



How the Pensions Commission approached adequacy

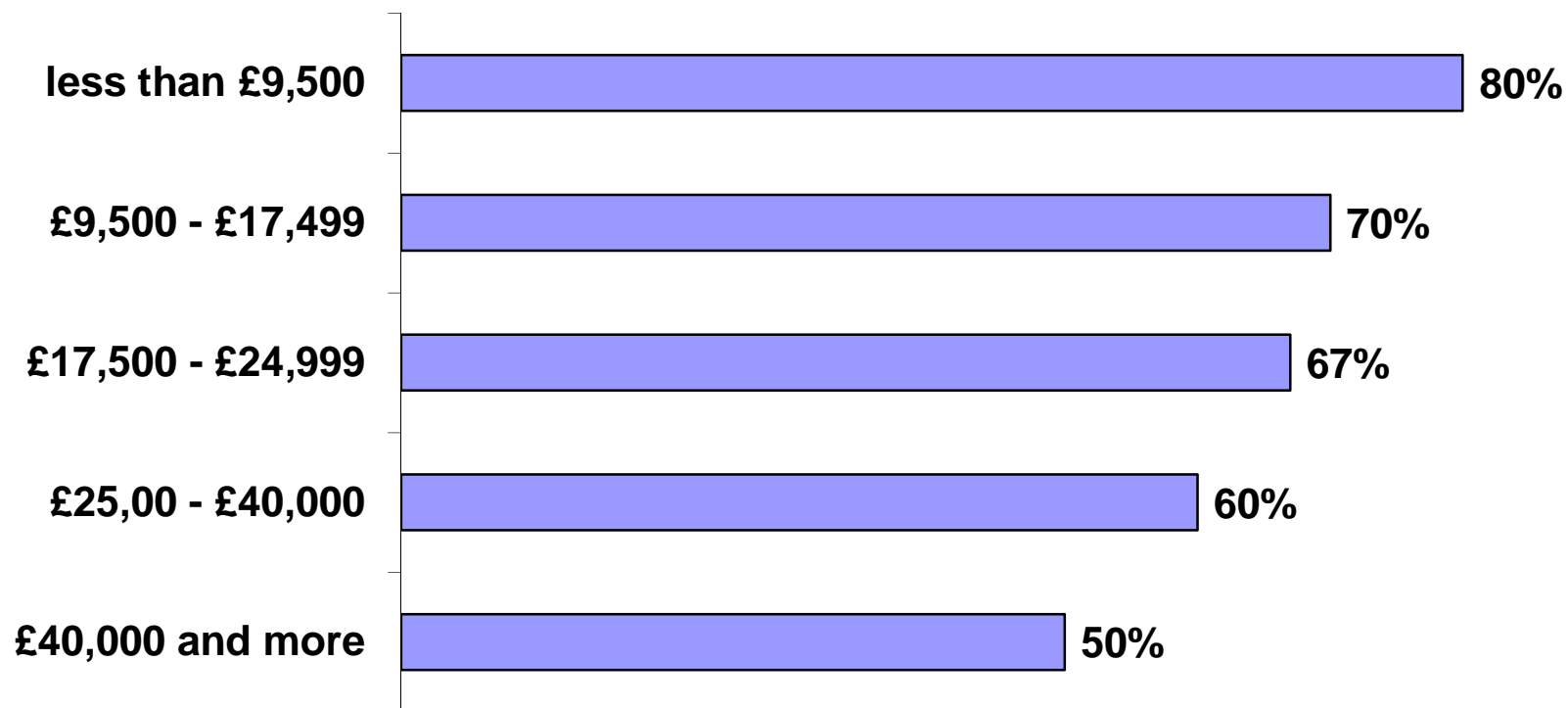
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PPI Policy Round Table for IPSPC
27 January 2011

