best suit their needs. They should promote guidance and advice as a voluntary option that will benefit many customers, but in the expectation that it will only be taken up by a minority.

People would be able to opt-out from these whole-of-retirement products and chose cash or self-managed drawdown-style products without an income for life. This would mean that the pension freedoms would still exist (an important point politically). However, communications would always talk first about whole-of-life pensions and accessing other options should be conditional on people receiving mandatory guidance or advice (an exception could be made in cases where savers had a very small or very large pension pot, or also have a DB pension scheme). Declining a pension that included an income for life could also come with a cooling-off period and strong health warnings emphasising the high risk of running out of money. In the case of drawdown-style products, people could be asked regularly if they wished to switch to a whole-of-retirement product with an income for life.

A requirement to default people who have not engaged into a semi-personalised recommended pension, based on a limited set of information. From the late 2020s, pension providers should also offer a proposed default pension to people who have not made an active choice by the time they reach their planned pension age. This would not be the same product for all savers as people's circumstances vary. The task would be to default people into an option suited to their needs, using a strictly limited set of information. A semi-personalised recommendation for a particular whole-of-retirement pension would not constitute regulated advice, and the legal boundary between guidance and advice might need to be revised to reflect this. Providers could have legal protection on this point if they demonstrated good governance arrangements and a sensible product selection process. DC savers would be required to provide a minimal amount of information in order to access any money. They would also need to agree to the proposed product. If there was absolutely no contact payment could not begin (as is the case today). Therefore, while the system would create a default for each saver, it would not treat everyone alike or be based purely on passive inertia.

Information used to make semi-personalised recommendations might include: preferences about the share of the fund people want to be able to access as a lump-sum now or in the future; whether the policy-holder is single or in a couple; and postcode (which predicts life expectancy). Gender would not be considered. This is in line with existing caselaw on gender-neutral insurance and helps level-up incomes for women in retirement.

A screening question relating to health would also be needed to determine whether people needed referral to guidance or advice tailored to those with short life expectancies. Anyone identified as being at risk of dying soon should be required to take guidance or advice to access their money, in order to protect people who have experienced lifetime disadvantage, including many disabled people.

Pension providers that offer people semi-personalised default pensions would need to be subject to strict regulatory and governance requirements, to ensure they operate in members' best interests. The cost of the products should be kept under review and the government and regulators should consider capping the percentage value of the fees providers levy on funds, if costs seem excessive. This is important because inertia will lead most people to remain with the same provider for accumulation and decumulation. Strong regulation and governance (not competition) will be essential for securing consumers' interests.

Consolidation

The approach to decumulation proposed here will be very difficult to achieve if savers have numerous small pension pots. People will be more likely to opt out if faced with a series of decisions about small amounts of money, rather than being presented with a single choice for their entire retirement savings. It will also be hard for providers to make appropriate default proposals if they do not know whether they are managing the customer's only pension. A default-based approach to decumulation therefore requires pension consolidation.

The pensions industry is already examining options for consolidating very small pots without people's active consent.[48] There are important technical and legal issues to resolve but it is likely that a procedure will be in place in the

CORE FEATURES FOR NEW WHOLE-OF-RETIREMENT PENSIONS

Pension providers not governments should design pension schemes. A new framework for DC decumulation should therefore specify what whole-of-retirement products need to achieve, not how they should achieve them.

So what outcomes should the system aim for? Whole-of-retirement decumulation solutions for DC pots should include a core set of features developed through consultation and debate. Here we present a possible list informed by UK initiatives to scope out future whole-of-retirement pensions as well as proposals from the Australian government in 2018:

- An income for life (but not necessarily a guaranteed level of income, or the same income across the whole of retirement)
- Inflation-related increases (though not necessarily index-linked guarantees)
- An income for a surviving partner (essential for gender equality)
- Flexible access to your money (eg with lump sum and/or drawdown elements)
- The ability to change your mind (ie to withdraw remaining savings and use them differently)
- Designed to meet retirement needs rather than make bequests (except in the case of early death)

In addition, politicians of the left should require that a new framework for accessing pensions delivers fair arrangements for people with low life expectancies. This could be achieved by requiring providers to identify and act in the best interests of people with unusually low life expectancy. There could also be a requirement that people identified as most likely to die soon take guidance or advice on a personal solution that works for them.

late 2020s. Small pot consolidation will reduce costs for providers, but it should also bring important consumer benefits with respect to value for money, simplicity and transparency. A future government should support this process and introduce regulation as needed.

The industry will commence with the consolidation of very small pots. However, once that process is working well, a future government should require providers to automatically consolidate all small and medium-sized DC pensions (unless customers actively decline). Most consumers would then have a single DC fund and the consolidating provider would have full visibility of all the saver's pension holdings (a process would be needed to fairly allocate funds between pension providers).

Consolidation of all pots could take place a few years before the minimum age for drawing a pension. This would act as a far stronger 'wake-up' nudge than existing initiatives involving communications and offers of guidance: a big moment like the consolidation of a person's whole DC pension wealth would hopefully encourage more people to start thinking through their options. It would also enable providers to choose appropriate investment strategies for the pre-retirement years. Where people only have a small pension pot (even after consolidation) they could be placed on a very low risk investment pathway on the assumption that they would take the whole amount as cash. People with larger amounts would remain in higher risk investments, on the basis that their money would remain invested and would only be accessed gradually in retirement.

Some of the benefits arising from automatic consolidation could be achieved in principle using pensions dashboards, which will present consumers with consolidated information about their pension entitlements. When these become available in the next few years they will greatly assist active decision-making by people who are engaged. But they are probably an inadequate solution for providers trying to serve passive savers, if they have minimal information about their circumstances. And, even if providers had enough information to make good recommendations, without prior consolidation many people would still end up with a confusing and inefficient array of mini pensions. Lastly, using pensions dashboards to make recommendations to disengaged consumers is likely to be ruled out by legal concerns about looking-up information about people's holdings in other funds without permission.

Pre-retirement

The focus of pensions strategy is currently on supporting people to make active decisions once they reach the minimum age for drawing a private pension (55 today – rising to 57 in 2028). But for most savers this is not a good time to access a pension: the longer people work and save, and the later they start to access their money, the more they will have for their retirement. The system should therefore be redesigned to ensure that most people access their money at or near the state pension age.

> Politicians should introduce tougher restrictions on drawing on a pension more than, say, three years before the state pension age

First, the minimum pension age should be raised so that **people can only access a pension five or seven years prior to state pension age** unless they are permanently disabled. Once the state pension age reaches 67 this would mean a minimum pension age of 60 or 62 (nb the minimum access age for the new Lifetime ISA is 60). When people are in their 50s they should receive only limited information about how to access their pension, with most of the focus on the benefits of saving more and working longer.

Second, DC providers should be required to **set each scheme's planned pension age to the saver's expected state pension age**. This would apply both to new funds and historic schemes set up many years ago. People would be required to actively change their planned pension age after their scheme has commenced if they wished to deviate. Following this change:

- Communications from providers should focus on preparation and engagement in the run-up to the planned pension age and make little reference to the minimum pension age.
- Standard investment strategies should be aligned to people taking a whole-of-retirement pension at state pension age. People should not have to engage with their pensions earlier to make this choice.

Third, politicians should introduce **restrictions on drawing on a pension more than, say, three years before the state pension age**. Earlier we recommended that it should only be possible to take a product that does not include an income for life following guidance or advice. This requirement could apply to any form of pension access more than a handful of years before state pension age (with an exception for pots that are still small, even after automatic consolidation).

An exception to this approach could be introduced for people only wanting to access their tax-free lump sum. This could be permitted without guidance or advice, as long as the remainder of the pension fund remained invested in anticipation of being converted into a whole-of-retirement pension plan once people reached their planned pension age.

Most communications, engagement and guidance efforts should come in people's 60s and ramp up progressively as state pension age nears. And although these communications should explain people have the legal right to take their money from the minimum pension age, access at the state pension age should be presented as the standard and recommended option.

Early access for people with lifetime low and middle earnings should be presented as a fallback in the event of illness or unemployment, rather than an early-retirement lifestyle choice. For people out of work, guidance and advice services would need to help people maximise their income, taking account of the complicated interactions between private pensions and social security (see p29). A key goal for people out of work before state pension age should be to help them smooth their incomes across the periods before and after pension age (when state income rises considerably). This might entail taking a higher income from a private pension initially, and then taking less once the state pension is in payment.

3. Everyone saving enough

Reforms to the state pension and the introduction of auto-enrolment have significantly improved the retirement prospects of low and middle earners. But present policies are still insufficient to provide a good income for most people in retirement. This is because the coverage of workplace pensions is only partial and there is much less voluntary saving than the pensions commission wished for.

People in 'regular' employee jobs need to save more. On top of that, action is needed to support the self-employed, those with multiple mini-jobs and people whose working life involves breaks for caring responsibilities. Voluntary action will not be sufficient: politicians need to introduce new saving requirements and more government financial support.

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Retirement living standards

Hopes and expectations for retirement living standards vary between people, depending on their individual circumstances and lifetime earnings. However, pension experts have developed some useful benchmarks for understanding good outcomes for retirement living standards.

The pensions commission used a proportional income target, **the replacement rate**, where the stated aim was to replace a fixed proportion of each person's previous earnings. It said that people with very low lifetime earnings should be able to replace 80 per cent of their prior gross earnings; middle earners two-thirds; and very high earners a half. This replacement rate approach reflected the design of traditional DB pensions.

More recently the Pension and Lifetime Savings Association has promoted an income threshold approach. This involves calculating **income standards** for a 'minimum', 'moderate' and 'comfortable' standard of living by pricing up the cost of baskets of goods and services which the public equates to these three levels. This approach builds on the longstanding work of the Joseph Rowntree Foundation and Loughborough University to define a minimum income standard (ie a minimum socially acceptable standard of living, based on what the public thinks people need).

