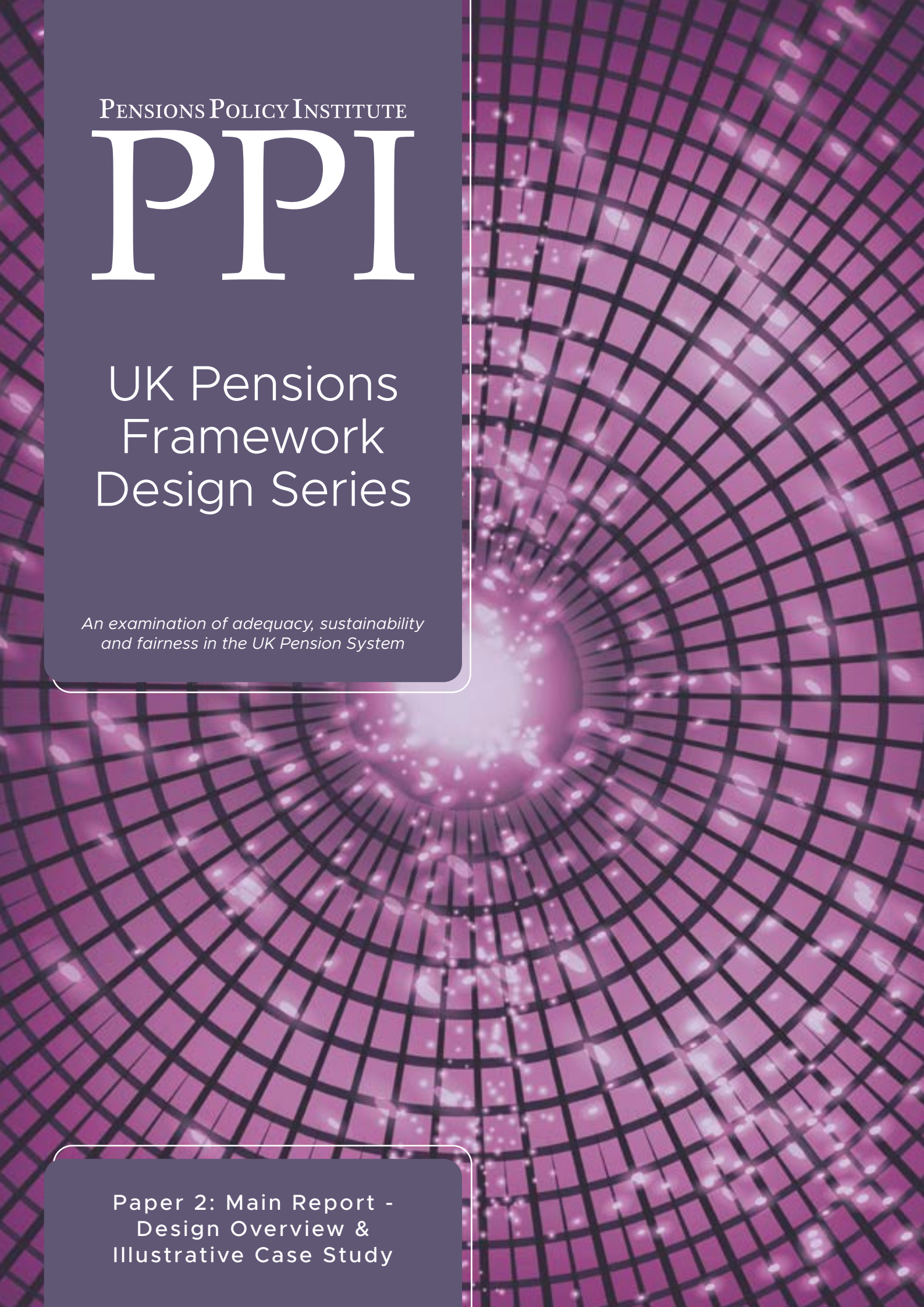


PENSIONS POLICY INSTITUTE

PPI

UK Pensions Framework Design Series

An examination of adequacy, sustainability and fairness in the UK Pension System

Paper 2: Main Report - Design Overview & Illustrative Case Study

contents

PENSIONS POLICY INSTITUTE

PPI

The Pensions Policy Institute (PPI)

We have been at the forefront of shaping evidence-based pensions policy for 20 years.

The PPI, established in 2001, is a not-for-profit educational research organisation. **We are devoted to improving retirement outcomes**. We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. The PPI gives you the power to influence the cutting-edge of policy making. Each research report combines experience with independence to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our **independence** sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

By supporting the PPI, you are aligning yourself with our vision to drive better-informed policies and decisions that improve later life outcomes and strengthening your commitment to better outcomes for all.

As we look forward now to the next 20 years, we will continue to be the trusted source of information, analysis, and impartial feedback to those with an interest in later life issues. The scale and scope of policy change creates even more need for objective and evidence-based analysis. There is still much to do, and we look forward to meeting the challenge head on.