Criteria used in Pensions Commission's first report

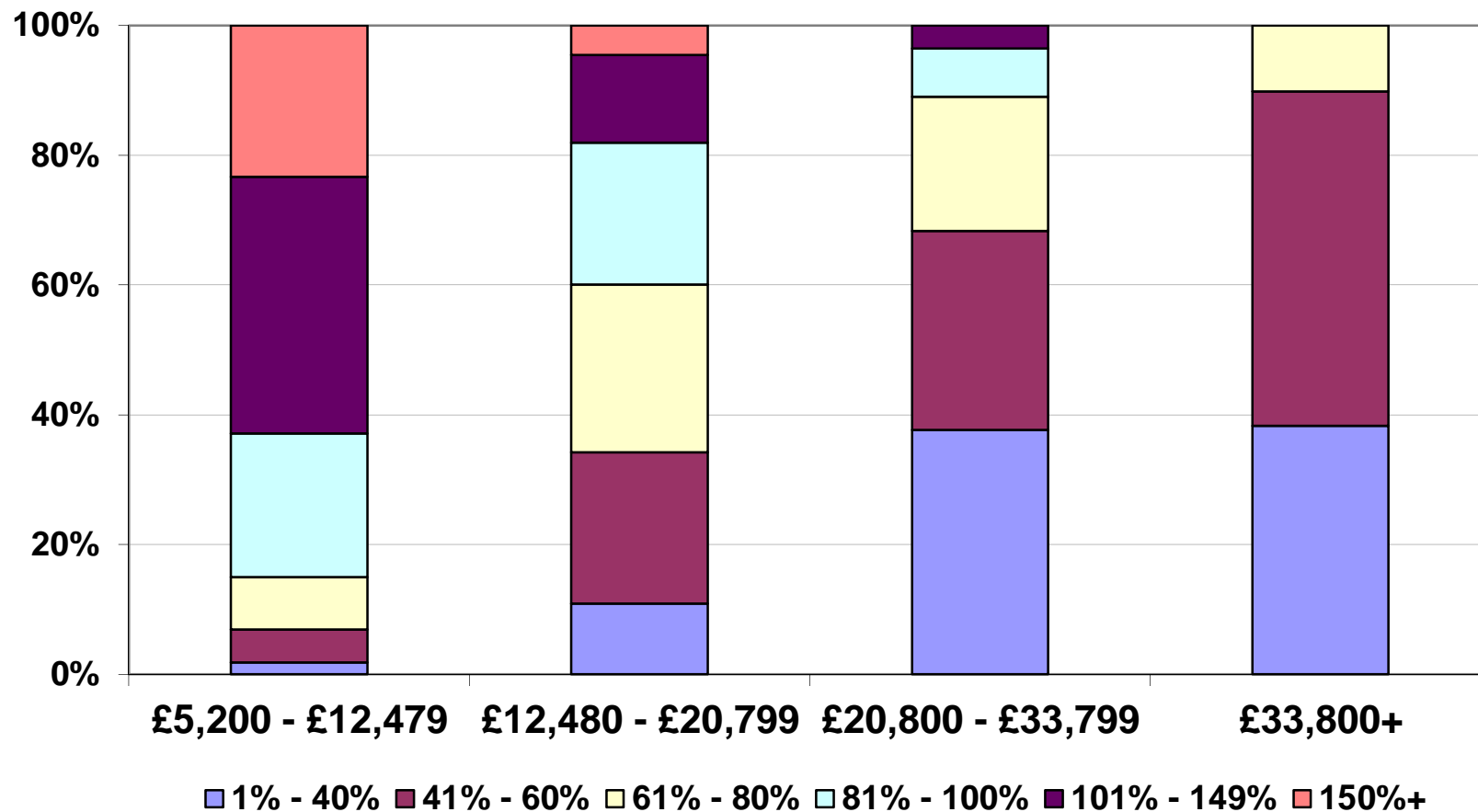
- International evidence: relative pensioner incomes higher in most other countries, so does not suggest UK outcomes are over-generous
- Actual net replacement rates in 1990s: 70%-90+% (lower for top quartile incomes)
- Consumption can be maintained with lower gross income (NICs, work expenses, lower saving – although falling consumption later in retirement)
- 'Desired' retirement incomes ('enough to live on') rise in absolute terms, but fall relative to current income
- Conclusion: "There can be no clear definition of pension adequacy" (!). But the benchmarks we proposed commanded general acceptance