RETIREMENT LIVING STANDARDS BENCHMARKS

The replacement rate approach: the aim is to achieve a percentage of an individual's gross earnings prior to retirement.[49]

Replacement rate	Pre-retirement gross earnings – 2021 examples	Gross retirement income
70 per cent	Low earnings – eg £16,000	£11,200
67 per cent	Around median earnings – eg £25,000	£16,750
60 per cent	Medium-high earnings – eg £40,000	£24,000
50 per cent	High earnings – eg £70,000	£32,500

The income threshold approach: income standards are developed through public deliberation about what basket of goods and services people should be able to afford in different circumstances.[50]

Living standard	PLSA description	Net income for single adult outside London (2021)
Minimum	'Covers all your needs, with some left over for fun'	£10,900 plus rent/mortgage
Moderate	'More financial security and flexibility'	£20,800 plus rent/mortgage
Comfortable	'More financial freedom and some luxuries'	£33,600 plus rent/mortgage

Note: The income thresholds are updated over time, both to reflect the rising cost of each basket of goods and to take account of changing public views on what should be in the basket. The minimum level is taken from the Joseph Rowntree Foundation's longstanding work on the 'minimum income standard' (ie a minimum socially acceptable standard of living). The moderate and comfortable levels are higher living standards developed by the PLSA and using the same methodology. High inflation means these numbers are now out of date. The 2022 MIS value for a single pensioner is £12,800.

Both these approaches assume people's needs are roughly constant across retirement. In practice, this may not always be the case. Some needs may be higher in early retirement (eg leisure), and others higher closer to the end of life (eg care and support). The variable nature of such requirements explains why it is useful for older people to have assets as well as a regular income. Nevertheless, most costs are the same for retired people of all ages, and the evidence suggests that on average people's consumption remains fairly flat in real terms across later life.[51] The pension system should therefore be designed so that people can maintain their standard of living across retirement, taking account of inflation.

The proportional and income threshold approaches each have advantages and disadvantages, from the perspectives of both personal financial planning and public policy. The income threshold approach is more easily adaptable to personal circumstances in retirement – it varies to take account of whether you are single or in a couple, and if you have ongoing housing costs. But it is not a personalised threshold linked to your individual earnings history. The proportional approach relates to individual prior earnings and consumption, but it is not a guide to whether people will achieve any particular standard of living. Those with low lifetime earnings can achieve their personal replacement rate but still have an income below what the public thinks is an acceptable minimum.

A centre left government should adopt two goals for retirement living standards. The first priority should be to ensure that everyone can reach a minimum income standard, taking their own living circumstances into account. A desirable but secondary objective should be to help mid and high earners to achieve their personal replacement rates and/or the PLSA 'moderate' and 'comfortable' thresholds.

Achieving both these goals will require significant policy change. First, the current auto-enrolment minimum pension contribution is not high enough for lifetime low earners to achieve the minimum income standard. A 2021 study by the Resolution Foundation showed that achieving the MIS requires a DC pension pot of £70,000 in 2021 prices (in addition to state income). This value is an average, taking account of the expected mix of household sizes and tenures among retirees. The Resolution Foundation concluded that it would not be feasible for low earners in their 50s to save this amount (if they do not have previous pension entitlement). For a 45-year-old working full time on the living wage a saving rate of above 20 per cent of earnings is needed. Even for low earners in their 20s, who can expect to be auto-enrolled across their whole working lives, achieving this DC pot will require an ongoing contribution rate of around 11 per cent of total earnings.[52]

A follow-up report from the foundation found that out of the lowest fifth of hourly earners (excluding those in DB schemes) just 4 per cent are saving more than 11 per cent of their earnings.[53] In cash terms, only 1 per cent of this group are saving enough annually to achieve the £70,000 pension pot needed for a minimum adequate income. This problem stretches well beyond low earners: only 19 per cent of workers are saving enough cash each year to be on track to achieve the saving target over a lifetime in work. Even among the top fifth of earners, one third of workers are not saving enough to meet the goal. This is compelling evidence that the UK's pension policy is failing to meet people's basic needs and expectations.

Turning to the other benchmarks, modelling by the Pensions Policy Institute indicates that 90 per cent of all current DC pension savers will not achieve their personal replacement rates, if they just receive current minimum auto-enrolment contributions: everyone earning more than £12,700 needs to save more (2020 prices). The PPI also concludes that 'moderate' and 'comfortable' living standards will be well beyond mid and high earners' reach (even though these measures are based on what the public thinks it is reasonable for them to expect). For a single homeowner outside London without a DB pension the 'moderate' living standard requires a DC pension pot of £440,000, and the 'comfortable' standard a pot of around £1m (2021 prices).[54]

Middle and high earners who are single will come nowhere near to meeting these thresholds saving at the minimum auto-enrolment level. The targets are a bit more attainable for couples who both have substantial earnings histories (because living as a couple is cheaper and both will have a state pension). However, under current policies, even mid and high earning couples who both work full-time for most of their careers are likely to fall short of the 'moderate' and 'comfortable' thresholds respectively. And the position is even worse for people with housing costs – all these calculations assume people are homeowners without a mortgage.

LOW-INCOME HOUSEHOLDS AND EMPLOYEE PENSION CONTRIBUTIONS

This chapter recommends that most increases to auto-enrolment deductions should take the form of employer pension contributions. But even increases to employee contributions for low earners will have limited negative impacts on poverty and hardship. The main causes of low living standards for working households are inadequate in-work social security, high housing and childcare costs, and insufficient hours of work.

Perhaps surprisingly, low hourly wages are a less important driver of hardship. This has been demonstrated in the last few years, when we have seen large increases in the minimum wage but no commensurate decrease in in-work poverty. The flip side of this is that a modest increase in employee pension contributions by low-paid workers will not lead to a spike in poverty.

This is partly because many people with low earnings live in households with other earners. But it is also because of the way the tax and benefit system works: (1) low earners are entitled to tax relief on employee pension contributions, even if they earn too little to pay income tax; (2) workers receiving universal credit get an increase in benefits to offset their employee pension contributions (a one pound reduction in take-home pay leads to a 55p increase in universal credit). These tax and social security rules combined mean that five pounds of extra employee pension contribution translates into less than two pounds of lost net income.

From a whole-life perspective, employee pension contributions make low earners better off – even before factoring in the employer contributions that they unlock. Nevertheless people in dire financial circumstances can always opt out from pension contributions if they wish. Since workplace pensions are not compulsory, everyone can still decide to maximise their immediate income (even if this means they will get a bit less money across their lifespan). This opt-out approach should be retained, so that people have the ultimate choice.

Increasing contributions: is there a case against?

There is substantial evidence that higher pension contributions are needed to secure acceptable retirement living standards. So, is there a case against? One possible reason for caution is that increases in contributions might not be affordable for individuals and/or employers. This is an important consideration given the very poor performance of the British economy during the last 15 years and the likelihood of continuing economic challenges over the next decade, with the return of high inflation.

Any increase in payroll deductions will be easier to accommodate when wages and corporate earnings are rising in real terms at a healthy pace. This is not an excuse for indefinite delay but suggests that a staged approach to higher pension contributions may be advisable. There might also be a case for a 'handbrake' mechanism whereby planned increases are postponed if the economy is growing well below trend.

It is also important to avoid a situation where low earners 'over-save' into a pension if they do not have enough money now. We have seen that low earners need to be making higher contributions to achieve acceptable minimum living standards in retirement. However, many households are not achieving this minimum even while in work. So policymakers might worry that, rather than 'smoothing' lifetime consumption, higher contributions could end up 'backloading' consumption into the retirement years. To put it another way, is it sensible to reduce low earners' take-home pay when millions of workers now face poverty, unmanageable debt or the necessity of foodbanks?

After 15 years of stagnant living standards, politicians need to avoid reducing disposable incomes for poorer households, even if this will help them from a whole-life perspective. The solution is for most of any increase in pension contributions to come from employers not employees. This chapter recommends that all increases except those arising from the abolition of the lower earnings threshold should be paid for by employers. Focusing on employer contributions will stop extra payroll deductions from translating into an instant decline in household incomes. For middle and high earners, such extra employer costs will gradually be passed onto employees through suppressed wage growth in the future. But for low earners this can be prevented by continuing to raise the minimum wage (nb from 2024 the government intends to peg the national living wage to two-thirds of median earnings).

Raising employer contributions will also help make saving worthwhile whatever people's circumstances. The Institute for Fiscal Studies has shown that without employer contributions there are circumstances when many people should save little or nothing from the perspective of smoothing their lifetime consumption – eg parents with dependent children who have high outgoings.[55] But when employer contributions are taken into account saving always makes sense.

The scope of auto-enrolment

The first step in raising contributions should be to extend eligibility for auto-enrolment and require that contributions are paid for every pound of earnings. Two measures that are needed were promised by the government following its 2017 auto-enrolment review. Ministers said these would be implemented in the 'mid-2020s' but no steps have been taken to give them effect. The two reforms are:

Reduce the age of eligibility for auto-enrolment from 22 to 18: this will modestly improve lifetime pension saving, get young adults into the habit of pension saving and make the administration of auto-enrolment easier for employers.

Deduct pension contributions from the first pound of earnings: for low earners who are enrolled in a workplace pension this will lead to a significant increase in pension saving. At the moment, contributions are not deducted from the first £6,240 of earnings. Someone earning £12,500 a year will therefore only receive pension contributions for around half their earnings, with deductions of 8 per cent of eligible earnings translating into 4 per cent of total earnings (ie around £500 rather than £1000 per year of pension saving). Eliminating the lower earnings threshold is the only reform we propose that would impose a direct cost on employees (a reduction in net annual income of £250 per worker). For this reason, the measure should be staged over at least 2 years and be implemented alongside increases to the national living wage.

Going beyond these announced policies, a future government should also widen the scope of auto-enrolment in the following ways:

Increase the maximum age of auto-enrolment from state pension age to 75: people working beyond state pension age often want to top up inadequate savings, so it seems odd to exclude this group from a pension with matching employer contribution.

Reduce the auto-enrolment threshold from £10,000 to £4,000 per year for each employee job. At the moment employers are only required to enrol workers who earn more than £10,000 per year in a particular job. Reducing the enrolment trigger to £4,000 would bring almost 2 million more jobs into auto-enrolment (three-quarters of them held by women).[56] This will particularly help people holding several mini-jobs (who may have total earnings exceeding £10,000 but not receive any pension contributions). A £4,000 threshold is suggested to exclude low paid jobs with hours equivalent to less than one day a week (to avoid bureaucracy for micro-employers).

