Association of British Insurers

ABI response to the Independent Review of the State Pension Age Interim Report

6 January 2017

About the ABI

The Association of British Insurers is the leading trade association for insurers and providers of long term savings. Our 250 members include most household names and specialist providers who contribute £12bn in taxes and manage investments of £1.6trillion.

Executive summary

The ABI very much welcomes this independent review and the approach taken to raise such a wide range of interlinking issues. It will be important that the resulting responses are refined to just a few key, clear recommendations.

It is clear from the analysis in the report that the SPA should not be considered in isolation from other aspects of the overall pensions picture. The State Pension is a foundation for saving, and SPA is an important aspect of planning for retirement. The ABI's direct interest in the SPA is in its interaction with private pensions and with income protection. We note that these financial products can help support fuller working lives and, by providing access to income depending on individual circumstances, can help mitigate the impact of the variations in life expectancy and healthy life expectancy. We also note that housing wealth and minimum pension age for private pensions should be borne in mind in considering the relative value of the State Pension and replacement rates.

Given that automatic enrolment is increasingly helping individuals to take responsibility for adequacy of income in retirement to suit their own needs and aspirations, a policy objective for the State Pension of providing a basis to protect most people from poverty appears appropriate. In considering the SPA issue so widely, the review has rightly identified a number of areas where problems owe more to employment and ability to save than State Pension or SPA – for instance, the poorer pension outcomes identified for carers and for women. Potential approaches to under-saving in private pensions, not discussed in this response, may help to address these concerns.

Targeted measures to address the challenges identified would be more appropriate than a variable SPA. Variable SPAs between sub-groups are notable by their absence in other countries and in the UK would have an impact – as yet unknown – on people's choices in work and accessing private pensions, and on the role that income protection can play in providing an income until they retire.

This interim report rightly highlights the cost of the State Pension and increases to it, as well as changes to SPA. Maintaining early access seems least important as a driver of the policy intent to protect people from poverty, and none of the three drivers mentioned – early access, a general annual increase and maintaining a full State Pension amount for most – will of themselves deliver fair outcomes for everyone. The triple lock is an inefficient way to meet the policy intent of protecting pensioners from poverty; although it has been effective at gradually increasing State Pension income, and this income remains uneven between pensioners, the case for the triple lock weakens over time.

Consultation questions

Q1. Is our interpretation of the policy intent for the State Pension correct?

As the report acknowledges, the policy intention of the State Pension appears to have changed over time, fluctuating from protection against poverty to a measure which contributed some level of adequacy over and above this. Given that automatic enrolment is increasingly helping individuals takie responsibility for adequacy of income in retirement to suit their own needs and aspirations, a policy objective for the state pension of providing a basis to protect most people from poverty i.e. set just above the weekly means test, appears both appropriate and proportionate.

Q2. How successful are other international policies? Are there any other policies that we could consider? How should the UK policy on State Pension age take these examples into account?

From the international comparisons in the report it is apparent that the UK is broadly in line with other OECD countries though we are amongst those with the highest retirement ages. The comment by the IFoA about the absence of countries operating variable SPAs between different sub-groups is particularly notable given the key challenge identified by the report of delivering fairness despite the marked differences in life expectancy between different sub-groups.

Q3. Considering the main drivers of State Pension expenditure, which ones are more important to the policy intent, if they were presented as a trade-off? Maintaining early access, a generous increase annually or making the full State Pension amount accessible to most people? Which of these delivers fairer outcomes?

The overriding problem is that across the board solutions will never deliver outcomes which are fair in the context of each individual circumstance. At a general level it might seem fair that everyone receives the same State Pension at the same age, set such that on average someone can expect to draw State Pension for up to a third of their adult life. However at a more granular level an across the board solution is arguably unfair for a variety of different groups. For instance:

- Those with a lower life expectancy, whether due to where they live, occupation or socio-economic status will not draw their pension for as long. Therefore, arguably they should have a lower SPA.

- Those who, through no fault of their own – ill-health, caring responsibilities etc. - have been unable to build up any private pension will be disadvantaged by receiving the same State Pension as those who have had more opportunity to build up a private pension. It could be argued that they should receive a larger state pension to compensate.