Benchmark Replacement Rates Assumed for Pensions Commission Modelling: Percentage of Gross Earnings



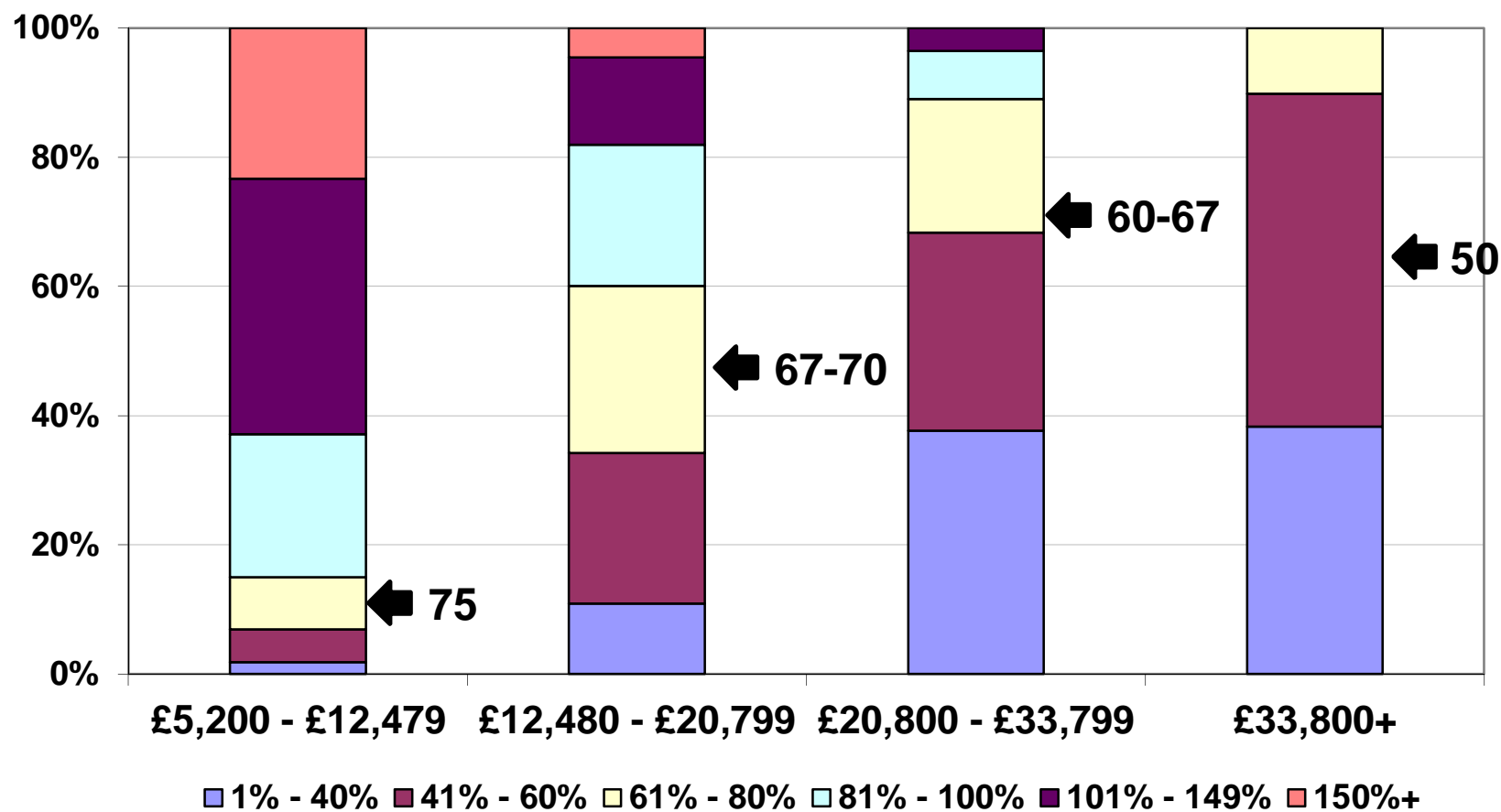
Source: Pensions Commission, First Report, figure 4.11 (2004 earnings)