Our Vision

Better Informed policies and decisions that improve later life outcomes

We belive that better information and understanding will help lead to a better policy framework and a better provision of retirement income for all.

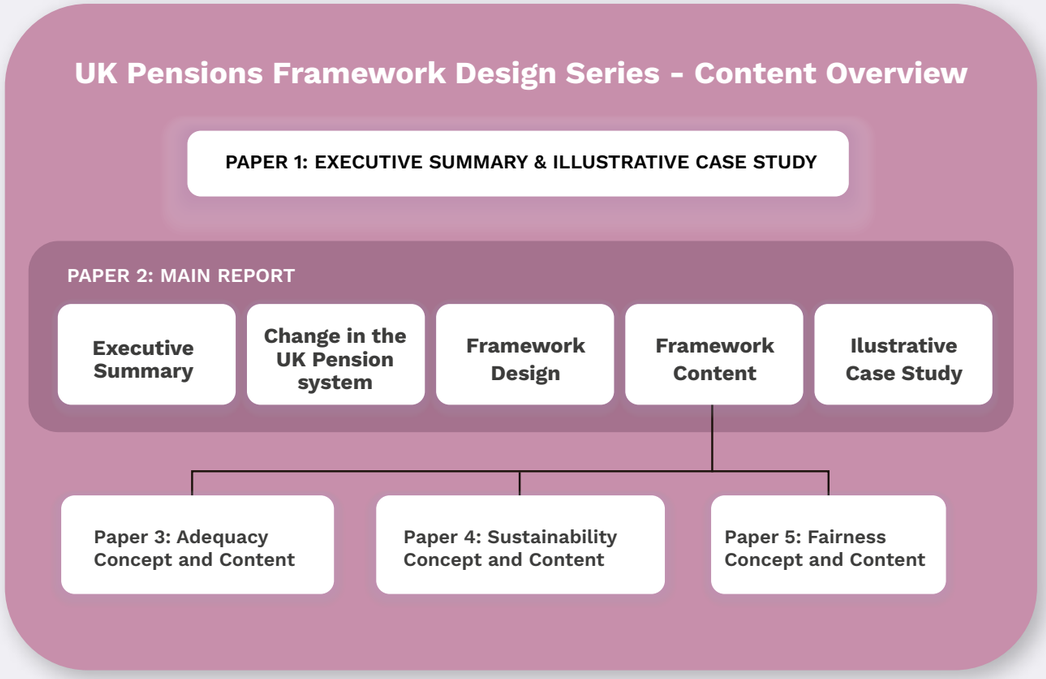
Our Mission:

To promote informed, evidence-based policies and decisions for financial provision in later life through independent research and analysis.

We aim to be the authoritative voice on policy on pensions and the financial and economic provision in later life.

For further information on supporting the PPI, please visit our website:
www.pensionspolicyinstitute.org.uk
or
contact Danielle Baker,
Head of Membership & External Engagement, at
danielle@pensionspolicyinstitute.org.uk

The UK Pensions Framework Design Series: Main Report



The **UK Pensions Framework Design Series** comprises five papers which together document the process of developing the UK Pensions Framework, undertaken over the course of 2021.

The UK Pensions Framework is a long-term analytical instrument which seeks to build a clear picture of how strengths and weaknesses in the UK pension system are evolving over time. From its first release, due in Q4 2022 and annually thereafter, it aims to provide a consistent and systematic approach to examining and simulating changes in adequacy, sustainability and fairness in the UK State and private pension system, which overall determine the financial security that people have in later life.

This paper presents the Main Report. It provides a detailed insight into the context, structure and content of the Framework, what the Framework is, why it is needed and how it has been designed. It expands upon an overview provided in the Executive Summary and Illustrative Case Study. Further examination of the concepts underpinning analysis of Adequacy, Sustainability and Fairness, along with their proposed content indicators, is provided in three supporting papers.

This report has been authored by:

Anna Brain, Research Associate

Anna joined the PPI as a Research Associate in January 2021, having previously worked for them in 2019.
Her research has focused on a range of topics, including intergenerational trends in long-term saving; pension systems and their sustainability; structural and social determinants of health, wealth and digital inequalities; interactions between pensions, health and social care policy; and evolving transitions in later life.

Prior to joining the PPI, Anna worked closely with asset, investment and pension fund managers for nearly ten years at EY and Bloomberg before pursuing her passion for policy research and thought leadership. She recently achieved a Master's in Public Policy and Ageing with distinction from King's College London, which focused on economic, health, social and policy concerns in the management of population ageing, demographic change and COVID-19.

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A Research Report by Anna Brain

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The UK Pensions Framework

In association with...

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Yvonne Braun	ABI & PPI Governor
Zoe Alexander	Nest

Doug Brown,
CEO UK Life, Aviva

Aviva are delighted to sponsor the PPI UK Pensions Framework. We believe that the Framework will make a valuable contribution towards ensuring that UK pensions policy helps deliver positive outcomes for pension savers across the UK.