The reverse of this is that using across the board solutions to remedy specific problems is inefficient. For instance, no one would suggest that the SPA should be reduced by 5 years for everyone to ensure that a particular group of people with a lower life expectancy don't lose out.

Consequently none of the three drivers, of themselves, will deliver fair outcomes for everyone – instead the aim should be to deliver fair outcomes for the majority supplementing these measures by carefully targeted action where specific need is identified.

Maintaining Early Access

The general proposition that, on average, people should expect to receive the State Pension for up to a third of their adult lives seems to have been accepted as an appropriate rule of thumb. Indeed it seems to have been interpreted as meaning, 'on average for a third of their adult lives', sensibly omitting the words 'up to' which otherwise make this guideline entirely meaningless. Although the precise proportion is arbitrary and begs the question of whether it should be based on a median or mean average calculation, nonetheless, a calculation based on some proportion of expected adult life would seem to be as fair a basis as any other for calculating SPA. Consequently maintaining early access (in other words over time providing for people to spend a greater proportion of their adult lives in receipt of the state pension) would not seem to be the most important driver of the policy intent.

A generous annual increase

A generous annual increase is currently provided by the triple lock. However, as noted in the report, the impact of the triple lock over time is significant. Each time it is activated, pension payments increase by the highest of the triple lock factors, adding more each time to the consolidated amount to be uprated in the future. It is also illogical, as, for instance, in the extreme case of 5 years of deflation and declining earnings, the State Pension would still increase by more than 13%. And even in more mundane scenarios, it is quite likely that the triple lock could result in pension increases rapidly outstripping what they would have been if based on one or two of the factors in isolation. It is not surprising therefore that it is projected to cost an extra percentage point of GDP within 40 years or so. It is also unpredictable given the uncertainties surrounding future earnings and inflation.

It has been suggested that 'The point of the triple lock was to reverse 30 years of decline in the state pension'[1], and it has been effective in doing this gradually. However, as per question 1, we understand the policy intent to be to ensure the State Pension is set at a level to protect people from poverty. If setting the amount of the single state pension at £155.65 per week is judged to be insufficient to achieve this, then the amount should be adjusted in line with the policy. However this is very different from simply providing a generous increase annually via the triple lock on an ongoing basis.

[1] Steve Webb 10/8/16

The current report also notes the particular importance of the triple lock to disadvantaged groups. It is undoubtedly correct that there are disadvantaged groups which should be identified and helped. But a generous annual increase, as an across the board solution to remedy a specific issue, is an inefficient way of doing this. It is also complicated by the uneven income profile between recipients of the State Pension. The vast majority of those who benefit from the triple lock receive the basic state pension; as time goes by, more and more of those benefiting from the triple lock will be those on the new State Pension, and the case for the triple lock weakens.

Making the full state pension amount accessible to most people

Given the policy is to set the State Pension at a level which protects people from poverty, then it would seem absolutely appropriate to ensure that this full amount is accessible to the vast majority, if not all, those of State Pension age. As now, this could be achieved through the State Pension for those who qualify for it in full, and a means-tested amount for those who do not – and this is important to achieving the policy intent.

Q4. Is the Pensions Commission's assessment of the proportion of GDP expenditure on pensioner benefits, over time, still valid, when considering State Pension age affordability post-2028? Is State Pension age the best tool to maintain a steady GDP proportion for pensioner benefits?

As noted above, the impact of the triple lock on GDP projections is significant, the uncertainty it creates due to the unpredictability of the relative levels of the triple lock factors could significantly undermine the accuracy of the GDP predictions.

Subject to this, it is worth a note of caution over relying too heavily on the maintenance of a steady GDP proportion as the key indicator of the 'right' level of pension expenditure. However it does go some way towards ensuring pension spending is proportionate and is not perceived as imposing an unfair burden on the working population.