Distribution of replacement rates for "minimum" income in retirement by current gross income



Source: Pensions Commission, Second Report, Appendices figure D28 based on Omnibus Survey, 2005

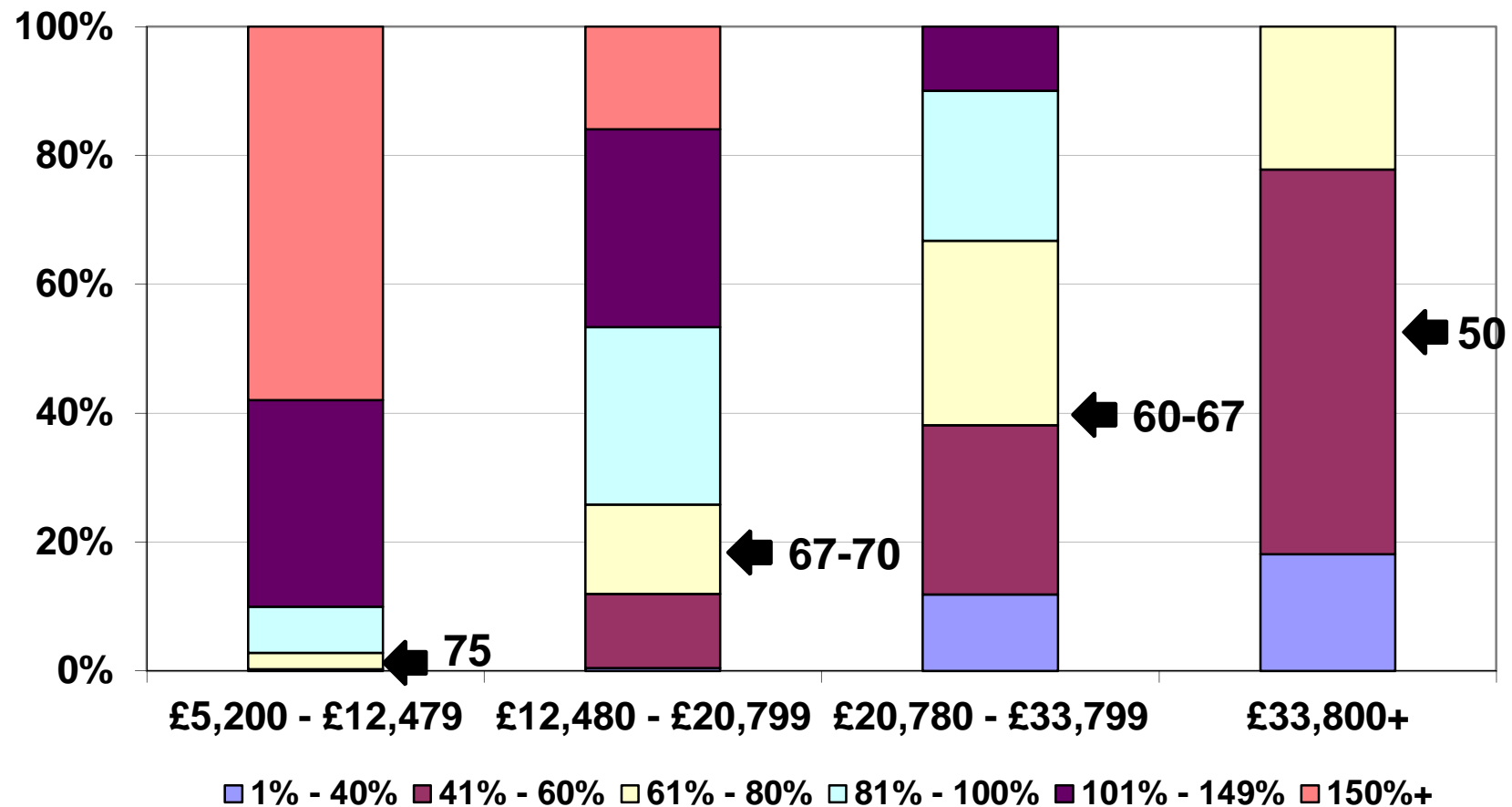
Distribution of replacement rates for "minimum" income in retirement by current gross income