Require auto-enrolment contributions on day one of employment, or soon after: employers can currently wait three months before auto-enrolling a worker. This disadvantages people with insecure, temporary jobs. Options to consider include: requiring the first three months of contributions to be paid retrospectively for employees who are still with the employer at this stage; reducing the maximum waiting period from three months to one month; or day one auto-enrolment for everyone with a contract that is open-ended or over one month. Consultation with employers and gig economy firms should take place to establish the bureaucratic pros and cons of different models (including asking employers who currently do not apply the three-month delay how they manage pensions for short-term workers).

Clarify the legal definition of non-employee 'workers' (who are entitled to workplace pensions) and improve communications and enforcement: contracted workers who are not employees are entitled to auto-enrolment pensions – this includes many 'gig economy' workers. But awareness and compliance is poor, despite recent efforts by the pensions regulator and initiatives by a number of large platform businesses including Uber.[57] Ministers have recently required employers to issue a 'day one' statement of rights for non-employee workers, but they have u-turned on a previous commitment to clarify and simplify the legal test for employment status.[58] A future government should re-consider this, as well as acting to improve communications and enforcement.

Review options for providing employer pension contributions to all contractors who have an employer under tax law: in a related measure, the government could consider what arrangements should apply to people who are currently treated as employees for tax purposes but are self-employed under employment law and so do not benefit from an employer pension contribution (eg people working through personal service companies who are providing off-payroll work 'within IR35'). Auto-enrolment may not be appropriate for this group, in which case other options for delivering equivalent employer pension contributions could be considered.

Some of these reforms are likely to lead to the creation of more small pension pots (caused by more savers with very low earnings and/or moving frequently between jobs). They would therefore need to be accompanied by the implementation of plans for the automatic consolidation of deferred small pots, which the industry and government are currently developing (see page 17).

Finally, although auto-enrolment rates are currently very high, policy makers should consider whether to intensify 're-enrolment' requirements, so that people who opt-out are frequently required to decline their pension rights. At present employers are required to re-enrol people who have opted-out every three years. This could be reduced to every one or two years, or (if feasible) to every time employees receive a rise in their hourly pay.

Increasing employer contributions

The removal of the lower earnings threshold for contributions is an important first step to increasing pension saving for all employees. For low and middle earners it will significantly raise the percentage of total salary reaching their pension pots. If economic conditions permit, it should therefore be implemented rapidly after a new government reaches office.

Once people are making contributions on every pound of earnings, ministers should then raise pension contributions to 12 per cent of total earnings. As we have seen this percentage is around the level required for an acceptable retirement income for a low earner saving across their working life. The increase should consist entirely of employer contributions.

Ministers should immediately announce their intention for contributions to rise but implementation should again be staged (perhaps rising by one percentage point per year). The government could publish a desired timetable but also promise a 'handbrake' delay to any planned increase, should GDP growth or real earnings growth contract or rise significantly below trend.

Combining these proposals, the fastest possible timetable would be:

April 2025	Halve lower earnings threshold
April 2026	Abolish lower earnings threshold
April 2027	4 per cent employer contribution

April 2028	5 per cent employer contribution
April 2029	6 per cent employer contribution
April 2030	7 per cent employer contribution

In considering these increases government should focus on the impact of business and particularly small businesses, taking account of the totality of taxation and regulation they face. If possible, ministers should seek to reduce the costs businesses face in other ways at the same time as implementing higher pension contributions. One option to consider is whether the rate of employer national insurance could be reduced at the same time, or whether targeted reductions could be introduced for small businesses.

Proposing a rise in employer contributions may prove controversial but there are powerful reasons for recommending that only employers should shoulder the burden of extra pension payments:

A gradual and partial impact on employees: economic theory tells us that employees end up bearing most of the costs of any increase to employers' payroll costs: higher employer contributions will be mainly passed onto employees through suppressed pay rises over time (a proportion might also be absorbed in higher prices or lower profits). However, for employees, a gradual and invisible transition is preferable to an overnight pay cut. This is particularly true during ongoing economic difficulties. Ministers can also provide targeted protection for people on low hourly pay by raising the minimum wage at the time of an increase in employer contributions and in the years following.

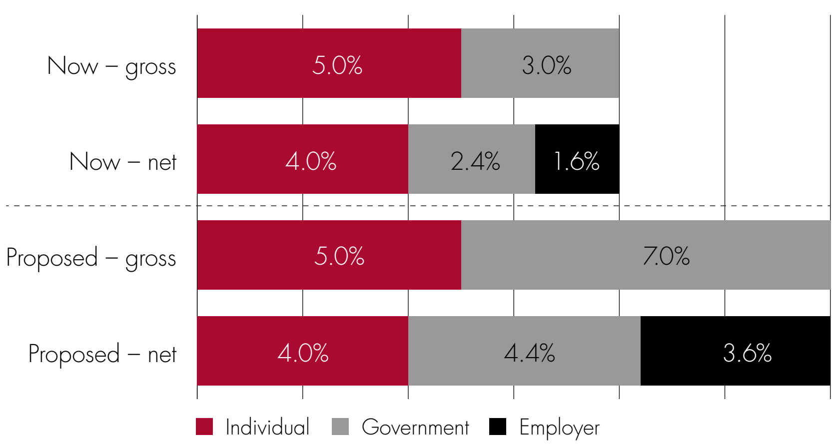
A balanced three-way split: increasing employer payments will shift the balance between employee and employer contributions from 5:3 to 5:7. This new split between employee and employer translates into a roughly equal split between employee, employer and the government after tax relief is taken into account. This is because employer contributions are treated more generously than employee contributions by the tax system. Under current rules the split would be approximately 4:4:4 for basic rate taxpayers (see figure 2). Employers would recoup almost half of their extra pension contribution through increased tax relief. The percentage of low and middle earners' pension contributions that comprise government subsidy would draw a little closer to the amount already enjoyed by high earners with generous employer pension schemes. And whatever people's lifetime earnings, pension saving would always be in their financial interests: for each pound of take-home pay that employees gave up, they would receive two pounds from employers and the state. This would make pension saving pay for everyone – including people who receive means-tested benefits in retirement (see page 30).

The risk of opt-outs is lower: auto-enrolment opt-out rates have been low since the introduction of auto-enrolment, even after employee contributions reached 5 per cent. But each percentage point increase in employee contributions risks raising opt-outs. This is an important consideration given the extra that employees will already be paying following the removal of the lower earnings threshold.

Fairness for good employers: good employers who make generous pension contributions are currently under-cut by employers who just follow the minimum requirements. This proposal would go a long way to harmonising pension contributions between employers. Currently only 10 per cent of private sector jobs come with employer contributions at the level of 7 per cent or above.[59]

Room is left for additional employee saving: Finally, by keeping the employee contribution rate at its current level, ministers will create headroom for workers to be able to afford additional top-up contributions (both for pensions and potentially for short-term saving). We examine this possibility next.

Figure 2: Increasing employer pension contributions would result in a three-way split in contributions between individual, employer and government



Note: the government contribution includes both tax relief paid to pension funds directly and the savings experienced by individuals and employers as a result of employers paying pension contributions rather than the same amount in wages.

Extra employee saving

This chapter's core recommendation for minimum pension contributions is first to eliminate the lower earning threshold (which will increase contributions for employees and employers), and then to raise employer contributions from 3 per cent of total earnings to 7 per cent. Employee contributions should not be increased further when opting out means workers will lose their matching employer and government contributions.

However, politicians should explore the introduction of extra workplace saving by employees. This should be clearly distinct from the core requirements of auto-enrolment pensions to retain the simplicity and high take-up of workplace pensions. The system would work by employers levying additional employee deductions and giving people the choice to ‘opt down’ back to the auto-enrolment minimum of 5 per cent of earnings. As with auto-enrolment, the additional employee saving would be opt-out, but the loss of an employer contribution would not be at stake if people said no.

This extra saving would have two purposes:

- **Pension saving:** even a 12 per cent contribution is unlikely to be sufficient for people with above-median lifetime earnings, and for people in the second half of their working life with little or no pension saving so far.[60] For these groups there is a strong case for an extra ‘opt-down’ employee pension contribution worth, say, an additional 3 per cent of earnings (lifting the total pension contribution to 15 per cent).

- **Short-term saving:** payroll saving schemes are designed to help people save regularly by diverting a proportion of people’s pay into savings before it reaches their bank account. Most existing schemes are opt-in and have very low levels of take-up. However Nest is currently trialling an opt-out saving scheme with Suez UK which has secured participation from 40 per cent of new starters, according to initial evaluation data.[61] Future payroll saving deductions could also consist of 3 per cent of total earnings, which would enable someone on median earnings to save over £700 in a year.

The widespread implementation of opt-out payroll saving could assist employees to save for emergency or lumpy spending, bringing significant benefits to low and middle earners, especially the millions of people with next to no savings. Increasing financial resilience is a good in itself, but it will also support future retirements by making people less likely to need to opt out from auto-enrolment and less likely to have unmanageable debt as they reach pension age. At present there is some anxiety within the pensions sector about promoting short-term payroll saving, because pension contributions themselves are far too low. These concerns will be substantially reduced if minimum pension contributions rise to 12 per cent of total earnings. However, there will still be a trade-off to make between encouraging higher pension contributions and immediate saving. There are lots of possible permutations for how extra savings into a pension or short-term savings could work:

- People could have a choice of whether to use the money for their pension or for short-term saving.

- Some people could be defaulted into pension saving (eg those with more than median earnings of £26,000 per year; and/or people aged over 45) and others placed in a short-term savings scheme.

- A single ‘sidecar’ product could be offered, where the extra saving initially funds a day-to-day savings pot, and then any money over a certain level goes into a pension.