We have seen huge changes in the pension system in recent years. From the shift to DC pensions, the advent of pension freedoms, the impact of auto-enrolment and the rise of ESG, the pension system is almost unrecognisable from a few short years ago. And at the heart of many of these changes is pensions policy.

Yet, just like the pension system itself, pensions policy is both hugely complex and constantly evolving. As a result, it is almost impossible to assess how any one change in pension policy affects other aspects of the system. This framework helps to change that. By providing a holistic view of pensions' policy, the Framework is intended to foster a policymaking environment that delivers the positive member outcomes that we all want to see.

The Framework identifies three key objectives of the pensions system; adequacy, sustainability and fairness. These were the product of considerable discussion, debate and challenge from across the industry. These objectives will be assessed by a series of indicators that will enable policymakers to quantitatively and qualitatively track changes over time and promote understanding of how policy changes affect each of the objectives.

The Framework promotes holistic thinking around some of the macro themes and trends affecting the pensions system such as the shift towards DC pension provision and their impacts on pension schemes, their corporate sponsors and most importantly their members. It also examines the importance of ESG in ensuring the wider sustainability of the pensions system- a topic of fundamental importance to Aviva and our millions of pensions customers. Similarly, we hope that asset owners, pension scheme trustees, independent governance committees and pension members will all see value in the Framework.

In developing the Framework, the PPI have engaged experts from across government, regulators, and industry. We would like to thank everyone who so generously gave their time and energy to supporting the project. The work is undoubtedly better for their input. We would like to give a special thanks to the PPI themselves for their expertise, professionalism and most of all their sheer determination to embark on what is by anyone's estimation a major contribution to the pensions policy landscape.

Yet this Framework is only the beginning. Next year it will be used to provide a baseline for the UK pension system and in subsequent years there will be ongoing assessment system against this. We are hugely excited by what lies ahead and we invite everyone to embark on this journey with us so that together we can ensure that pensions policy truly delivers world class outcomes for pensions savers across the UK.

EXECUTIVE SUMMARY

This report provides a descriptive overview of the PPI UK Pensions Framework, along with the rational for its design and a case study of how it can be used.

Its aim is to provide a non-technical insight into how the framework has been developed to examine adequacy, fairness and financial sustainability in the UK pension system, as well as what the content will cover. This report precedes the first full analysis of the system which is due to be published in Q4 2022, and annually thereafter.

Executive Summary

The UK Pensions Framework provides a long-term instrument for bringing together clear, comprehensive and objective analysis of adequacy, sustainability and fairness in the UK State and private pension systems - which overall determine the financial security that people have in later life.

Its purpose is to build, for the first time, a single resource that can support evidence-based policymaking and debate by documenting how changes in the UK pension landscape are impacting these three dimensions over time. It looks at them from the view of individuals, households, employers, the pensions industry and Government to show how changes interact, how they shape the living standards of older people today, and what they mean for the retirement prospects of pensioners tomorrow. This report describes how and why the framework is designed. It precedes the first full analysis of the system, which is due to be completed Q4 2022 and repeated annually thereafter.

The UK pension system is changing, and its changes are affecting everyone. A series of major demographic forces, economic trends, industry developments and policy reforms over the past two decades are reshaping the pensions landscape and transforming the way in which people need to prepare for retirement. Policy momentum is changing too. As implications for individuals become more apparent and risks emerge, policymakers, the pensions industry, consumer groups and employers are responding to the need to work together towards creating the conditions necessary for people to confidently secure positive retirement outcomes. Without a clear overview of what these changes could mean, however, it will be challenging to understand how the pension system is working to deliver its overall goal of providing financial security, and to design policies that are correctly targeted to support it.

For the UK pension system to be successful in its goal, it needs to support retirement outcomes that are adequate, fair and sustainable. However, what society considers to be adequate, based upon expectations of living standards, minimum income or financial resilience, may not be financially or socially sustainable if it is not affordable. But what is considered affordable, based upon the resources available in the system and the nature of retirement, may not be considered adequate. The challenge for any pension system is to balance these objectives. The extent to which the outcomes are positive can impact differently among groups, and the way in which people respond can depend on two factors: whether they have confidence the system is working, and whether they think it is fair.

