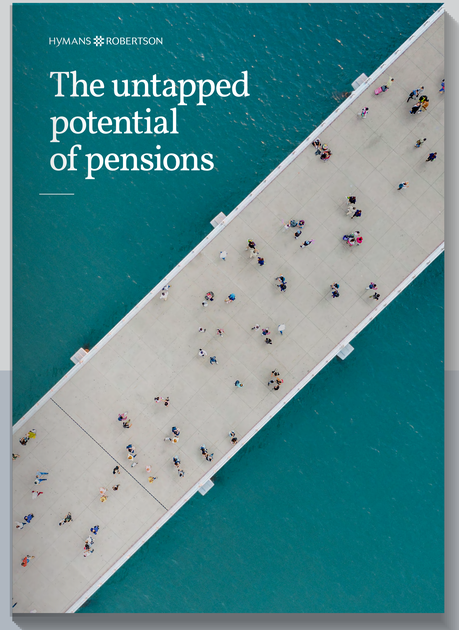
HYMANS ROBERTSON

The untapped potential of pensions



Policy team

If you'd like to discuss any of the ideas this paper explores please contact a member of the Policy Team.



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The untapped potential of pensions

The government is committed to changes in pensions. We're encouraged by how quickly the pensions and retirement landscape has changed since the last review ahead. The promised second phase presents an opportunity to make lasting changes to pensions, so they can give people financial independence in later life for as long as they live.

But it's also an opportunity to meet other important aims, which might seem unrelated at first glance. These include improving equality, unlocking billions of pounds and investing in economic growth all at huge scale.

People expect the government to set adequate default rates for pension saving. And they want the government's support in getting people saving into pensions, but the current default rates aren't enough to give people adequate retirements.

The industry knows this, but most savers don't. They set when Pensions Dashboards launch, laying bare the inadequacy of many pots. Before this parliamentary term ends. The government needs a plan to get people on the path to adequate retirements.

The Resolution Foundation's Intergenerational Commission has argued that pensions are the most significant intergenerational issue of our time. Its recent work estimates that many future pensioners will be materially worse off than previous generations. Now that many people are living longer, this is a huge issue.

The Commission has also argued that pensions are a key part of the solution to the UK's productivity challenge. Its recent work estimates that the UK could add £40 billion a year to the economy by 2030 if it could increase the amount invested in productive assets by 2 percentage points of GDP.

Pensions are the UK's largest pool of long-term capital. They can help to fund the infrastructure and innovation that will drive growth in the future economy.

Pensions can also help to address the UK's regional inequalities. Research by the Centre for Cities has found that the UK's largest regional cities have the highest concentrations of DC pension assets relative to the size of their economies. Pensions can help to unlock investment in these cities, which can in turn help to drive economic growth.

A big change requires lots of work, and this would be a big job for the pensions industry. But it's also a huge opportunity to also help us, as a country, to help current and future generations of workers, and the economy.

What we could achieve

In addition to more adequate pensions for all workers...

The Treasury would get **£28.5bn** a year

- £22bn from tax changes
- £3bn from DB surpluses
- £3.5bn from reforms to the state pension
- £0.5bn from collective pension saving and investment charges

To invest in

- £30.5bn national wealth fund
- £5bn pension for [illegible] workers
- £5bn pension income
- £5bn auto-enrolment increases

Employers would get **£14.2bn** a year

- £7.2bn from offering collective pension schemes
- £7bn from DB pension surpluses

Employees would get **50%+** more

- Deposit-free mortgages for [illegible] pension purchases
- Financial resilience through a national savings vehicle

Industry ideas to match the government's ambitions

Last year, we published a paper to plot the key steps needed to make the government's ambitions for ongoing and billions in pensions, we've developed our ideas to help it reach those ambitions. We see pensions as a key part of the government's plans to grow the economy, fix the pubic finances, the economy and future generations.

Our package of proposals comes in two parts.

The first part is lowering people's taxes to save money, the second, proposals for where to invest it.