Introducing extra employee saving would bring additional complexity for employers, so it could be introduced gradually – for example by initially being compulsory only for large employers, and voluntary for smaller employers. Policy-makers would need to think carefully about extra burdens on employers and savings providers. Changes to law and regulation might also be needed, especially to facilitate ‘opt-out’ arrangements with low levels of individual involvement.

A pension-only system of extra contributions would be easy to design and implement, as it would work on the same lines as existing auto-enrolment. There would be a little added complexity in operating payroll systems and explaining ‘opting down’ as well as ‘opting out’ to employees. The burden of administering defaults would rise, if they were different default options for employees with different circumstances.

Similarly, operating payroll saving is already established among some large employers. The major challenge would be to implement schemes at scale, given the increase in participation that promoting or mandating participation and shifting to ‘opt-out’ would entail. A new market in financial institutions willing and able to operate millions of small savings accounts and receive monthly contributions would need to be developed.

Developing a hybrid pension/saving offer would be more complicated. Nest Insight is piloting a hybrid payroll savings scheme – on an opt-in basis – which involves savings over a certain level being transferred into a pension pot. Savings and pension providers would need to be separate both because their regulatory regimes are different and because the two types of account would need different investment strategies. Combined arrangements for collecting contributions would therefore need to be established: either employers would be required to pay two sets of auto-enrolment payments, or the pension provider would act as an intermediary for the savings provider.

Finally, in thinking about a new system of short-term, opt-out payroll saving, the government may also wish to consider whether payroll saving should be financially rewarded, following the example of Help to Save accounts for low-income households and Lifetime ISAs. A generous and well-targeted approach would be to disregard payroll saving for universal credit calculations (copying the arrangement for employee pension contributions). For low-income households, every pound saved would then be offset by 55 pence in extra benefits.

Employers going beyond the minimum

We’ve seen there is a strong case for raising the minimum requirements placed on employers (remembering that most of the extra costs will ultimately be borne by employees and the government). But action is also needed to support more employers to go beyond the minimum. The balance needs to shift between firms that see pensions as a question of legal compliance, and those that want to go further – either as a positive choice or because their business environment demands it.

A future government should explore a range of options for supporting good employers to go beyond the minimum. These include:

- Collective employer pensions – promoting the adoption of CDC workplace pensions, either by individual employers or at sector level (see chapter 2)

- Higher employer contributions – beyond-minimum employer contributions within DC pensions (eg to at least 10 per cent of total earnings)

- Employer matching contributions – extra employer contributions available to match additional contributions by employees

- Replacing employee with employer contributions – this can either be without strings attached or as part of a 'salary sacrifice' agreement (which bring tax advantages).

Employers, the pensions industry, unions and non-profit campaigns are already seeking to support more employers to go beyond the minimum. Areas for further action include:

- **Accreditation:** An accreditation scheme for good pensions with above-minimum employer contributions already exists (the Pension Quality Mark). The development of the forthcoming Living Pension standard, linked to the Living Wage campaign, offers an opportunity to significantly extend awareness and take-up of such kitemarks.

- **Bargaining:** Pensions are a significant feature in industrial relations, with trade unions prioritising good pension provision where collective bargaining exists. Stronger trade union rights and more collective bargaining will help workers to negotiate for better pensions. In fragmented and low-paying occupations sectoral bargaining could also make a big difference. This can be achieved through new sector-specific 'fair pay agreements' which are currently being introduced in New Zealand and have been proposed for the UK by the Fabian Society.[62]

- **Procurement:** public bodies and large businesses should use the power of procurement to improve pension provision within their supply chains. This will be possible with the Living Pension, which like the Living Wage will apply to contractors as well as employees. For large and profitable companies, promoting good pensions across supply chains could be included within investors' ESG considerations. Public bodies should also have minimum standards: at present outsourcing usually results in workers having far worse pensions than public sector employees.

- **Communication to employers:** official communications to employers should do more to promote beyond-minimum employer contributions. This could start with the way auto-enrolment requirements are explained (eg the tax advantages of beyond-minimum employer contributions). Official communications could also signpost to voluntary pension accreditation standards.

The self-employed

Auto-enrolment has been a huge success among private sector employees, but pension saving by the self-employed has been going backwards. Urgent political action is needed to help millions of self-employed people secure a decent retirement.

Perhaps surprisingly, the first way to help the self-employed is to improve auto-enrolment for employees. This is because most self-employed workers will spend a significant period of their life as employees, many will also have a partner who is an employee and some will combine an employee job with self-employment. If the self-employed are 'undersaving' – from a lifetime, household perspective – it really matters that employees are not under-saving too.

> A new approach to pension saving is required for self-employed people who do not operate through a company

New arrangements are also needed for people who may consider themselves self-employed, but are treated as employees in tax law (see page 22). This applies to contracted 'workers' who should be auto-enrolled into a pension; and to people who work through a limited company if their relationship is deemed equivalent to employment. This latter group is responsible for their own pension arrangements, but ministers should consider whether there should be an expectation or requirement for the engaging employer to pay them an employer pension contribution. More generally, the government should promote to people who work through companies the considerable tax advantages available if they make pension contributions rather than take money immediately in wages or profits (incorporated self-employed workers can pay themselves employer pension contributions and benefit from generous associated tax relief).

Meanwhile a new approach to pension saving is needed for self-employed people who do not operate through a company. This has been acknowledged repeatedly over the last five years, but effective policy action has been ducked. The government's 2017 review of auto-enrolment promised trials and research but did not offer solutions. Since then there has been extensive debate and scoping, including assessments of whether services already used by self-employed people could prompt pension saving (eg banking, accounting, electronic payments, fintech apps). None of these avenues appears particularly promising. The only touchpoint which can reach almost all self-employed people is the tax system. A future government should therefore introduce a new self-employment pension framework based on the infrastructure of HM Revenue and Customs.

A major opportunity is approaching to build pension saving into the architecture of tax collection. In the next few years annual tax self-assessment for the self-employed will be replaced by digital tax reporting (called 'making tax digital') which must take place at least quarterly through online accounting platforms. All self-employed people with earnings over £10,000 will be required to take part by April 2024. From this date the self-employed could be asked to make regular pension contributions alongside their tax reporting. The amount collected would automatically rise and fall with people's reported earnings, to accommodate the volatile nature of self-employment income for many people.

As things stand, while it would be theoretically possible for government to request a pension payment alongside an annual tax self-assessment, the timing is very poor: few people can easily make a big annual pension contribution just at the moment they receive their tax bill for the year. But once regular digital reporting is embedded, politicians should task HMRC to establish a linked pension facility for everyone who pays income tax on self-employed earnings over £10,000. This earnings threshold could be reduced once the scheme is established, depending on wider decisions about requirements for digital tax reporting. A lower threshold would draw more people in who might struggle with digital reporting, but it could particularly assist those with a mix of employee and self-employment earnings.

A new self-employment pension offer will need to meet the following requirements to succeed:

1. **Compulsory pension accounts and opt-out contributions**
2. **Product design to meet the needs of the self-employed**
3. **Financial incentives to encourage and reward saving.**

Requirement 1: Compulsory pension accounts and opt-out contributions: policymakers are already exploring nudges within tax reporting that encourage self-employed people to make pension contributions as they calculate or pay their tax. But mere communication prompts are very unlikely to achieve the degree of behaviour change required. A future government therefore needs to design an opt-out system for self-employed pension saving.

To establish high coverage all self-employed workers should have a nominated pension fund linked to their tax records. People with an existing pension could have it digitally linked to their tax account, with a handful of clicks, using technology currently being developed for pensions dashboards. Those with no previous fund would either need to open a new pension of their choice, as part of a tax reporting transaction, or permit HMRC to randomly assign them a pension from a panel of providers that had met specified standards. Following this one-off transaction, HMRC would then be authorised to seamlessly collect pension contributions alongside tax and forward payments to people's nominated funds. The self-employed would make one payment to HMRC.

The pension contributions themselves would be opt-out, as with auto-enrolment: the default would be for 5 per cent of gross self-employment profits to be deducted but people would be able to refuse to make contributions on each reporting occasion. In designing the system policy makers would need to consider how difficult it should be to say no. The intensity of the default could range from: (1) allowing people to delete a contribution from a pre-populated online form; (2) creating a complex online pathway before allowing people to opt-out; (3) requiring people to make an automated phone call to opt-out; through to (4) mandating payment upfront but then giving people the option to reclaim the money later (and give up the tax relief already accrued).

Just because someone does not get an employer contribution, why should their pension also miss out on the associated tax relief?

Requirement 2: A product designed to meet the needs of the self-employed: self-employed people face significant financial risks and see ebbs and flows in their income. Those in a position to put money aside therefore tend to rely on short-term saving, or on longer term investments that can be quickly liquidated (eg ISAs, buy-to-let properties). By contrast a pension can only be accessed at 55 (rising to 57 soon). To meet the needs of self-employed people and deliver high participation, there is a strong case for any new state-facilitated saving scheme being a hybrid product and including an element that can be accessed quickly as well as a pension.

The first few thousand pounds of people's saving, or a fixed proportion of the total fund, could be set aside for instant-access saving (like the proposed 'sidecar' savings for low-earning employees – see page 24). There would be complexities to work through. Different investment strategies would be required for the two types of saving, with the instant access portion being held in cash or very safe investments. The government would also need to consider the tax position of the accounts – should the short-term saving element be supported by tax relief and social security? And if people need to access more than the money in the short-term pot, should the tax penalty for early access to the pension portion be lower than for a standard employee pension? Detailed consultation and research would be needed to design the parameters for these approved hybrid products.

Requirement 3: Better financial incentives to encourage and reward saving: self-employed savers already benefit from income tax relief on pension contributions. This should be clearly communicated within a future opt-out pension system, so people always know how much tax they will save when they make a pension contribution. But there is also a strong case for increasing the amount of government financial support available to people taxed as self-employed, because they do not receive employer contributions or the tax and national insurance relief associated with them. At present, self-employed workers with earnings below the upper rate of income tax have much worse incentives to save into a pension than comparable employees. In fact, it is more financially advantageous for them to save into a Lifetime ISA than a pension, if they are eligible for the former.