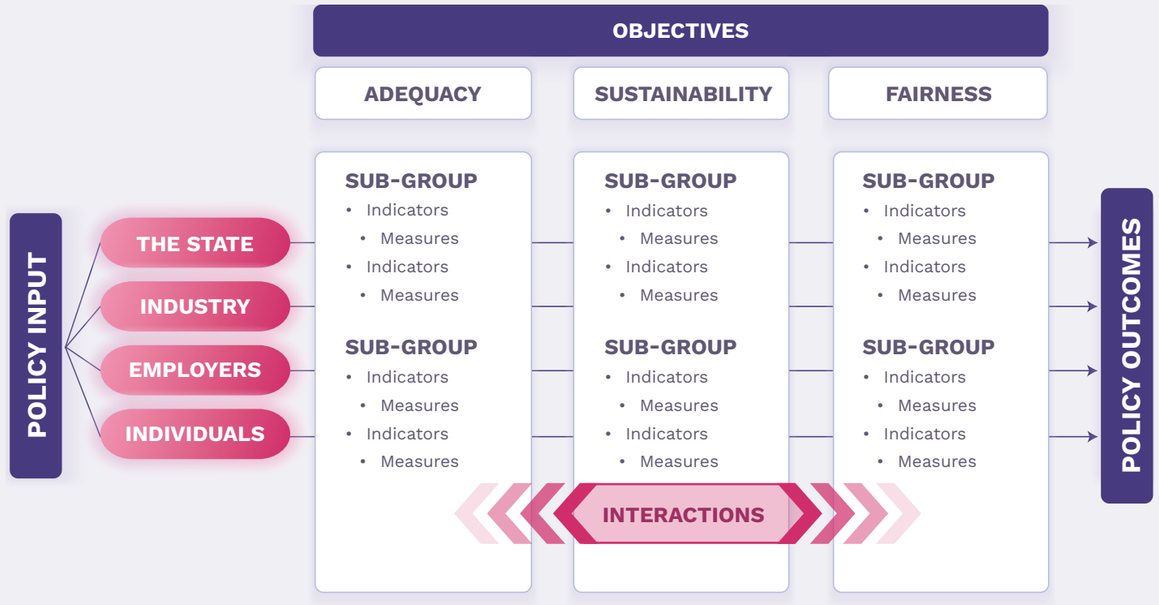
Transformations in the pension system are continuously shifting the balance between these objectives. Together, the scale of their effects has created the need for an analytical framework, tailored to the UK pension system, that can help to tackle its complexity by providing a single source of analysis into the implications of change through time. Until now, however, pension frameworks have largely been developed with the study of single dimensions such adequacy or inequality in mind, or for the purpose of learning lessons from around the world. In the case of international research, the tendency to place emphasis on system comparisons has generated a gap whereby the effect of country specific patterns and features, and the interactions that exist between them, have become difficult to track over time.

The purpose of the UK Pensions Framework is to fill this gap by providing a systematic approach to examining and simulating change in the UK pension system across all three dimensions of adequacy, sustainability and fairness. In doing so, it seeks to build a clear picture of how strengths and weaknesses of the UK pension system are evolving.

The challenges of pension reform underscore the need to develop consensus among all stakeholders around issues facing people in later life, what the system is aiming to achieve, and how it might be able to deliver on its goals. An important part of this process will be recognising that every individual and every retirement journey is different, and that people will require different levels of support if they are to be encouraged to save for retirement, feel a sense of ownership of their pensions, and live with dignity and security in later life.

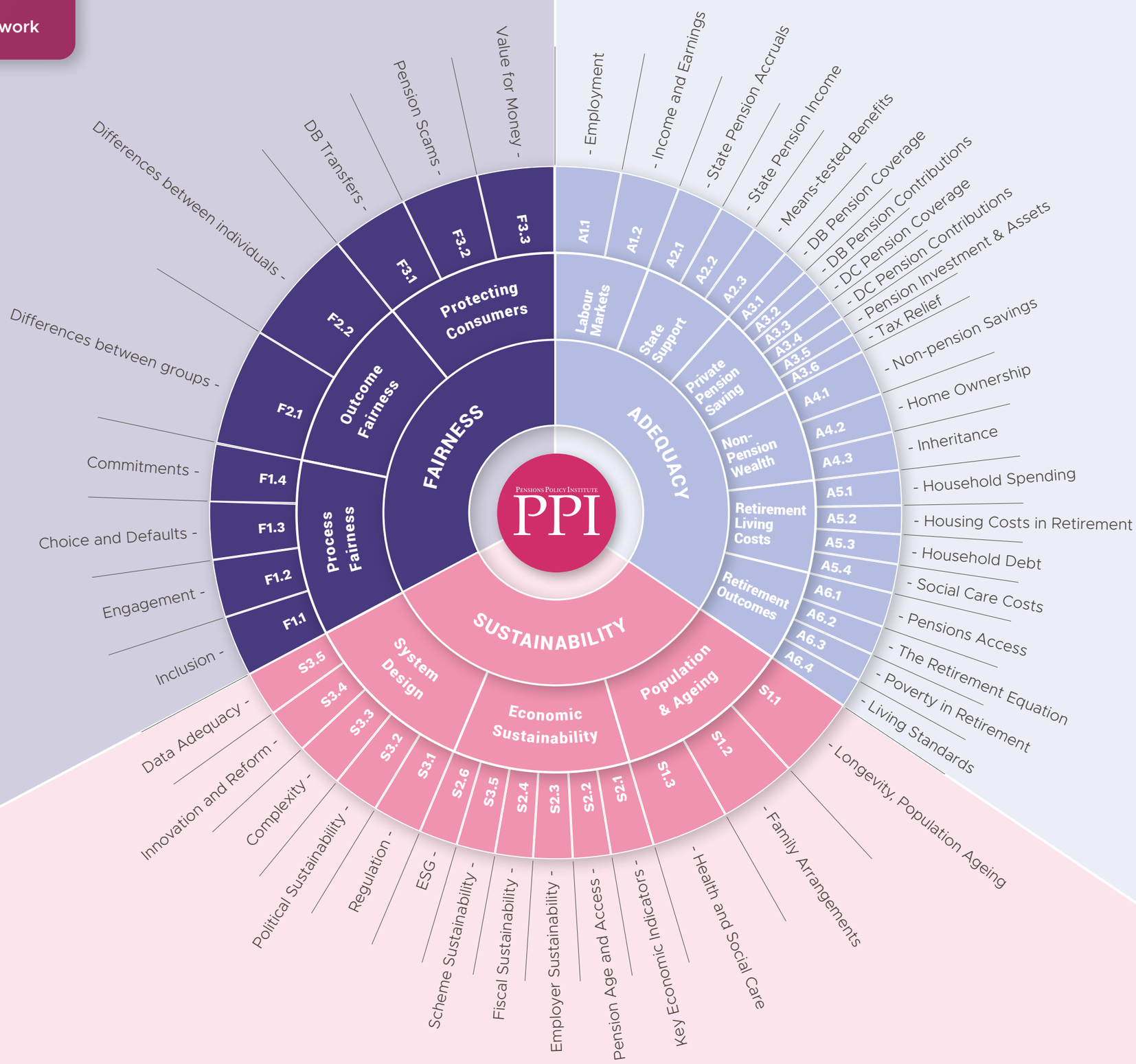
The structure of the Framework follows a consistent logic. Within each of the three overall objectives are a series of sub-objectives that represent core components of the pension system. Within each of the sub-objectives, a series of metrics have been identified to indicate the state and outcomes of the pension system. They are referred to as the indicators. They comprise both content indicators, which measure the shape and status of the system, and performance indicators, which measure its outcomes. Indicators are examined from the perspective of different stakeholder groups in order to establish how policy outcomes are produced in context of the current system, or a proposed change to it.