Discounting the cost of the triple lock, it appears from Figure 6 that linking pensions to earning and adjusting SPA in line with life expectancy may be sufficient to maintain a steady level of GDP from the mid-2030s onwards. Consequently we would agree that adjusting SPA in line with the aim of ensuring one third of adult life is spent in receipt of State Pension is the most appropriate tool. However, breaking this link and raising the SPA such that on average this proportion becomes less than a third should be avoided if at all possible.

Q5. Are there any other issues around opportunity to achieve adequacy for future generations that we need to consider? How can we best take into account wider economic impacts, for example, the likelihood of low interest rates in pension outcomes or the changes in housing costs and overall wealth distribution?

The report makes the point that private pension income will, over time, cover more people but that the prospects for some in disadvantaged groups are likely to be limited because of affordability.

It is important to recognise the interaction of State Pension, SPA and private pensions. Some selected retirement dates in private pensions have been set at the SPA at the time they were taken out. As such, there have been peaks at 60 and 65 for accessing pensions, particularly for buying an annuity. The date that private pensions are accessed is now much more fluid, as the retirement market is now much more flexible, default retirement ages have been scrapped and selected retirement dates on private pensions are less relevant. But SPA will remain relevant to private pensions, as receiving State Pension may continue to be a trigger for stopping work and taking private pension benefits, and will feature in individuals' retirement planning.

In addition, the previous Government consulted in 2014[2] on raising the normal minimum pension age for private pensions from age 55, and pegging it to 10 years behind SPA. We supported an increase in minimum pension age to 57 by 2028, for similar reasons to the planned increases in SPA, primarily increasing longevity. But we questioned whether this should be automatically linked to SPA. If we assume SPA will continue to increase it may be demotivating for savers to see the date they can access their savings extend, which could mean they divert savings elsewhere. We also suggested[3] in response to the 2014 consultation that the reviews of SPA, such as this one, might also consider whether any change to minimum pension age is appropriate.

More broadly, while increased participation in private pensions will help improve adequacy, there is a more widespread risk that the level of private pension provision will be very uneven. This arises partly because the ultimate level of private pension saving is disproportionately dependent on contributions early in someone's working life. Although, so far, levels of automatic enrolment opt out have been reassuringly low among younger employees, factors such as student debt and housing costs put particular financial pressure on this cohort. There is an increasing risk that it is those with the most disposable income, possibly helped by wealthy parents that will benefit disproportionately from DC pensions. This will potentially be exacerbated by the proposed Lifetime ISA which is only available to those under 40 – a proposal which some commentators have already characterised as a wealth management tool for the well off.

Q6. Are there any other factors that may impact the value of the State Pension for each generation?

The value of the UK housing stock, and who owns it, may be another relevant factor that could affect the relative value of the State Pension between generations. Figure 10 does not reflect capital which people may obtain from downsizing their houses or from equity release. Whilst the increasing value of the UK housing stock will in general terms provide extra funds in retirement, the benefits are likely to be very uneven, both in terms of the generations who benefit, income groups and crucially regional variations. However, any analysis which does not take some account of this will be incomplete.

[2] www.gov.uk/government/consultations/freedom-and-choice-in-pensions
[3] www.abi.org.uk/~/media/Files/Documents/Consultation%20papers/2014/06/HM%20Treasurys%20Freedom%20and%20choice%20in%20pensions%20consultation.pdf

Q7. Are replacement rates linked to pre-retirement income a good measure of adequacy for the future? What would be the most relevant alternatives?

The report sets out a number of reasons why replacement rates are becoming less relevant as a measure of desired retirement outcomes. Housing wealth should also be borne in mind. For instance, someone in a higher income bracket living in London may well realise significant funds through downsizing – in which case a replacement rate of say 50% reflecting their pension needs could well overstate what they actually require for the standard of living they expect, given their access to funds from housing wealth.

Despite these drawbacks target replacement rates are still helpful to an individual in determining the level of income they are likely to need to 'keep them in the style to which they are accustomed' and hence inform their private pension strategy. However, considering replacement rates in the context of State Pension levels is not necessarily consistent with the notion of the State Pension being set at a level to avoid pensioner poverty, which arguably is an absolute rather than something to measure by reference to someone's income during their working life.