As a solution, politicians should consider paying the self-employed a government pension contribution that is broadly equivalent in value to the tax relief on employer contributions. After all, just because someone does not get an employer contribution, why should their pension also miss out on the associated tax relief? A scheme along these lines would hugely increase government support for their pensions. If auto-enrolment contributions for employees rise to 12 per cent of total earnings, we have seen that the value of their tax relief will rise to 4.4p per pound of earnings (see figure 2 on page 23). By contrast, a self-employed worker contributing 5 per cent of their earnings would receive in tax relief just 1p for each pound of earnings.

The solution to this disparity is to introduce a **3p self-employment pension bonus**. Provided the self-employed worker made a pension contribution of at least 5 per cent of their earnings, the government would make a matching contribution worth 3 per cent of all their earnings up to the upper rate tax threshold. This bonus would be available to people

GOVERNMENT PENSION CONTRIBUTIONS AND NATIONAL INSURANCE FOR THE SELF EMPLOYED

Self-employed people pay 3p for each pound of earnings less in national insurance than employees. This is despite their entitlements to national insurance benefits being almost identical (following the introduction of the new state pension in 2016). There is a strong equity argument for equalising contribution rates by adding 3p in the pound for self-employed workers. This policy was announced by former chancellor Philip Hammond in 2017 but was cancelled following a political backlash.

This chapter shows there is also an equity argument for increasing government support for self-employed workers' pension contributions. A neat solution would be to equalise national insurance rates but also give self-employed workers the right to claim 3p in the pound as a self-employment pension bonus (i.e. a government contribution roughly equivalent to the amount of tax relief available to employees and company directors via employer pension contributions). By raising NICs at the point the 3p pension bonus was introduced, the government would create a strong 'use it or lose it' nudge for self-employed workers to sign up.

Self-employed people who paid pension contributions would end up better off – because the extra national insurance contribution would be charged only on the portion of earnings above £12,570 but the government match contribution would be paid from the first pound of earnings. The 3p rise in NICs would raise around £1bn according to HMRC.[64] It is not possible to say whether the two policies would exactly cancel each other out, because this would be dependent on the degree of take-up of the pension bonus which is highly uncertain – but the costs and savings of the two policies are of the same order of magnitude.

with self-employment earnings below £10,000 but they would have to claim it through an annual tax return (they would not be automatically opted in to the scheme as they would not be covered by regular digital tax reporting).

As well as levelling the playing field with employees this proposal also has the advantage of making similar tax relief available for self-employed people whether or not they work through a limited company. It could be introduced in the context of a rise in national insurance for the self-employed (see box) but this is not an essential feature of the scheme: in terms of fairness for the self-employed there is a case for a pension bonus with or without wider tax changes.

The cost of this proposed bonus would be an estimated £1.1bn per year in 2019/20 (it is less now because the pandemic reduced self-employment participation and earnings).[63] This is based on the government making a 3p matching contribution for every pound of self-employment earnings up to the upper tax threshold with a 60 per cent take-up rate. If the proposal was introduced in the context of a rise in national insurance for the self-employed this would largely cover the costs (see box).

Pension saving and gender equality

All proposals for improving pension saving need to be scrutinised from the lens of gender equality (and also take on board other equality and diversity considerations). Chapter 2 discussed some of the issues relating to decumulation – how women are disadvantaged by the lack of life expectancy protection in the new decollectivised approach to drawing down a pension; and by the absence of consideration for survivor benefits in the large majority of products bought using DC pension pots.

But most of the problems relate to the process of pension saving, which leave women with much smaller pension pots at the point of retirement. Women already have lower lifetime earnings, but the way workplace pensions treat low-paid work widens the gender pensions gap further. Women are more likely than men to have jobs earning under £10,000 per year, and therefore to not be auto-enrolled into a pension. They are also more likely to have earnings a little above this line and so to be saving too little, as a result of the lower earnings threshold excluding a high share of their pay from pension contributions. The proposals in this chapter to support low earners to save more are therefore essential for gender equality.

Another issue affecting low earners is a tax loophole which has seen people in some DC pensions miss out on tax relief if they earn less than the income tax personal allowance (i.e. £12,570 in 2022/23). This anomaly deprives 1.2 million low earners (three quarters of them women) of an average of £53 per year. The government has promised to pay people what they are missing out on, but only from the 2025/26 financial year onwards and using a new claim process which is unlikely to have full take-up.[65]

Women are also missing out on pension contributions for taking time off to care. During **maternity, paternity and parental leave** employees receive some protection, as employer pension contributions continue for as long as paid leave does. But these contributions are not payable after paid statutory or contractual leave expires (often after nine months of maternity or parental leave). As a first step, the law should change so that employees receive these contributions for as long as they are on maternity or parental leave.

When maternity, paternity or parental leave pay is below someone's normal pay, or stops altogether, their employee pension contribution declines in parallel. This reflects parents' ability to pay, but it results in pension saving declining and the loss of valuable tax relief. Politicians should explore options for the government to pay an element of employee pension contributions during maternity and parental leave. For example, people could receive employee contributions up to value of those paid for a full-time job on the national living wage – which would be worth up to £500 for 12 months leave.[66]

A similar approach should be considered for recipients of maternity allowance, a benefit paid to mothers not eligible for SMP, such as women who are self-employed or have recently left a job or started with a new employer. Where maternity allowance is in payment and mothers do not have an employer they should be able to claim credits from the government to allocate to a pension.

Beyond maternity leave, there is a wider case for paying pension contributions to people who aren't working or are working limited hours because they are **caring for children, disabled people**

or older people. The Pensions Policy Institute modelled a version of this policy that would pay pension contributions at the level available to someone working full-time on the national living wage (£820 per year in 2019). Coverage included everyone looking after children or caring for an adult with either no earnings or earnings below the full-time national living wage (over 2 million people). This policy and the proposal for maternity leave contributions described above were jointly costed at between £1.3bn and £1.8bn per year in 2019. They would increase the eventual value of the DC pots of people who take time out to care by between 20 per cent and 50 per cent, depending on their circumstances.[67]

To start off, much cheaper versions of these policies could also be considered. For example, coverage could be narrowed to parents with children aged under three or five, and to working-age carers receiving carer's allowance or the carer's element of universal credit. The government could also consider a lower value of pension contribution. For example, a new credit might match the pension tax relief the government provides to a full-time worker on the national living wage, even if it did not pay the whole contribution. As with the case of self-employment, the logic would be that people should not miss out on a tax break, just because they are not benefiting from employment-related pension contributions.

The final way women miss out on pension saving is through **divorce or separation**. Industry research has found that 71 per cent of divorcing couples do not consider splitting their pension assets during divorce proceedings. This contributes to especially bad pension outcomes for divorced women. The Pensions Policy Institute found that divorced women have median pension assets worth only half as much as for women in general.[68] There is widespread support for introducing reforms to divorce proceedings to make splitting pension funds the default – including better guidance and training for practitioners.

A more intractable issue is support for women who separate who have not been in marriages or civil partnerships. As things stand it is unusual for separating couples to have any rights to their partners' pension assets. In parliament, a private member's bill proposing cohabitee rights on separation was introduced in 2020 but there is little chance of such a law being passed at present.[69] **F**

4. Help from tax and social security

Tax and social security rules make a huge difference to whether people see pension saving as worthwhile and affordable – and to what level of income they can secure for retirement. Tax relief and social security have already been discussed a number of times in this report, when discussing specific groups such as the self-employed. This chapter goes further and explores whether there is a case for more fundamental changes to the tax and social security rules that affect private pensions.

When it comes to private pensions, the aim of the tax/benefit system should be to create good incentives for saving, support people to achieve adequate outcomes, and enable them to smooth their lifetime income and consumption. The system should be as simple and coherent as possible, and it should be fair. This means that resources should be targeted to where they are needed most, and that people in similar circumstances should receive similar levels of support.

We deliberately consider tax and social security alongside each other, as from a fiscal perspective they are equivalent. For example, the last chapter looked at the case for new credits for the self-employed and for carers that would replicate the existing help employees get through tax relief. Official statisticians would be likely to classify these credits as public expenditure, rather than foregone taxation. But they are no different to tax relief from a fiscal or economic perspective.

Social security

Rules for **means-tested working-age social security** have recently been improved to increase financial incentives for pension saving. The means test for universal credit is based on people's earnings after employee pension contributions (under previous benefits only half the value of employee pension contributions were included in the means test). This arrangement means that for every pound deducted people now receive more than half back through higher benefits. Taking employer contributions and income tax relief into account too, low-income households lose only around two pounds in net income for every 8 pounds saved into their pension pots under current auto-enrolment rules.

This extremely advantageous situation is barely discussed even by pension experts – and almost nothing has been done to promote it to low earners. The DWP, advice agencies, employer bodies and the pension industry should actively promote these financial benefits to universal credit recipients and their employers.

There is a case for applying the same rule to payroll saving (see page 24). This would be a well-targeted and automatic way of rewarding saving by low-income households. The policy would build on Help to Save, the government's current scheme for low-income savers. This provides a 50p match to every pound saved for four years. 200,000 households are making deposits each month, which counts as a quiet success story (the total number of eligible households is around 3 million).[70] Each deposit is very low so the cost of the government's match payments is modest (deposits made in 2021/22 will cost the government a maximum of £55m).

When it comes to **accessing private pensions before state pension age**, the design of working-age social security is much less satisfactory. With the rise of the pension age to 66 (increasing to 67 in 2028) more people are stopping working before pension age. When this happens, early access to a pension makes sense from the perspective of smoothing lifetime consumption. This is especially true because working-age social security provides much less than the state pension – and than the amount the public considers to be a reasonable minimum living standard.

Given the financial pressures on people out of work before pension age, politicians should revise universal credit rules for people aged 60 and above. First, pension income taken after 60 could be treated in the same way as earnings for the purposes of UC. This would mean that for each extra pound of net pension income, people would lose 55p not one pound in benefit income. Second, the more generous savings rules used for means-tested pension credit could be applied (see box).