Figure Ex1: A schematic overview of the structure of the UK Pensions Framework



The Framework will also consider how policy outcomes might interact with other aspects of the pension system and public policy to produce trade-offs or unintended consequences, and how these impacts could change over time. To complete the analysis, each indicator is classified by the extent to which they support their respective objectives, before being grouped together to provide an overall insight into the strengths and weaknesses of provision for adequacy, financial sustainability and fairness across the system. Output will be brought together in chart format (Figure Ex2), a detailed example of which is provided as an illustrative case study in Chapter Four.

Figure Ex2: A visualisation of the content of the UK Pensions Framework



Comparing outcomes year on year can help to develop a picture of how pension outcomes, opportunities and risks are evolving over time

This report begins by articulating the need for a new analytical resource in the context of today's changing pensions landscape, before providing an overview of the content of the Framework and its three key dimensions. It ends with an illustrative case study which uses auto enrolment reform to demonstrate how the Framework can be used to compare the impact of changes in the pension system over time; and as a tool to simulate the possible effects of policy proposals.

The primary purpose of the Q4 2022 report will be to establish baseline measures against which changes can be assessed going forwards. Successive annual reports will aim to include analysis of findings related to specific indicators, groups of indicators, and overall Framework objectives which together can provide a clear overview of the strengths and weaknesses in the UK system. They are also expected to include analysis of cross-system issues that span multiple dimensions of the UK pension system, such as savers' journeys through from working life into retirement, environmental, social and governance (ESG), risk transfers, and how the system is working in respect of stakeholder groups. A technical update detailing the Framework's analytical methodology is also due to follow.

From 2023 onwards, and when policy simulations are conducted to support research, analysis will be compared against the baseline to establish how the system is evolving.

Building the UK Pensions Framework is a significant undertaking, and refining the output will require steady, measured steps in years ahead

Already, the scope and design of the Framework have posed many challenging questions, such as the extent to which non-pension factors that influence retirement outcomes including social care and home ownership should be incorporated; the way in which the wider objectives of sustainability and responsible investing should be reflected in the content; how to manage issues around availability of data; and whether or not the findings should be used to develop an index score to summarise system performance year on year. Many of these questions are addressed in Chapter Two. However, the overwhelming conclusion from work to date is that not every question can be answered immediately, and that the important goal for this year is to establish the foundations upon which the future of the Framework can be built.

Despite the transformations in pension provision to date, transitions in the UK pension system are by no means complete. On the contrary, the system is characterised by sensitivity to risks - demographic, macroeconomic, political and market, which demand continuous reassessment of principles and priorities. In turn, these reassessments bring about ongoing transitions from one state to another. They are also complicated by the notion that none of the components of the UK pension system, or the risks associated with them, exist in isolation. At any point in time, a transitory shift in one area can, through a complex web of interactions, lead to a catalogue of impacts in others. By recording and investigating the continuous nature of changes and interactions over time, the framework aims to provide stakeholders in the pension system with a comprehensive long-term resource that can ultimately support the development of policy and better outcomes in later life.