Q8. What evidence is there to suggest "burnout" is a feature of certain professions and what are the alternatives for workers in those roles? How can FWL strategy support best the transition required, if that is the case?

No response.

Q9. To what extent can a delay in State Pension age act as a direct mechanism to enable Fuller Working Lives? What factors would increase the likelihood that people remain in gainful employment during any such delay?

The answer to this depends mainly on the triggers for early exit from the labour market although people's reasons for working beyond SPA may also be instructive. The report notes that the triggers for early exit include ill health, difficulty in returning to work after redundancy and caring responsibilities. The largest single reason to continue after SPA is the rather vague, 'not ready to stop work' although a significant minority cite financial reasons. Consumer research by the ABI in 2014 found that the main reasons given for choosing to defer buying an annuity included wanting to continue working (51%), and needing to continue working (22%)[4].

For those already minded to carry on working for financial reasons, a delay in SPA is likely to reinforce that decision, especially given that deferring State Pension is already an option. However, in general terms it is not an obvious or appropriate mechanism for enabling Fuller Working Lives and could cause further hardship for some.

[4] Crouch et al (2014) Retirement choices: measuring the effectiveness of the code of conduct https://www.abi.org.uk/~/media/Files/Documents/Publications/Public/2014/Pensions/Retirement%20Choices%20Measuring%20the%20effectiveness%20of%20the%20code%20of%20conduct%20following%20its%20implementation.pdf

It would be more effective to analyse the reasons for early exit and consider measures to tackle these – for instance the role of income protection and encouraging employers to be more accommodating to those in ill-health or with caring responsibilities.

Q10. How can we best take into account the sensitivity of the life expectancy projections when considering an appropriate State Pension age for the future?

There is inevitably a balance between the risk of setting a higher SPA to come into effect in say 20 years' time which in due course proves to be too soon or too late to deliver the 'one third' aim or leaving fixing changes until much nearer the time with consequent undesirable uncertainty especially for those nearing retirement.

It will be vital to take account of the need for certainty by notifying any changes sooner rather than later, in line with the previous Government's commitment to give any individual affected by changes to their State Pension age a minimum of 10 years' notice.

Q11. Do you think that regional factors have an impact on Life Expectancy and how? How should the Government factor in the combination of regional and socio-economic factors?

As the data in the report suggests, there are regional differences in life expectancy. But there are also more local differences, differences between those in different occupations, those with different levels of deprivation and so on. It is not possible to unpick these different factors and it would therefore seem impractical to factor in these variations to, for instance, create a different SPA for different sub-groups based on different life expectancies. As noted in our response to Question 2, it is instructive that the IFoA have not identified any countries operating variable SPAs between different sub-groups.

It is also important to consider the interaction with private pensions in providing an income that reflects regional and (more importantly) individual differences in life expectancy. Annuity providers underwrite on the basis of detailed information about health and lifestyle, including postcode, meaning that those who, in the professional judgment of the insurer, have a shorter life expectancy will receive a higher income. Further, a regionally adjusted State Pension could have an impact on this market.

Q12. Are Healthy Life Expectancy and Life Expectancy improving sufficiently for the majority of the population? Are there specific aspects of Healthy Life Expectancy that would directly interact with State Pension age and how?

It is not possible to provide a definitive answer to this question given the subjectivity of the term, 'sufficiently'. However, some of the data in the report is very concerning. For example, Figure 21 shows that for 65 year old women in England, the most deprived decile have a life expectancy of 18.6 years of which 5 years will be spent in bad health in contrast with the least deprived decile who can expect to live 22.9 years of which only 2.6 years will be in bad health. Whilst it is difficult to see how this contrast, however stark, can directly interact with the SPA, it does illustrate the sort of area where direct intervention is needed to reduce the disadvantages for some sub-groups which are inherent in a uniform SPA. Private pensions cannot address this underlying issue, but can help individuals to take an income to match their needs in line with their health and life expectancy, through an annuity or through a flexible income or lump sums.

Q13. The Pensions Commission suggested that lower Life Expectancy should be tackled through improvements to health and occupational health. Do you agree? How should we take into account the Life Expectancy and Healthy Life Expectancy information when considering State Pension age?