A similar pension penalty exists with respect to two non-means-tested income replacement benefits, employment and support allowance and jobseeker's allowance. People who receive a private pension income of more than £85 a week have their benefit payment reduced by half of any amount over this level – despite these benefits being non-means-tested with respect to other sources of income such as non-pension savings or a partners' income. For the sake of consistency, future ministers should consider scrapping these rules too – or significantly raising the value at which they start to apply.

UNIVERSAL CREDIT AND DRAWING A PENSION

Working-age social security penalises people for accessing their pension. Under universal credit, if someone receive a private pension income the money is offset pound for pound against their benefits. This means there is no point in drawing a pension as a regular income if this does not lift you out of eligibility for universal credit.

People who access a pension as a lump sum can also be disadvantaged because universal credit penalises savers for holding non-pension financial assets of over £6,000. It you have any savings above this amount you lose £1 per week in benefits for every £250 you hold; and above £16,000 of savings you lose entitlement to universal credit entirely. After state pension age the rules on savings are much more generous under pension credit: people can hold savings up to £10,000 before losing means-tested pension credit; they only lose £1 per week for every £500 they hold; and there is no upper limit that removes eligibility altogether.

The upshot of these complex rules is that if someone knows to take small lump-sums from time to time – without ever exceeding the £6,000 savings limit – they can use a pension to top up their social security income. But anyone who draws a regular income or takes a big lump sum will lose out.

The case for reform has become even stronger following a recent change, which sees low-income couples only move from universal credit to pension credit when the younger (not the older) partner reaches state pension age. This means that the older member of a couple receiving means-tested benefits has no incentive to access a private pension even after state pension age, until their partner also turns 66.

Housing benefit after state pension age. Social security for pensioners is designed as a platform for private saving. The new state pension slightly exceeds the value of means-tested pension credit, which means few new retirees need to rely on the latter. For homeowners this greatly reduces the risk of pension saving leading to reductions in means-tested benefit income – they can be confident that pension saving will always pay.

But things are less clear-cut for low-income tenants who need housing benefit in retirement. Under current rules, they lose 65p in housing benefit for every pound of private pension income they have. This is a clear disincentive to saving – and some people could end up receiving less in retirement than they paid in during working life (the 65p in the pound deduction in benefits is more than the 50p in the pound of pension saving that comes from employers and the government under current auto-enrolment rules).

This is a growing issue because there will be far more retired tenants in the future – and a growing number of them will have a modest private pension as a result of auto-enrolment. A future government must therefore take steps to ensure that pension saving pays for tenants. This can first be achieved by increasing auto-enrolment employer pension contributions (as proposed in chapter 3). Employers and government would then contribute two-thirds of the value of pension saving.

On top of this, housing benefit should be reformed in three ways:

- Payments should be deducted by 55p for each pound of private income, instead of 65p in the pound, mirroring how universal credit works for earnings. This change should ensure that it is always worth people saving into a workplace pension.
- Local housing allowance should be increased to match local rents (it used to cover the value of 30 per cent of private rents in each locality but its value is currently frozen in cash terms).
- Rules on the treatment of savings should match those found in pension credit (at present this happens if people also receive pension credit, but the new state pension means more people are claiming housing benefit only).

After these reforms the maximum rental support for private tenants would be greater, help would be withdrawn more gradually as incomes get higher, and people with savings over £16,000 would no longer be excluded (as they are now, if they are eligible for housing benefit but not pension credit). Together these changes would expand the number of people eligible for housing benefit, especially within the private rented sector, with more people with small private pensions able to receive partial housing benefit. This would be an important step given the rising numbers of retired private tenants expected in the next 10 to 20 years.

Tax relief

Most of the proposals in this report can be implemented without major changes to taxation rules. For the sake of simplicity and speed there is a case for doing just that – and working within the boundaries of current policies on tax – not least because attempts to reform pension tax relief have attracted controversy in the past.

However, the tax relief system we have today is confusing, incoherent, distributionally regressive and very expensive. For many years there has been a strong case for reform, and an incoming government should at least consider its options.

This is particularly true in the context of the proposals for extra financial support made in this report. Politicians are unlikely to want to increase the total level of subsidy for the pension system, since it is very high already (see box). They could instead seek to recycle resources, so that help for people who don't get enough now is funded by reducing tax relief for people who are not so obviously in need. For example spending £1bn on a self-employment pension bonus, or a similar amount helping carers, would become plausible if the money was recouped from within the pension system.

The minimum aim for reform would be to generate sufficient funds each year to pay for the policies proposed for the following groups:

- Low and middle earning employees (more tax relief arising from higher minimum employer contributions) – estimated at £4bn.[71]
- The self-employed (the proposed 3p self-employment pension credit, as well as the rising cost of existing tax relief as more people start to save) – estimated at £1bn, although this could be funded by a rise in national insurance for the self-employed.
- Parents and carers (the proposal for credits to be paid while people are out of work) – cost dependent on the generosity of the scheme (eg £500m to £1bn).
- People making short-term savings (new financial incentives for payroll saving).
- People out of work aged 60 to 65 (reforms to universal credit).
- Tenants in retirement (reforms to housing benefit).

Reforms for the last three groups have not been costed but would each be in a range from £50m to several hundred million pounds per year.

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Politicians are unlikely to want to increase the total level of subsidy for the pensions system, since it is already very high. They could instead seek to recycle resources

THE COST OF PENSION TAX RELIEF

Figure 3 presents the costs of pension tax relief in 2019/20. It shows that tax reliefs on pension saving were worth an extraordinary £42bn more than the tax collected on private pensions in payment. The lion's share of this relief was for employer contributions.

Figure 3: the cost of pension tax relief, HMRC estimates, 2019/20

Employee contributions – income tax	£7,200m
Self-employed contributions – income tax	£200m
Employer contributions – income tax	£26,600m
Employer contributions – employee NICs	£6,800m
Employer contributions – employer NICs	£12,900m
Tax exemption on investment income	£7,300m
Gross cost of tax reliefs	**£61,000m**
Less income tax paid on private pensions	-£19,200m
Net cost of tax reliefs	**£41,800m**

The distribution of this tax relief is extremely regressive. Figure 4 presents a Fabian Society estimate based on HMRC data which shows that at least 51 per cent of tax relief goes to support the pension saving of people earning enough to be paying the upper rate or additional rate of income tax (ie with incomes in excess of around £50,000). There are only 4 million employees in this category, out of a total of almost 28 million employees in total (20m employees are basic rate taxpayers, and 3.7m do not earn enough to pay income tax).[72] This skew also means that more tax relief is enjoyed by men than women (both in cash terms and as a percentage of their pension contributions). There has only been a modest increase in the share of tax relief received by basic rate taxpayers following the introduction of auto-enrolment (rising from an estimated 44 per cent in 2016/17 to 49 per cent in 2019/20).

Figure 4: The allocation of pension tax relief between basic rate and higher/additional rate taxpayers, 2019/20

	Basic rate	Higher or additional rates	Total
Employee/self-employed contributions – income tax	£3,700m	£3,700m	£7,400m
Employer contributions – income tax	£10,000m	£16,700m	£26,600m
Employer contributions – employee NICs	£5,900m	£900m	£6,800m
Employer contributions – employer NICs	£6,600m*	£6,300m*	£12,900m
Total	**£26,200m***	**£27,600m***	**£53,700m**

* Fabian Society estimate. HMRC does not publish an estimate for the allocation of employer NICs on employer contributions. This Fabian Society calculation uses HMRC data for the distribution of gross employment income between basic, higher and additional rate tax payers. It under-reports the share of employer NIC tax relief benefiting higher/additional taxpayers, because it assumes that employer contributions are a constant percentage of employee earnings across the income distribution (whereas average employer contributions are actually more generous for high earners than low earners).

This money can not all be easily reallocated. £19bn is spent on public sector pension schemes (out of £53bn on public and private schemes together). If this money was withdrawn the exchequer would have to either compensate public employers in other ways or reduce the generosity of pensions. A further £11bn of tax relief goes to private sector DB schemes (with a share of this linked to pension scheme deficit payments). Major changes to the tax treatment of DB schemes might trigger the few remaining private sector schemes to close (there would also be significant administrative complexities in changing the tax treatment of employer DB contributions).

Debate about better use of tax reliefs therefore primarily focuses on the right form of support for the growing DC sector. In 2019/20 DC pensions only accounted for £23.5bn of total tax relief – however this value is rising quickly each year (rising by 61 per cent between 2016/17 and 2019/20). Meanwhile tax relief for private DB pensions is steadily declining as the number of active members fall (a decline by 17 per cent over the same period).[73]

Before exploring options for pension tax reform, it is important to review the rationale for tax relief. The original purpose for pension tax relief was to prevent 'double taxation' – ie paying tax both when you originally earn an income and again when you take it as a pension. To avoid this problem the UK system has traditionally worked on the basis that pension contributions are not taxed when they are made, because they will be when they are taken as a pension.

Other reasons for tax relief have since accumulated. First, it can help to ensure pensions adequacy: as we've seen there are lots of people who will struggle to achieve an acceptable income in retirement, and government contributions are an important way of plugging the gap. Second, tax relief creates the right incentives. It rewards delayed gratification over immediate consumption, and it ensures that saving pays (as just discussed, this is particularly important in the case of people who may be eligible for means-tested benefits).

Balanced against these considerations, there is the case against tax reliefs: (1) an effective tax system should be as simple as possible with minimal exemptions and loopholes; (2) the tax system should maximise public revenue, bearing in mind that every pound foregone translates into a pound less of public spending; and (3) in practice almost all tax reliefs tend to favour high income groups the most.

When it comes to pension tax relief, defenders of the status quo often start by raising the spectre of double taxation. But today's tax system is already highly flawed from this standpoint:

- **National insurance on employer contributions** – employer pension contributions are exempt from employer and employee national insurance but NICs are not then charged on pensions in payment. This means national insurance on employer contributions is never paid (figure 3 shows that the government passed up almost £20bn in NICs in 2019/20). This has distributional implications because high and middle earners typically receive larger employer contributions than low earners (as a percentage of earnings as well as in terms of cash).