Arrows show where benchmark replacement rates come in scale of preferences

Source: Pensions Commission, Second Report, Appendices figure D28 based on Omnibus Survey, 2005

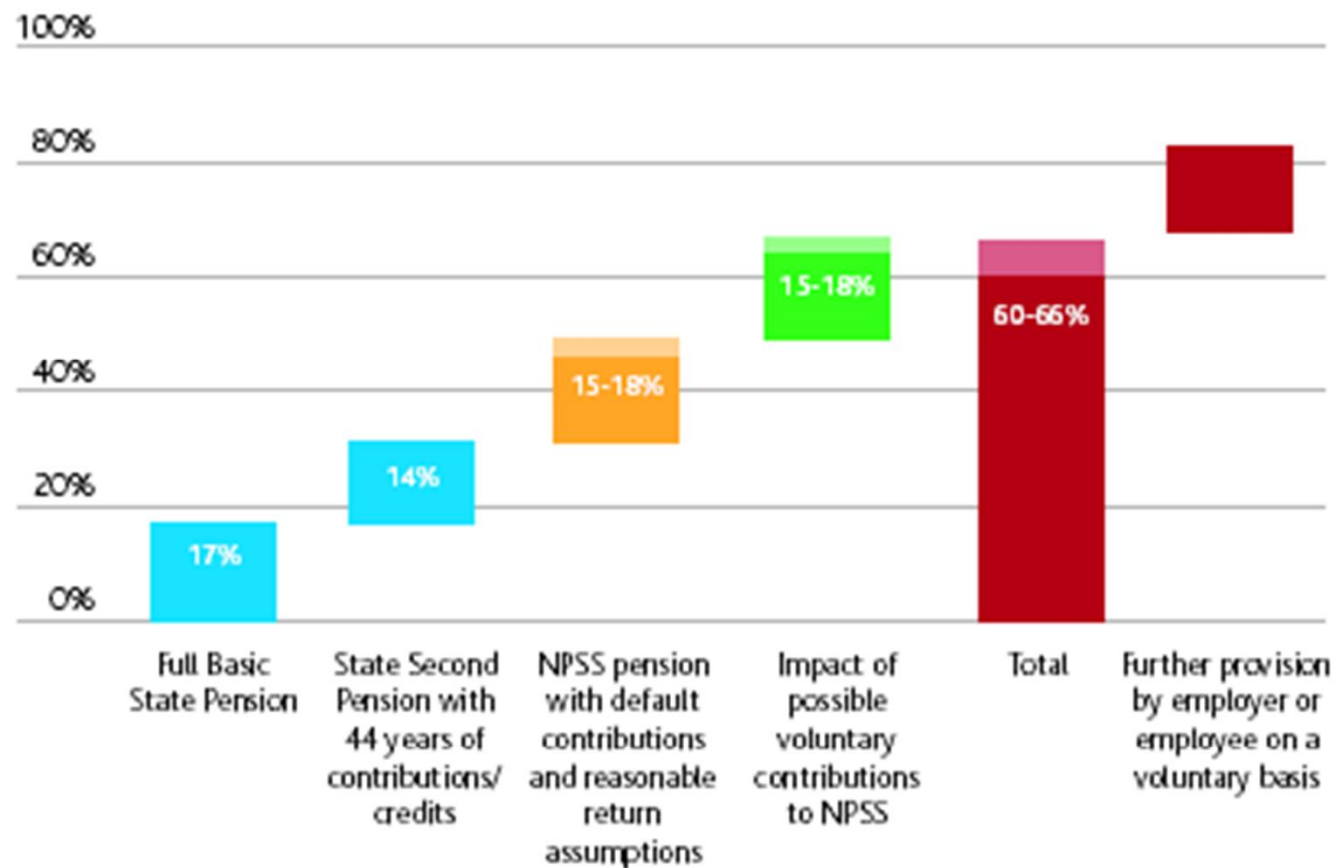
Distribution of replacement rates for “comfortable” income in retirement by current gross income