Cash is a powerful tool for increasing pension contributions. Just for the contributions themselves and the employers and the Treasury. On the form of a tax exempt tax relief. We tried to propose it as a way of increasing money, which, once in effect, would pay for itself in the next decade.

- Two changes on pensions tax
- Collective pension saving
- Using pensions surplus for UK investment
- Sustainable state pensions

We then propose to direct big flows and big to the Treasury in three areas.

- Investment where it's needed
- Enhancing auto-enrolment
- Including [illegible] workers in pensions

Tax changes on pensions

Changing the way pensions are taxed can give the government £22bn extra by lowest to UK growth every year. It can do that in two ways.

We propose changing the tax arrangements on pensions so that they're the same for everyone. Currently, the pensions we get the same tax relief as the government's top rate. This is unfair. So the Treasury to cover and it does future contributions tax relief at the basic rate of income tax for everyone.

Currently, the government provides tax relief on pension contributions at an incentive to save. It gives the most to those who pay the most in tax people retire, as much wasted as before income is taxed when it's paid to the pensions.

We propose giving a flat rate relief on pension contributions. Instead, the government would pay a simple and transparent top-up to boost the saver's pension. Any basic rate taxpayer would receive 25p for every £75 they put in.

This higher pension would be more focused on short-distance retirees despite from saving for retirement. It would also help to reduce the gap in pensions between men and women.

Implementation could take years alongside a gradual rise in the state pension age. A good case for change is the Pensions and Income Savings Association (PICIA) proposal to move to a single rate of tax relief for pensions. It uses PSA calculations. The scheme proposes to succeed 80% of the minimum standard. Under the PICIA, it would rise to 100% of the minimum standard. The PICIA also proposes that the government would pay the top-up pension minimum standard.

It's also critical for the government to maintain, and ideally increase, the amount of money that individuals are able to save in pensions. Any reduction in the annual allowance would be a tax on future growth.

Employers would also receive an employer contribution. Including [illegible] for £22bn in revenue.

Tax changes on pensions



Colleen Cooper
Head of Pensions Policy and Advocacy



Hannu Rissa
UK Actuarial Consulting

Our proposal

Change the way pensions tax relief is given and collect billions in extra revenues for the Treasury.



One of the biggest barriers to change in pensions policy is cash flow to the Treasury. We propose changing the tax arrangements on pensions in a way that's cost neutral for the Treasury in the short term, but which would start to give the money to the Treasury sooner. The cash flow UK investment, economic growth and higher pensions savings.

Changing the way pensions are taxed can give the government £22bn extra by lowest to UK growth every year. It can do that in two ways.



How it would work

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Including [illegible] for £22bn in revenue.



Tax relief on pension contributions

By changing **when** tax relief is given, we estimate the government could bring forward £22bn in tax revenue each year (£15bn from income tax and £7bn from National Insurance contributions).

There are potential ways to implement the change to the tax system. Our examples show one way it could be done.

How it could work for a basic-rate taxpayer

Under the current system

Sam, a basic-rate taxpayer, earns £40,000 a year. He pays £4,000 into his pension. This is saved at 20%, namely £4,000 gross. The government gives Sam £1,000 in tax relief. This is the 20% of the £5,000 gross contribution.

Over the 35 years until retirement, Sam's pension savings grow at around 5% a year, on real terms. Sam's £4,000 contribution has become £23,000 in today's money.

When he retires, Sam's total retirement pot is **£1,150,000**.

Under our proposal

Sam's pension contributions are saved tax-income where they are into the pension.

Sam, in effect, contributes **£3,000** of his salary to his pension. This is saved at 25%, namely **£3,000** to go into his pension. The government pays the other **£1,000** in tax relief. This is the 25% of the £4,000 gross contribution.

Over the 35 years until retirement, Sam's pension savings grow at around 5% a year, on real terms. Sam's £3,000 contribution has become £17,250 in today's money.

When he retires, Sam's total retirement pot is **£862,500**.

Under this scenario, Sam's pension is 25% worse off at retirement than under the recommended proposal.