- **Lower income tax rates in retirement** – high earners receive income tax relief at their marginal rate of tax for both employee and employer contributions. For example, people who pay upper rate income tax (currently charged on incomes over £50,271) receive tax relief worth 40 per cent of the value of contributions. However, most or all of their pension income will go on to be taxed at the basic rate. This is because a large proportion of high earners end up having pension incomes below the upper rate threshold – and even the small minority who will have enough to pay the upper rate in retirement will still pay basic rate tax on all their income up to this threshold. Since almost all pension income will be taxed at the basic rate, there is a strong case for applying the same rate of income tax relief to all pension contributions when they are made.

- **Tax-free lump sums** – people can take a quarter of their pension tax-free in one or more lump sums. This is a popular policy and may help incentivise saving, but it undermines the case for exempting pension contributions from upfront tax. It also creates a disincentive to convert pension pots into long-term incomes, and favours high income groups far more than those with less. HMRC last estimated the cost of the policy in the early-2010s, at £2.5bn per year.[74]

- **Low earners receive income tax relief but do not pay income tax** – one tax relief policy is designed to benefit people with low lifetime incomes. People earning less than the income tax personal allowance receive money from the government towards their pension, even though they don't earn enough to pay income tax, to ensure they don't miss out on a match payment. This rule only applies at present to one form of DC pension, but this will change in the coming years.

It is very hard to project the cumulative impacts of all these loopholes at the level of individuals. But their overall effect is clear: (1) almost everyone can expect to pay less in tax on their pension income during retirement than the amount of tax relief they receive during working life; and (2) high earners will usually benefit far more than low and middle earners, both in cash terms and as a percentage of the value of their pension.

The government attempts to cap the extent to which very high earners can exploit the system by applying annual and lifetime limits on tax-advantaged pension saving. But this is a sticking plaster applied on top of a system that is stacked in favour of high earners.

Tests for reform: There is a strong case for fundamental reform of pension tax reliefs. In progressing this agenda politicians should consider a series of tests:

- Do proposals for reform move the system closer to tax neutrality (ie neither double taxation nor zero taxation)?

- What level of financial top-up is needed to help secure acceptable retirement incomes for people in different circumstances?

- What financial incentives are needed to secure desirable behaviours by individuals and employers – and how can these be clearly communicated?

- What distributional allocation of tax relief between low, middle and high earners is appropriate – thinking about the value of tax relief in terms of cash and as a percentage of people's earnings?

- Do reforms come with administrative complexity and the risk of unintended consequences?

The answers to these questions come down to judgement, but a centre left politician might come to the following conclusions:

1. Overall the system should reward pension saving, rather than being neutral between spending and saving. Tax relief should be greater than the tax people will pay on their private pensions, both to top-up retirement incomes and to create positive incentives. But the value of tax relief should not exceed likely future revenues by as much as it does today: taxes on pensions in payment should rise and/or the total level of tax relief should fall.
2. Tax relief should be designed to incentivise and reward beneficial behaviours. This requires clear communication and a system that is simple to understand. The design of incentives should encourage individuals to (1) make pension contributions during working life and (2) convert their pension pot into an income for life. It should also encourage employers to provide more than the legal minimum in employer pension contributions.
3. Taxpayer support should be broadly proportionate to people's earnings (taking account of both employer and employee contributions) since the aim of pensions is to replace lifetime income. High earners should not benefit proportionately more than low and mid earners as they will not pay a significantly higher average tax rate once they retire (and men should not benefit proportionately more than women). This implies a fundamental shift away from today's system of tax relief linked to people's marginal rate of income tax.
4. Pension tax reform should encourage high quality pensions – and at least 'do no harm' to existing provision. If reforms risk seriously undermin-

ing existing pensions – especially DB schemes – they should not proceed, or exemptions should be created.

Politicians should consider a series of possible reforms to income tax, national insurance and the tax treatment of lump-sum payments (note, that significant reforms would require a revision to the detail of the proposals in chapter 3 for increasing pension contributions, which are predicated on the current tax system). In examining reforms, the first instinct should be to seek to apply the same rules to all pension schemes to retain consistency. However carve-outs should be considered for DB pensions, if the impact of any changes risks the financial sustainability of schemes or creates very high administrative burdens. Any such exemptions should only apply to schemes that are available on the same terms to all employees to prevent senior executives creating DB pensions only for themselves for tax-related reasons.

The reform options to examine are:

Income tax relief: Proposals to reform pension tax relief frequently focus on income tax rules on employee pension contributions. As we have seen this is only a small proportion of overall tax relief (see figure 4). The key proposal is to equalise the rate of income tax relief for people on all tax bands – for example at 30 per cent, midway between the 20p and 40p rates of tax. This rate would be broadly revenue neutral – so a lower rate could be set to generate rather than recycle revenue.[75] An even more progressive policy would be to introduce a higher match for the first slice of contributions into workplace schemes (eg £1,000 per year) and then a lower rate thereafter. This would however add to the administrative complexity of running pension schemes. For the sake of transparency, a new single rate of tax relief might be rebadged as a pension 'tax credit' or 'match payment' – with people promised, say, 40p of government money for each pound they save from net earnings.

However, if tax relief on employee contributions is reduced for high earners, many will make 'salary sacrifice' arrangements to receive the payments as employer contributions instead. To deal with this, any changes to income tax relief would have to be applied to both employee and employer contributions. In a significant change to the way income tax works, employer contributions would need to be treated as taxable income, and then the new single rate of income tax relief would apply to both employer and employee contributions. A modest increase to the upper rate tax threshold could also be made to reflect the expansion of the tax base. This proposal would be administratively straightforward for DC schemes but would be potentially complex for DB schemes, where the value of the employer contribution may not be individually apportioned. If there were serious difficulties, DB schemes could be exempted or given a long transition period.

National insurance: The distribution of tax relief is less skewed towards high earners for NICs than for income tax (because national insurance is not a progressive tax in the first place). From the perspective of progressivity, national insurance is therefore a lower priority for reform. However, from the perspective of 'lost' tax revenue, changes to national insurance reliefs are particularly important since NICs are not charged on income in retirement. This has become a more important issue over time, as politicians have gradually raised NICs while freezing income tax. The 2022 increase means that employee and employer NICs are now worth a combined 28 per cent of earnings on a band between £12,600 and £50,300 of annual pay. With this rise, the national insurance revenue foregone through pension tax relief will be even greater in future years than the amounts presented in figure 4. Options for saving some of this huge expense should be examined. However, any reforms need to ensure that employers still have good incentives to support pension saving. Politicians should consider the following options:

- **Reduce national insurance and raise other taxes:** the rising cost of national insurance relief is the result of rising NIC rates. The most obvious solution is to reduce these payroll taxes and raise other taxes, although this measure stretches well beyond pensions policy. The Fabian Society has previously proposed a 'tax swap' where NICs are cut and income tax increased by the same amount.

- **Charge national insurance on high pension incomes:** employee national insurance could be levied on pensions in payment. This would make up for NICs not having been paid on employer contributions in the past. This is the only policy that could address the historic under-taxation of today's pensioners and it would lead to today's affluent pensioners making a higher contribution to public services they rely on. The policy would be politically controversial but, as it would not apply to the state pension, only fairly affluent pensioners would be hit – ie those with private pensions over the threshold for paying NICs (currently £12,560 per year). It would collect limited amounts as a result.

- **Levy employee national insurance on employer contributions:** making this change would equalise the treatment of employer and employee contributions from the perspective of the individual (so there would no longer be a financial advantage in being paid one over the other). Some of the £6bn in revenue raised could be retained by the Treasury. But since basic rate taxpayers would be the main losers from the measure, a high share of the proceeds should be returned to people by setting the flat-rate pension tax credit (proposed above for income tax relief) at a higher level to account for national insurance as well. Again this could be presented as a transparent pension tax credit from the government of (say) 50p for each pound of net earnings contributed by either individual or employer.

- **Reform employer national insurance on employer contributions:** taxpayer support for employers making pension contributions should continue, to encourage them to pay more than minimum pension contributions. But politicians could consider introducing reforms to make the system cheaper and simpler and to reward only voluntary action. One option that would not require wholesale change would be to levy employer NICs on the element of employer pension contributions that constitute compulsory auto-enrolment payments (plus the equivalent share of contributions for high earners exempted from auto-enrolment). This would channel tax relief only at additional voluntary contributions. A more fundamental reform would be to levy employer NICs on all pension contributions but to create a cashback scheme for employers that would return a fixed percentage of their voluntary employer contributions, creating a simple, clear signal to reward good pension provision. This option would sit well with proposals from the Office of Tax Simplification to replace employer NICs with a simple payroll levy.

Tax-free lump-sum: the pension lump sum is a popular feature of the pension system but it is expensive and runs counter to the purpose of pension saving. To limit the benefits it brings, especially to high earners, a cap could be placed on the maximum amount of lump sum that can be taken by an individual. Policy makers could also consider charging national insurance on lump sums, if they were also introducing national insurance for pensions in payment. Either or both of these measures would create an incentive for people to take a higher share of their pension assets as a regular income. They would both be straightforward to administer within a single pension scheme, but there would be complexities in tax reporting when people had more than one pension (with the risk of people under-declaring tax or being hit with a large and unexpected bill). This is another reason to want to promote as much pension consolidation before retirement as possible (see page 17).

Recommendations

PILLAR ONE: An income for life

1. Reverse the direction of recent policy and develop a framework where pensions deliver incomes for life as the norm for most people.

Employer collective pensions

2. Challenge large employers who would have once operated defined benefit pensions to establish collective pensions using the CDC model – especially those with large numbers of low and middle earners.
3. Authorise and legislate for multi-employer CDC pensions – including sector-based pensions and 'master trust' schemes that would be available to all employers.
4. Encourage sector-based collective pensions in industries with large numbers of low and middle earning jobs – and especially in sectors like social care that are dependent on public funding.