Source: Pensions Commission, Second Report, Appendices figure D29 based on Omnibus Survey, 2005

- It is hard to argue for any precise schedule of replacement rates as being definitive, but there were no objections to Commission's proposal
- There is a good case for arguing that appropriate replacement rates fall for those with higher incomes
- Around median incomes, the Commission's benchmark (67 per cent) would be regarded as a minimum by about half of those earning at that level. At lower incomes, few saw the benchmark as giving even a minimum
- At all income levels except the highest, the benchmarks fall short of what large majorities would see as 'comfortable'
- The Commission's proposals were designed to allow those on median incomes to hit the benchmarks – but only with maximum voluntary contributions

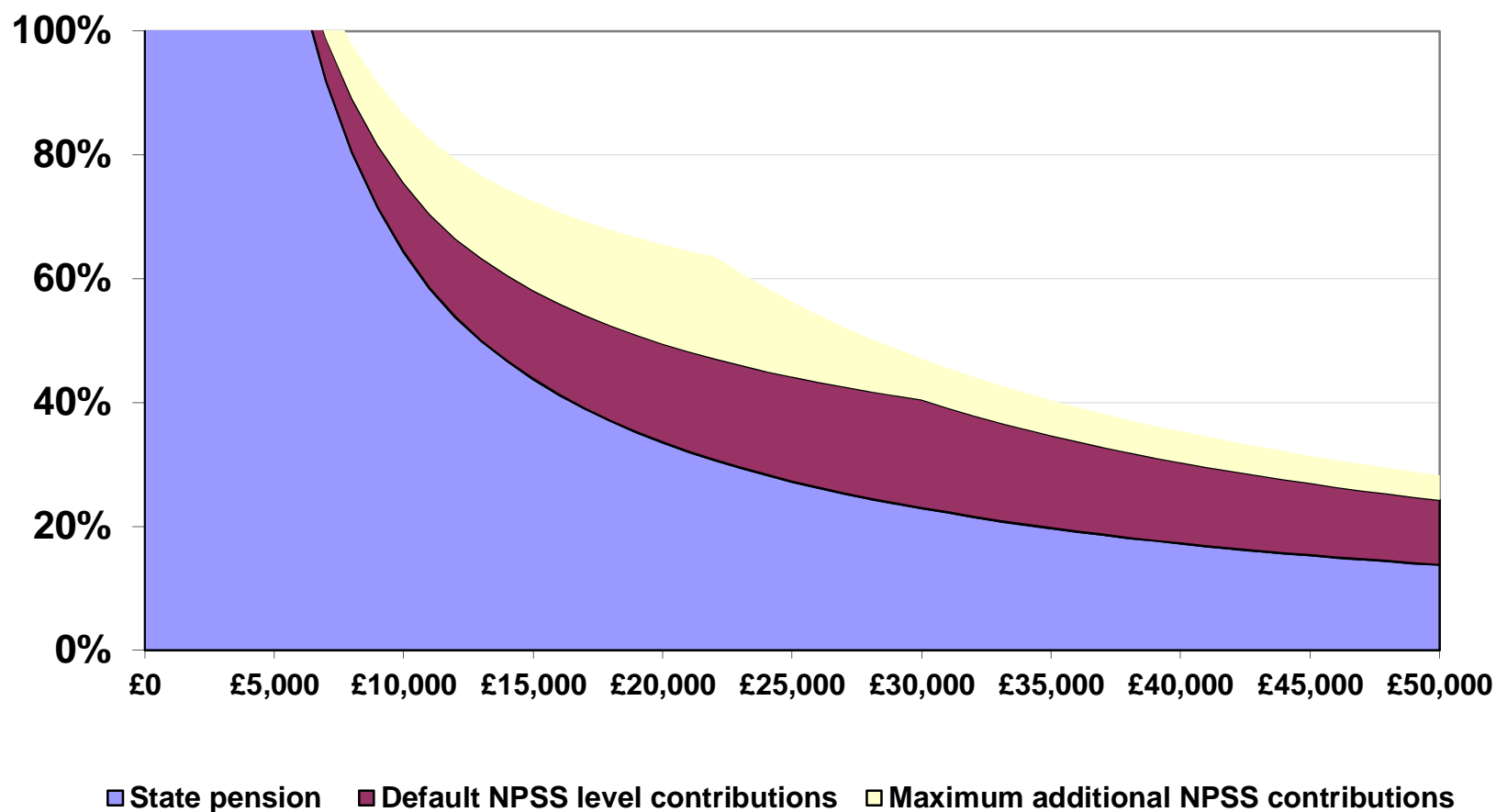
Potential pension income as % of earnings for median earner: at point of retirement in 2053