Introduction

Demographic forces including population ageing and rising life expectancy are interfacing with economic shifts that have produced low interest rate economies, low wage growth and a changing labour market landscape to transform the traditional notions of how we work and, crucially, how we retire. Over the past two decades and more, along with a series of policy reforms which dramatically altered the pensions landscape, these shifts have led to:

- Longer working lives with pensions being received at older ages
- The demise of Defined Benefit (DB) pensions outside the public sector
- Increased personal responsibility for retirement outcomes, a rapidly expanding Defined Contribution (DC) pensions market and the need for significant and complex decisions from savers
- Higher levels of participation in workplace pensions than ever before
- A lower, flat-rate new State Pension (nSP)
- Long-term declines in pensioner poverty, but with evidence of increases since 2015
- Greater flexibility in how people access and spend their income at retirement

The UK Pensions Framework provides a systematic approach to analysing the impact of change across the UK pension landscape, the actions and interactions that lead to different outcomes, and the way in which facets relate to each other over time. It also seeks to highlight and explain differences in financial security and experiences that people have in later life, the drivers of these differences, and what might happen if new policies are introduced.

Given the significant risks that change can pose to the adequacy of retirement income for current and future pensioners, the sustainability of the overall system, and the prevalence of inequalities in later life, it is important that a comprehensive analysis of research, statistics and time series data is available to document and explain developing trends and transitions. At present, no single resource is designed and dedicated to achieving this in the UK.

This report provides a non-technical insight into the structure of the UK Pensions Framework, along with the rationale for its design, an overview of the content, and a case study of how the information can be used. The first full analysis of the UK pension system will take place in 2022, and annually thereafter.

Chapter One examines key changes in the UK pension system, along with how the UK Pensions Framework can track them to inform policy debate over time

1

2

Chapter Two describes the overall design of the Framework, including what it looks like, how it was designed and how it will be used. It also outlines what the 2022 report is expected to cover, before highlighting some of the limitations of the work

Chapter Three briefly outlines the Framework definitions of Adequacy, Sustainability and Fairness, and provides an overview of the sub-objective groups and indicators that will be used to assess them.

3

4

Chapter Four uses recommendations from the 2017 Automatic Enrolment Review to construct an illustrative case study designed to show how the UK Pensions Framework can be used to compare changes that take place in the UK pension system.

Chapter One:
How are the dynamics of the UK pension system changing and why?

This chapter outlines key changes in the UK pension system and how the Framework can track them to inform policy debate

FRAMEWORK

1. A basic structure underlying a system, concept, or text

The main aims of this chapter are to:

- Outline how recent economic trends, demographic forces and policy reforms in the UK pension system are transforming the way people work and retire today
- Describe how trends are expected to develop in the future and what further challenges lie ahead
- Demonstrate why the UK Pensions Framework is needed to bring together outcomes from across the pension system

Introduction

This chapter sets out how the UK pension system is in a state of transition, driven by a series of economic, demographic and policy changes and reforms that collectively have the capability to transform the pension landscape over time.[1]

Its purpose is to demonstrate the need for a resource that can regularly bring together clear and comprehensive analysis from across the pension system to support consistent long-term decision making in pensions policy, and to provide an instrument through which the effects of future changes in the system could be simulated for research purposes.

It discusses the questions:

- What is the UK pension system and how is it changing?
- How big is the UK pension system?
- What changes have impacted the shape and design of the UK pension system?
- What changes have impacted individuals, households and their pensions?
- What changes have taken place in the State pension system?
- What changes have taken place in the private pension system?
- How is the overall design of the system changing?

What is the UK pension system?

`

The overarching goal of pension systems is to support financial security in later life through poverty protection, smoothing consumption, insurance and redistribution[2]

- **Poverty protection:** Targets resources on people who are unable to save enough for retirement, or who are poor on a lifetime basis.
- **Smoothing consumption:** Allows people to maximise their wellbeing over a period of time by transferring consumption from working life into retirement, through saving.
- **Insurance:** Pools savings, and ultimately risk, across groups to protect people against uncertainties, such as how long they might live or how much their savings might be worth.
- **Redistribution:** Involves pooling incomes and redistributing them on a lifetime basis towards individuals, households and across generations.

The history of pensions in the UK goes back for centuries. The first employer pension was the Chatham Chest in 1588, which provided a benefit for sailors injured in the line of duty.

The State started to provide an income to older people in 1908, which was non-contributory, means-tested and paid only to people over age 70. The foundations of the current UK State Pension system were laid in the 1940s when male and female State Pension ages (SPa) were set at 65 and 60 respectively, and the National Insurance Fund was introduced. Since the 1960s, successive Governments have made many changes to both State and private pensions, resulting in today's complex and multi-layered pension system. Individuals who do not receive pension income above a minimum basic level are also entitled to means-tested benefits.