Higher and additional rate taxpayers would, in effect, receive the same tax relief as under the current system. Someone in an £11,000 contribution. Someone with £40,000 a year, would pay £7,000 of taxable income. Someone with £100,000 a year would pay £27,000 of taxable income. Introducing a single 25% rate would increase the tax revenue £7.5% of the current tax relief for higher- and additional-rate taxpayers.

The total increase £15bn for the impact of moving to a single rate of tax relief for pensions. The total increase of £22bn can be split based on higher earners. If the government took 5% of higher earners, it could be up to a third.



What it would achieve

Over the long term, we estimate that the changes would be worth around £22bn a year to the Treasury. This is the 20% of the £110bn in pensions tax relief that's given each year.

The Treasury would get the money sooner. Currently, it gets the money when people retire. Our proposals would bring forward the money that's paid in tax relief.

The government currently spends £40bn on benefits for people in pension contributions. It'll be £45bn in higher- and additional-rate taxpayers, and £5bn basic-rate taxpayers.



Part 1: How to make savings?

How it would achieve

Because future pensions would be tax-free, planning for retirement would also be simpler and fairer. And government "top-up" to make ceilings and straightforward than tax relief, which is complex and confusing for millions of their retirement savings.

This would have a meaningful impact on savings, so getting the implementation right is crucial. Fully implementing tax reform could take much more than five years. But the government could borrow against the revenue. It could then use the money to invest in the UK over the next decade.

We've drawn this work into two considerations. We could lower the government's current retirement saving and get out of our way to a 25% in national wealth fund. Hopefully it's more the money is invested in the UK in the next decade.

Using pensions surplus for UK investment



Tachbir Patel
Head of Corporate DB

Our proposal

Commit to a set date of surplus capture and—with the trustees' consent—give a portion to pensioners as discretionary increases.



UK DB pensions schemes hold an estimated **£400bn** surplus. Ministers have said they want to unlock some of this to help boost growth, unlock assets over the next decade could unlock **more than £100bn** in growth assets and billions more in tax revenues. Pensions Minister Laura Trott MP has said that it is time to release these surpluses.

Legislation and pensions scheme rules often mean this surplus—called 'trapped surplus'—can't be released. Changing rules to unlock this is a genuine opportunity. In his Mais Lecture, Chancellor Jeremy Hunt MP said that he is looking at making it possible to release surpluses.

We've got very low growth, with banks £2tn in schemes. Ministers MP and Rachel Reeves MP have said that they're looking at how pensions can help to the UK's economic growth. The government should look 100% of the pensions of pensioners, Now that many schemes are in surplus, it's the right time to do this.

The government should look 100% to focus on improving rules in the more immediate, through refinancing pensions or regulatory framework. This change in [illegible] Scheme Funding Code of Practice and the Pensions Regulator's DB Funding Code.

It should make many schemes in stress difference: the regulator 2022 scheme into the UK account for nearly 20% of assets.



Part 1: How to make savings?

How it would work

The DB pensions scheme has the surplus for other uses, the government must fill legislative and regulatory changes. The Pensions Regulator's DB Funding Code includes a 'backstop scenario'—a view that would give employers and pension schemes to allows flexibility to distribute surplus funds.

As well as removing the obstacles, the government could encourage DB schemes to release surplus funds. The Treasury has incentives for DC saving schemes with other workplace pension schemes, or tax relief for investment in UK productive assets.

Any changes must contribute to mitigate existing member benefits, so they shouldn't conflict with the Secure Pensions Act 2021. Trustees have a duty to act in the best interests of their beneficiaries. The Pensions Act 2021 and its responsible rule-making where the Pensions Regulator's DB Funding Code. It sets out how trustees and sponsoring employers can take risk-informed decisions on solvency.

Today's definition should be available to schemes that meet the funding requirements. TPR's DB funding code. The Pensions Regulator's DB Funding Code. It sets out how responsible surplus distribution and growth investment strategies.

Even consider reallocation of capital-bond economic growth wide-marketing pension security. Trustees and sponsors can't be forced to do so. Legislation and DC scale-investment as a potential finance could unlock hundreds of billions of pounds.