Converting DC funds into whole-of-retirement pensions that include incomes for life

5. Introduce legislation to enable pension providers to offer CDC decumulation-only pensions if they wish to.
6. From the mid-2020s, require all DC providers to offer at least one whole-of-retirement pension plan that includes an inflation-related income for life (or to transfer customers to another provider that will). Providers should have flexibility to determine what products they wish to develop, with the expectation being they would offer hybrid investment/annuity products or CDC decumulation-only schemes rather than traditional annuities.
7. Develop a set of core features for whole-of-retirement products that can be accessed without guidance or advice. Following consultation these features might include: an income for life; inflation-related increases; an income for a surviving partner; a degree of flexibility in how money is accessed; designed to meet retirement needs rather than make bequests; the ability to change your mind. There should also be a requirement for providers to identify and act in the best interests of people with unusually low life expectancy.
8. From the late 2020s, require DC providers to steer most savers towards pensions that include an income for life, as the norm. To achieve this providers should be required to:

   - Offer a range of whole-of-retirement products for savers to choose from, with each offering an income for life; and promote the option of shopping-around so people can consider similar products from other providers.
   - Take steps to educate and engage savers, to support them to make active choices about which of these income for life options might best suit their needs.
   - For savers who do not actively engage, propose a default pension by making a semi-personalised recommendation on the basis of a limited set of information. Savers would need to provide this information and agree to the proposed product in order to access their money.
   - Ask a screening question to establish whether savers have very low life expectancy – with people

in this situation required to take guidance or advice on suitable products before being able to access their money.

9. Retain the pension 'freedoms' by creating the right to opt out from a pension that includes an income for life, but only after taking guidance or advice (an exception could be made for very small and very large pots, and for people who also have a defined benefit pension). Also consider cooling-off periods and health warnings for people who decline whole-of-retirement products, and create future opportunities for savers to switch back to these products.
10. Create robust regulatory and governance requirements for providers offering whole-of-retirement pensions – especially once people can be defaulted into proposed products without making an active choice. Keep costs under review and consider charge caps in the future.

Consolidation

11. Support the existing industry-led initiative which is aiming to enable pension providers to consolidate very small pots without savers' active consent.
12. Once consolidation for very small pots is operational, require providers to automatically consolidate small and medium sized DC pensions (unless savers opt-out) a few years before minimum pension age.

Pre-retirement

13. Raise the minimum age for drawing a private pension to 60 or 62 once state pension age reaches 67; and require all DC pension schemes to align each saver's planned retirement age to their state pension age (unless people actively opt out).
14. Revise pension communication requirements for people in their 50s to focus on saving more and working longer, rather than accessing pensions. Communications should make minimal reference to the minimum age for accessing pensions and focus on people's approach to their planned retirement age.
15. Require most people wishing to access their pension pot more than, say, 3 years prior to the state pension age to take guidance or advice first. People could still access their tax-free lump sum, as long as the rest of the fund remained invested in anticipation of being converted into a whole-of-retirement plan later on.
16. Refocus communications and guidance for people who want to access their money before state pension age, with an emphasis on helping people combine pension and social security income if they are forced to stop working before state pension age.

PILLAR TWO: Everyone saving enough

Retirement living standards

17. Establish two policy objectives for pension saving:

    - First priority – to achieve acceptable 'minimum' living standards for everyone.
    - Additional priority – to help middle and high earners achieve personally acceptable living standards (ie replace a large share of their previous earnings and/or achieve a 'moderate' or 'comfortable' standard of living).

The scope of auto-enrolment

18. Implement two measures promised in the 2017 auto-enrolment review:

    - Reduce the auto-enrolment age from 22 to 18.
    - Deduct pension contributions from the first pound of earnings by removing the lower earnings threshold. This will double the pension contributions received by someone earning £12,500 per year. The reform should be staged over at least 2 with the cost to low-earning employees offset by rises to the national living wage.

19. Widen the scope of auto-enrolment in other ways:

    - Increase the maximum auto-enrolment age from state pension age to 75.
    - Reduce the auto-enrolment earnings threshold from £10,000 to £4,000 per year per job.
    - Require auto-enrolment contributions on day one of employment, or soon after – by scrapping or revising the current three-month waiting period.
    - Clarify the legal definition of non-employee 'workers' (who are entitled to auto-enrolment pensions) and improve related communications and enforcement.
    - Review options for providing employer pension contributions to all contractors who are classed as employees under tax law.

20. Consider intensifying 're-enrolment' requirements – eg requiring employers to re-enrol employees every one or two years, or after every pay rise.

Increasing employer contributions

21. Following the elimination of the lower earnings threshold (recommendation 18), raise minimum pension deductions to 12 per cent of total earnings by increasing employer contributions from 3p to 7p of each pound of earnings. Alongside this change the government could consider a modest reduction in employer national insurance (possibly targeted at small businesses).

22. Announce a timetable for increases in contributions, but with scope for delays if the economy underperforms. The fastest possible timing could be:

April 2025	Halve lower earnings threshold
April 2026	Abolish lower earnings threshold
April 2027	4 per cent employer contribution
April 2028	5 per cent employer contribution
April 2029	6 per cent employer contribution
April 2030	7 per cent employer contribution

Extra employee saving

23. Scope the introduction of top-up employee saving, both for additional pension contributions and short-term saving:

- Extra deductions should be presented and operated separately from core auto-enrolment pensions. They could be compulsory for large employers and voluntary in smaller workplaces. Where they are in operation they should be opt-out for employees (so that people would contribute more by default but have the choice to 'opt-down' to the standard auto-enrolment level).
- Employees with above median wages or aged over 45 could be nudged into saving an extra 3 per cent of earnings into a pension; other workers could be channelled initially towards short-term saving.

24. Examine the operational and legal requirements for running opt-out payroll saving at scale (including hybrid pension/saving 'sidecar' products); also consider the case for government financial rewards for payroll saving (for example, by treating workplace saving the same as employee pension contributions under universal credit rules).

Employers going beyond the minimum

25. Encourage and support more employers to go beyond their minimum auto-enrolment responsibilities through the following channels:

- Accreditation – including support for the forthcoming Living Pension accreditation scheme
- Bargaining – strengthen collective bargaining at workplace and sector level.
- Procurement – minimum pension standards in the supply chains of public bodies and large companies.
- Official communications – promoting voluntary action as well as compliance when explaining auto-enrolment.

The self-employed

26. Task HMRC with establishing a new self-employment pension system for everyone who has annual self-employment earnings above £10,000, following the introducing of digital tax reporting in April 2024. This would apply to people who are taxed as self-employed (i.e. not contractors treated as employees for tax purposes, or people who work through a limited company). The new system should meet the following requirements:

- Compulsory pension accounts – require self-employed taxpayers to link their tax account to an existing pension or to open a new one as part of a tax transaction.
- Opt-out contributions – a default level of 5 per cent of gross self-employment earnings (to match employee requirements) with the ability to decline at each transaction.
- A tailored product – a hybrid product designed to meet the needs of the self-employed, with an element of short-term saving as well as a pension.

27. Introduce a self-employment pension bonus worth 3 per cent of self-employment earnings up to the higher rate tax threshold. This would be a match payment for people making at least the proposed 5 per cent default level of pension contribution. It would sit alongside existing income tax relief as an equivalent to the tax relief employees and company directors receive for employer pension contributions. The bonus could be implemented alongside a 3p increase in national insurance for the self-employed which would raise around the same amount as the £1.1bn cost of the scheme.

Pension saving and gender equality

28. Improve pension protection during maternity, paternity and parental leave by: requiring employers to pay full contributions during unpaid leave; and scoping out options for the government to pay a share of parents' employee pension contributions and to make a similar payment to recipients of maternity allowance.
29. Consider introducing a pension contribution for the carers of young children and older and disabled adults. Options include paying a government credit equal to the value of the contributions people receive when working full time on the national living wage.
30. Reform divorce proceedings to make pension sharing on separation the default, with better guidance and training for family law practitioners.

PILLAR THREE: Help from tax and social security

Social security

31. Promote the very strong financial incentives for universal credit recipients to save into a workplace pension in communications, guidance and advice targeting individual and employers.
32. Revise universal credit rules for people aged 60 and above to support people with a pension income: (1) pensions should be treated the same as earnings, rather than being clawed-back

pound-for-pound through lower benefit payments; (2) the savings rules used for pensioner benefits should be applied.

33. Also revise Employment and Support Allowance and Jobseeker's Allowance rules so that pension income is treated the same as earnings.
34. Housing benefit for pensioners should be reformed in three ways to help low-income retired tenants, and ensure that pension saving always pays:

    - Payments should be deducted by 55p for each pound of pension income, instead of 65p in the pound (mirroring how universal credit works for earnings).
    - Local housing allowance should be increased to match local rents (the allowance used to cover 30 per cent of private rents in each locality but its value is currently frozen in cash terms).
    - The treatment of savings should always be as generous as the arrangements in place under pension credit.

Tax relief

35. Consider major reform of tax relief alongside the other proposals in this report. Tax relief is confusing, incoherent, distributionally regressive and expensive, and reform could pay for all the proposals in this report with implications for the public finances. But tax reform is also complex and controversial, and change could distract and delay from other urgent priorities.
36. Explore reforms to income tax relief so that:

    - All workers benefit from the same flat rate of tax relief irrespective of their marginal rate of income tax.
    - Taxpayer support for pensions is presented as a tax credit or match payment to increase transparency and understanding (eg a government top-up to contributions made from net earnings).
    - Employer pension contributions become taxable but are eligible for the same government flat-rate tax credit (this reform is required to prevent distortion and exploitation).

37. Explore possible reforms to national insurance. There are a number of options which could be pursued:

    - Charge national insurance on high pension incomes in payment (targeting affluent people in retirement who have benefited from generous pension tax rules in the past).
    - Reduce individual and employer national insurance rates and raise other taxes instead.
    - Levy employee national insurance on employer contributions, and then compensate employees by adding to the proposed flat-rate pension tax credit. The total credit (covering income tax and national insurance relief) could be a 50p match for each pound of net earnings, whether contributed by individual or employer.
    - Reform employer national insurance on employer contributions. For example, the exemption for employer contributions from NICs could be replaced by a clearer cashback scheme that rewards employers only for making voluntary contributions beyond the auto-enrolment minimum.

38. Explore reforms to the treatment of the tax-free lump sum – eg a cash limit on the maximum payment where income tax is not paid, or charging national insurance on the lump sums. F

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