Occupational health, and employer support for their employees' health more broadly, has a crucial role to play in extending Healthy Life Expectancy. The Government's Work, Health and Disability Green Paper puts forward a range of suggestions and recommendations for how employers can be helped and encouraged to retain and support staff with long term health conditions. This is particularly important given the positive relationship between work and health. Greater take up of group income protection insurance is raised as one of a range of solutions within the Green Paper.

As in response to Question 12, a uniform SPA is probably unavoidable. However, by identifying specific needs and sub-groups who are particularly disadvantaged, targeted solutions should be developed to reduce such disadvantage and private pensions and insurance can contribute to this. The Pensions Commission suggestion goes with the grain of this.

Q14. How can we best take into account the impact of caring responsibilities in later life and specifically within the decade prior to State Pension age?

As noted in our response to Question 9, raising the SPA alone is not an appropriate mechanism for enabling fuller working lives and could cause further hardship. This is especially the case for carers who, in addition to having reduced opportunities to contribute to a private pension, would have to last longer without the financial support of the State Pension. We have suggested that employers should be encouraged to be more accommodating to those with caring responsibilities.

The specific answers for carers are less likely to be across-the-board changes to the SPA but reform of the current support of this group, such as a higher level of, or increased eligibility for, Carers Allowance. It will often be the case that the degree of an individual's caring responsibility may fluctuate over time or start and stop altogether before SPA, in which case State Pension would not be an appropriate source of income. Further, the impact on private pensions and insurance should be considered if SPA did change to take account of caring resposibilities, and any read across to occupational schemes which reference the SPA would have to be carefully managed.

Q15. How can we best take into account the impact of poor health and disability in later life and specifically within the decade prior to State Pension age?

This is more a question of the appropriateness and adequacy of state benefits rather than of the SPA. This is also an area where the potential contribution of income protection, and the interaction with private pensions and the annuity market should be considered.

Q16. How would any State Pension age changes affect the self-employed in the future? How can we take into account the very diverse profiles in this group?

The comparative lack of pension saving by the self-employed is a significant problem, and the contrast with the employed has been exacerbated by automatic enrolment. However, it is difficult to see how this impacts directly on consideration of the SPA – it is an under saving problem, not a SPA issue.

Q17. Does ethnicity affect pension outcomes? Are educational outcomes improving for ethnic minority groups and how is this likely to translate into both improved employment rates, earnings, and ultimately retirement income? Are there any other data or consideration that you can contribute that might be significant in our consideration of ethnic minority impacts from a change in State Pension age?

No response.

Q18. What is the best way to take into account the lower pension outcomes for women in our recommendations?

The report makes clear that the disparity is between private pensions and not the State Pension, however, there is also a disparity in State Pension provision. Women typically receive a lower State Pension than men and are more likely to be reliant on the State Pension as their main source of retirement income. Although this discrepancy is gradually declining it will be decades before it fully disappears.

As recommended by the CII in their 2016 report[5] published last year women should be supported and encouraged to achieve equal and independent savings to build up their resilience. There are glaring inequalities in pension savings between men and women; the average man accumulates five times the pension pot of the average woman. But these are predominantly to do with employment and saving, and cannot easily be addressed by SPA.

[5] http://www.cii.co.uk/media/7414970/risks_in_life_research_report.pdf

Q19. For older workers in particular, the adequacy of income in retirement may be best considered at a household level. However, when planning future changes to the pension system, how reliable is this assessment now and how reliable will it be for future generations?

Intuitively we would expect consideration at a household level to be more helpful. The marginal extra expense of a two person household over a single person household is likely to introduce less distortion than the likely significant overstatement of treating such a household as two separate independent individuals. However, as family structures change this becomes more complex, with more people providing support for former partners, more multi-generation households and inter-generational wealth transfers.

Q20. Is it appropriate for this Review to include in its considerations the entry point for all the welfare policies that are linked to State Pension age? Which ones should be excluded and why?

In considering the interaction of private pensions, income protection and state benefits, it is helpful to consider the entry points for all relevant welfare policies, although the focus should remain on SPA.