A further step could be to increase. The member risk appetite by using part of the PPF's £8bn surplus. For example, a scheme that enters PPF could have a guarantee of no reduction to its members' pensions at point of entry.

What it would achieve

Once the schemes are secured, each government scheme would be freed to use the surplus as they wish. Some may choose to invest in productive assets in the UK. This includes a 'lasting a member'—a view that would give employers and pension schemes to allows flexibility to distribute surplus funds.

Diversification may expand as income some of the surplus to DC schemes. Some may choose to pay it to the Treasury as income tax. Others may choose to pay it to employers as corporation tax.

Accessing surpluses gives DB schemes an opportunity to improve member benefits. Many schemes have closed to accrual and invest money from assets invested in DC pensions to buy adequate DC pensions, and improve DB benefits where they haven't been up with inflation.

An indirect benefit could be to help keep DB alive. Many schemes have closed to accrual and have been struggled to see how to run on. Build up surplus.

Encouraging employers to invest surpluses in productive assets could unlock hundreds of billions of pounds for UK growth, with material amounts being available for use within the next decade. This could be a win-win-win for the Treasury, UK's budget, by maintaining long-term confidence in their UK gilts markets.

Tachbir Patel
Head of Corporate DB

Part 1: How to make savings?

A sustainable state pension



Emma Foster
UK Actuarial Consulting

Our proposal

Make the state pension sustainable for generations to come, by setting a target for how much the triple lock rises.

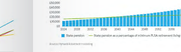


For years, to have good retirements, they need to have a decent state pension. The state pension is the foundation of a DC pension in the UK alone.

Pensions in the UK are lower relative to earnings than in many other developed countries. The UK's state pension replacement rate – a person's pension income as a percentage of their earnings – is around 35%. The OECD average is 63%. In the state pension and basic retirement is a potential pension to 54%, below the OECD average of 68%.

The Netherlands and Denmark provide similar flat-rate pensions to the UK's state pension. Both countries have pensions that are many countries. Not to the triple lock since 2010 C and this help the UK to catch up. The UK's pension is also unsustainable.

As a result of the triple lock, the state pension is now 94% of the UK's median earnings. It's projected to increase to average earnings in the 2040s. The difference is set to become bigger still.



Source: Government Actuary's Department, Fiscal Sustainability Report, July 2021

Many say that the triple lock should be reformed. Pensioners have seen average earnings. Governments sometimes have to make difficult decisions to keep the triple lock.

Source: Government Actuary's Department, public sector pensions UK: 2020 CMP, 19th April and 2016.

Part 1: How to make savings?

How it would work

The state pension in overall terms is its current form. In the review of the National Insurance Fund in April 2022, the Government Actuary's Department projected that the state pension would cost 6.1% of GDP in 2070. This includes a 'status quo scenario'—a view that would give employers and pension schemes to allows flexibility to distribute surplus funds.

It can only do so once the state pension has reached an adequate level. A good case for change is the Pensions and Income Savings Association (PICIA) proposal to move to a single rate of tax relief for pensions. It uses PSA calculations. The scheme proposes to succeed 80% of the minimum standard. Under the PICIA, it would rise to 100% of the minimum standard. The PICIA also proposes that the government would pay the top-up pension minimum standard.

Annual state pension over time, rising with triple lock

Annual state pension over time, rising with average earnings

What it would achieve

Over the long term, we estimate that the changes would be worth around £5bn a year to the Treasury. This is the 5% of the £110bn in pensions tax relief that's given each year.

The Treasury would get the money sooner. Currently, it gets the money when people retire. Our proposals would bring forward the money that's paid in tax relief.

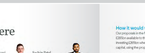
After 10 years, the state pension is around 27% above the current projections. Around 1.5 million people will be in state pension in 2070. Not that it would a rate higher than a saving an average of £5bn a year from 2070.

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Emma Foster
UK Actuarial Consulting

Part 1: How to make savings?