The development of the pension system reflects the notion that no single policy instrument exists to optimally support all four elements of providing financial security at the same time.[3] The UK pension system therefore comprises a series of instruments upon which reforms can draw in order to adjust the balance between elements to the desired level. In addition to means-tested benefits, which are aimed at protecting people without minimum levels of retirement income from poverty, the UK pension system comprises:

- **A first-tier unfunded public State pension** which redistributes money throughout the population to provide all individuals with a minimum standard of living.
- **A legacy second-tier additional State pension** which has been replaced by first-tier provision since April 2016, but provides individuals who retired before then with additional State pension income more closely related to their earnings level than the flat first-tier rate.
- **A third-tier occupational or private pension** which includes public and private Defined Benefit (DB) and Defined Contribution (DC) pensions, funded through individual and/or employer contributions. Contributions and returns receive tax relief. Private pensions are intended to distribute earnings across the life course.

Changes in policy design and pension outcomes highlight the need for a framework that can help to tackle the vast array of questions, uncertainties and challenges around the future of UK pensions.

Over the past twenty years, unprecedented change in the UK pension system has brought about many positive outcomes. However, it has also produced new concerns and highlighted the impact of existing challenges and inequalities.

Many changes, particularly industry-wide initiatives such as the implementation of automatic enrolment, have demonstrated what can be achieved through consensus and shared policy goals. Momentum is also accelerating for actors to build upon this collective approach and harness the potential for pensions to generate positive value for society. However, rates of improvement in pension outcomes are not keeping pace with rates of change in the system. As a result, there are widespread concerns that many people, particularly those approaching retirement in the next twenty years, will need greater support from policymakers, the pensions industry and employers to engage with their savings and optimise their retirement outcomes if they are to achieve a standard of living that meets their needs and expectations in later life.

Transitions in the UK pension system are by no means complete, however. On the contrary, the system is characterised by sensitivity to risks, market, political, demographic and macroeconomic, which demand continuous reassessment of principles and priorities. In turn, reassessments bring about continuous transitions from one state to another. They are also complicated by the notion that none of the components of the UK pension system, or the risks associated with them, exist in isolation. At any point in time, a transitory shift in one area can, through a complex web of interactions, lead to a catalogue of impacts in others.

Overall changes to the shape and design of the UK pension system

1. The concept of what constitutes a pension is changing as savings pots replace guaranteed income streams in retirement, and there is a need to define what constitutes a good outcome.
2. Responsibility for financial wellbeing is being transferred away from the State and employers towards individuals, although the State and other stakeholders still have key roles to play in risk-sharing and creating the conditions necessary for adequacy.
3. Pensions remain closely linked to labour markets as a result of growth in workplace pensions coverage; rises in the SPa; and policies to encourage employment and discourage early retirement among older workers. Dynamics between employers and pensions are also changing as people move jobs more often and delivery is supported by third-party providers.
4. Future reforms will likely build on the strengths of the DC system and strong framework that automatic enrolment has provided to expand pensions coverage and increase to target inequalities, improve predictability of outcomes, and enhance focus on lifetime income and consumer journey. However, the post-retirement income market is relatively under-developed, with significant longevity tail risk for individuals and households.
5. There is increasing complexity in the pension system, and the long-term nature of pensions means policy reforms can be slow to make an impact

[1] Pensions Commission (2004)
[2] World Bank (2008)
[3] Tinbergen, J. (1954)

6. Sensitivity to demographic and economic change continues to underpin sustainability concerns for unfunded elements of the UK pension system, including State and public sector pensions. Competition for funding is also growing between pensions and other public services like health and social care, which are also under pressure from population ageing.

7. A key challenge for the pension system is to limit the negative side effects of long-term trends such as longevity which, overall, are good news for society

8. Greater reliance on the private sector to provide pension solutions is creating the need for a more robust regulatory regime to help the industry build options that reflect the individual needs of pension savers; and protect savers from poor decisions and harmful outcomes.

9. For the pensions industry, scale is increasingly important in light of the need to simultaneously manage growing regulatory and operational duties and investments

10. Some policies are designed with conflicting mechanisms, with retirement outcomes relying simultaneously for example on both inertia (for example automatic enrolment) and engagement (for example pension freedoms)

11. Changing policy regimes are being driven by the need to respond to emerging social and environmental challenges, as well to help manage record peacetime debt levels

Overall changes impacting individuals, households and their pensions

1. Policy trade-offs between sustainability and adequacy are becoming more apparent now that coverage has increased, with pension adequacy becoming the biggest challenge facing individuals in retirement

2. Most people will need to save more and work longer if they are to maintain their working age standard of living from working through to later life.

3. Individuals need to balance long-term savings adequacy and short-term affordability pressures, recognising that financial trade-offs people make today can also have an impact on their future such as the growing numbers of people facing higher housing costs associated with mortgages and renting in retirement

4. The tension between saving for a home and saving for a pension is a concern for many, with housing assets representing a much greater proportion of people's portfolios than financial assets, and the two assets being subject to different tax treatment

5. To achieve financial resilience, disposable income will be needed in addition to pensions if people are to withstand short-term financial shocks in later life. For those with sufficient savings who want flexibility in retirement, more choices are available than ever before.