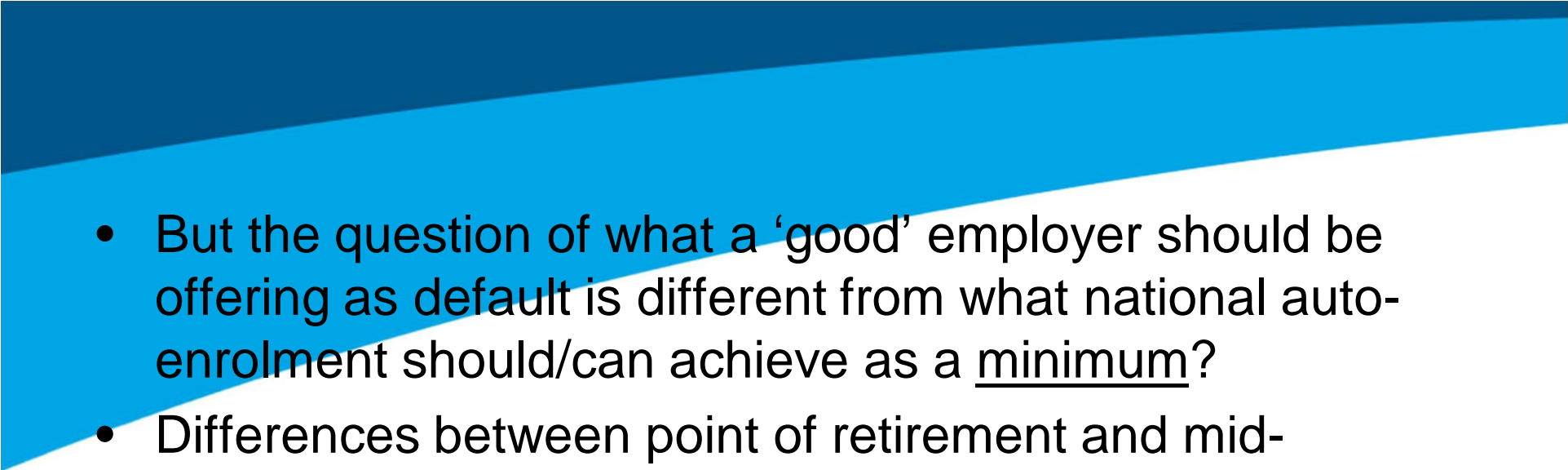
The role of the state



Replacement rates at the point of retirement for someone aged 20 today



Source: Pensions Commission, Second Report, figure 6.34

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- But the question of what a ‘good’ employer should be offering as default is different from what national auto-enrolment should/can achieve as a minimum?
 - Differences between point of retirement and mid-retirement incomes have become a larger issue with moves to CPI indexation (suggesting higher replacement is needed earlier on)