Investment where it's needed



Chris Arnold
Head of Investment Consulting

Tachbir Patel
Head of Corporate DB

Our proposal

Use the money saved from tax changes to invest in UK productive finance and growth.



Meaningful investment into the UK economy, especially productive finance, can help to boost growth and the UK's economic capacity. Pensions could play a much bigger role in these ambitions than currently envisaged.

The UK has a relatively small economy across the global financial scene, and the government's debt has increased to 100% of GDP. Despite the government's quantitative easing programmes, the UK domestic pension fund has not been able to fund enough investment in the UK. Actuarial projections for a target. Assumes that the UK's pension funds will be able to invest in productive finance.



In his Mais Lecture, Chancellor Jeremy Hunt MP said that he is looking at making it possible to release surpluses. In a recent report, the Chartered Institute Treasury Staff and Professionals (CITAPS) said that the UK needs to invest an extra £350bn a year over the next decade. The report looks at: capital markets and how they can be improved, the role of pensions and the investment to support energy, housing and water infrastructure.

The Pensions Minister, Laura Trott MP, has said that the government is open to the idea. In 2018, she said that she had no moral ground £20bn a year.

As Finance Bulletin in the 2020s Dr. Dave Blundell is a record of underinvestment by a little. Dr. will begin to see the benefits of investment. It's opportunities. For domestic, productive investment.

Part 2: How to overcome barriers?

How it would work

The government's role is to create the right conditions for investment. It should set out a long-term plan for productive finance, and ensure that the UK's regulatory framework is fit for purpose. The Financial Services and Markets Act 2023 will be the first piece of legislation to implement the government's plans.

Money is primarily invested in the UK economy, especially productive finance, can help to boost growth and the UK's economic capacity. Pensions could play a much bigger role in these ambitions than currently envisaged.

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The principles behind our thinking

Hymans Robertson is not just another pensions firm. We're a certified B Corp, so we really care about all stakeholders and sustainability. And we've been championing collective DB pensions for many years.

We've been the scheme actuary to Clara Pensions, the UK's first superfund, from its inception. We founded Club Vita, the UK's leading provider of longevity analytics. The Scotland Occupational Pensions Trust, which we chair, is focused on member outcomes and benefit adequacy. We've developed our technology and DC+ now underpins our master trust and is used by many other providers.

We've pioneered a lot of the things you're now seeing in the pensions industry and we're also a data- and technology-driven business. It's helped clients thrive for many years.

Our principles have been shaped by the 10 points below.

1. **Clear policy intent**
   We advocate for a government stance to ensure financial independence from the state and equality in later life.
2. **Aligned time horizons**
   As the long-term, collective pensions schemes open to new members will be key to the success of the pensions industry, closed DB and plans to be unchanging DC investment strategies and risk-growth.
3. **Affordability**
   Pensions must be affordable now and into the future for the government, employers and workers.
4. **Equity**
   Respecting differences and giving people what they need is key to an inclusive future.
5. **Sustainability across generations**
   Pensions must be sustainable for all stakeholders for the next generation in the spirit of a healthy social contract between people of all ages between generations.
6. **Adequate retirement security**
   Retired people need to have financial security.
7. **Personal resilience**
   Pensions should give access to emergency funds for their financial wellbeing. And the accuracy needs to be improved. Pensions should be having a diversity of pension design and investments, not a monoculture.
8. **Do right by all**
   Pensions must be good, on the all stakeholders terms where things are going and have time to adapt. The pensions sector must commit to a great ownership.
9. **Control and select go-to goals**
   We promote should boost stakeholders' financial needs, and government to utilities should be easy to see and appreciate.
10. **Holistic policies**
    We're mindful of the role private pensions play in the context of the wider personal and housing.

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Tapping the potential

Our package of proposals could improve pensions adequacy and retirement security while helping government finances and economic development. We've shown it's possible.

Our proposals are:

- Tax changes on pensions
- Collective pensions saving
- Using pensions surplus for UK investment
- Sustainable state pensions

...would get us access

£28.5bn a year

We can invest this money in productive finance, energy and water projects, as we've shown, and should include both employers and workers in pensions.

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