Q21. How far should this Review take into account impacts on occupational scheme rules? What are the most significant challenges for those pension schemes if State Pension age is changed?

It is welcome that the Review recognises that there are impacts on occupational scheme rules. However, whilst there are challenges these are consequential and we would expect any decision about raising the SPA to be based on the policy drivers for the SPA and the need to maintain its sustainability.

Q22. What are the alternatives to a universal State Pension age? How can they be designed and implemented so that both the principles of Affordability and Fairness are retained?

We don't think there are any alternatives, subject to perhaps using a reduction in the SPA simply as a mechanism to deliver benefits to individuals who meet specific criteria.

Q23. What other factors and trends are increasingly relevant and will be prevalent in the future when considering an appropriate retirement age for individuals?

It seems appropriate that there is a fixed point at which the state provides a degree of financial support to older people on a universal basis. Although the 'one third' rule is arbitrary it seems to reflect an appropriate balance between the period during which someone will generally expect to receive their income from working to the period where we would expect working to be, at the most, discretionary.

Q24. Is there any evidence that these Government policies have any impact on the decision to work longer? What other policies can Government adopt alongside the Fuller Working Lives strategy to strengthen Fuller Working Lives outcomes, for example supporting profession transitions and incentives to work longer for low earners?

No response.

Q25. What approach is more appropriate in your view, if we were to protect impacted groups? Should we consider ways to remove any barriers to building their own private retirement income or to support them through the welfare system or is there another approach altogether? Why?

We would envisage a mixed approach. Neither approach should be applied to the exclusion of the other. For instance there will be groups where removing barriers to building their own private retirement income will be wholly impracticable because saving is not affordable for them, such as those with severe health problems; and others where the benefit route is entirely inappropriate or irrelevant because they have sufficient income to save.

Q25a. How can the Government best support these disadvantaged groups? We welcome submissions that comment on these suggestions further or alternative proposals (NB omitted from summary list of questions.)

<u>Early access to the new State Pension after a long working life</u>

Early access might be a mechanism to deliver support for individuals satisfying particular criteria – for instance carers, or those suffering ill health – although we have above highlighted the challenges of this approach. This suggestion would go a step further and effectively lower the SPA for a sub-group defined by their occupation.

The suggestion is quite elegant in that by linking it with a long contribution history, by serendipity it picks up a sub-group which at least overlaps with one or more identified 'lower life expectancy' subgroups. However, it is not a perfect match and by introducing another criteria over and above the 35 year contribution history requirement, potentially introduces complication and possibly unfairness. It is more likely to benefit people with good health and unbroken careers who are in less need of support. It also raises questions about contribution credits obtained during qualifying non-working periods - would these count towards this proposed 45 year 'super-total' or only to the 35 year requirement?

<u>Early access but to a reduced pension</u>

At first glance this option sounds attractive but the amount of the reduction is clearly a relevant factor. Bearing in mind that the full state pension is set at a level to keep people out of poverty, providing an option for people to arrange their affairs to put themselves into poverty in their later years – whether by choice or by circumstance – seems undesirable. Consideration should also be given to the likely interaction with private pensions and the choices people make to access their pension as cash, drawdown or an annuity.

An individual with an adequate private pension may also decide to access their State Pension early purely for economic reasons, to allow continued above inflation growth in their private pension. This is not a scenario the state needs to support.

Enhanced working age benefits

On the face of it, this is preferable as it is specifically targeted to individual need and does not provide a later 'hangover' in the form of a reduced state pension post SPA.

Greater take up of income protection

Specifically for those who are unable to work due to health reasons, income protection could play a much greater role in providing people with an income until they reach retirement age, as well as allowing them to continue saving into a private pension.

Q26. How can the Government and others communicate any future changes on State Pension age? How important is stakeholder involvement in ensuring that the right messages reach the right people in good time.

We fully support the emphasis placed on communication and the recognition that different bespoke communication solutions are required to meet the communications needs of the different groups affected. Stakeholder involvement in ensuring that this happens in the right way is vital, and pension providers may have a role in reaching the right people.