6. As coverage increases, overall policy focus is shifting towards tackling inequalities and improving retirement outcomes among at-risk groups. However, inequalities are widening along dimensions of gender, ethnicity age, health, income level and other factors, some of which are exacerbated by issues of inclusion and eligibility criteria

7. Asymmetry of information between providers and savers is a challenge for those who need support to make good retirement decisions, and is exacerbated by lack of engagement, unclear expectations and barriers to saving that arise from behavioural biases including inertia and difficulty making optimal adequacy assessments

8. Lack of information is also a problem for providers, who know little about the profile and preferences of savers beyond the size of the accounts they manage or perhaps the employer they currently work for, presenting a challenge to long-term, holistic decision making

9. In some areas, there is significant debate over the conflict between the individual's right to choose outcomes that best meet their preferences in later life, and their right to be protected from harms that could be involved in the process of doing so

10. Lack of confidence among individuals in the overall system and their ability to navigate it could be exacerbated by poor retirement outcomes which risk further undermining pension preparations and people's trust in pensions as an important and effective tool for retirement

How big is the UK pension system?

The size of the UK pension system is vast and growing every year, both by the number of savers in the system and the value of savings

£9.7 trillion

The total value of accrued-to-date gross DB liabilities and DC assets of the UK Government and pension providers in respect of personal, workplace and State pensions in 2018.

In 2018, savers in the UK pension system had accrued an estimated £9.7 trillion in gross pensions entitlements and assets. The total was equivalent to 436% of UK GDP,[4] more than five times Government debt. Just under two thirds of the total, £6 trillion, can be attributed to unfunded or pay-as-you-go arrangements managed by central or local Government, with State Pension liabilities comprising the largest component at £4.8 trillion.[5] A further £3.7 trillion of the total related to private sector DB, DC and personal pensions, the assets underlying which continue to account for over 60% of all institutional assets under management.[6] In the private sector, £2.6 trillion relate to DB liabilities,[7] and one third or £1.1 trillion to DC assets.[8] Of this £1.1 trillion, around £400 billion was held in DC workplace pension schemes, and £700 billion in individual personal pensions, assets in income drawdown and assets backing annuities.

For most people, saving into a pension is the second biggest financial commitment they will make after buying a home. By comparison, the overall value of UK housing stock at the end of H1 2021 was £6.4 trillion, almost double the value of private pension assets and liabilities. Of the total, £4.9 trillion was held in private property wealth and £1.5 trillion in mortgage debt, meaning that more than three quarters of the value of the average home is tied up in equity rather than debt thanks to rising property prices.[9]

12.1 million

The number of people who were over the SPa of 65 in the UK in 2018, equivalent to 18.3% of the UK population, who were mostly retired with a combination of State, DB and personal pensions

The size of the pension system, the number of people saving, and the growing cohort size of older age groups in the UK demonstrates the significant scale of impact that changes to pensions and policy can have.

Perhaps the most significant overall change in private pensions policy in recent years is the extent to which individuals are becoming increasingly responsible for their own retirement risks, which comprise adequacy, investment and longevity risks. The challenge for policymakers underlying these changes has been how to meet the needs of a growing older population, whilst also managing the costs of the pension system. Costs are coming under increased pressure from growing burdens of public debt and competing pressure for funding from other public services such as health and social care. They are also heavily impacted by both economic factors such as low interest rates, and changes to the size and structure of the aging UK population.[10]

The far-reaching impacts of population ageing will be a defining factor behind the fiscal, economic and social changes that societies are likely to experience in the next three decades. Their consequences will impact not just upon social structures, economic growth and labour markets, but also upon

[4] ONS (2021b) GDP in 2018 was £2.2 trillion; ONS (2021d)
[5] ONS (2018a) Valued from the National Accounts. Figures do not include benefits such as pension credit or other forms of social assistance; ONS (2018a)
[6] The Investment Association (2020)
[7] The Investment Association (2019) & The Pension Protection Fund (2018). Comprises £2 trillion DB AUM and a deficit of £584 billion on a full buy-out basis. Figure includes DB and hybrid workplace pension entitlements, including trust-based occupational pension schemes, pensions administered by the Pension Protection Fund.
[8] The Investment Management Association (2019). Comprises DC workplace pensions, individual personal pensions, assets in income drawdown and assets backing annuities.
[9] Equity Release Council (2021)

Government budgets. The effect of demographic change on Government budgets is twofold, with important implications for pensions. On the revenue side, it reduces the size and changes the composition of the work force, which in turn reduces the size and changes the composition of tax revenues. On the expenditure side, public spending on welfare and services such as pensions, health and social care, adjusts to accommodate greater levels of need. The net impact is an increase in costs which mostly benefit older individuals, but are borne by the younger generation, as a result of the imbalance between the number of beneficiaries and the number of contributors in the system.[11]

What changes have happened in the State Pension system?

Transformative policy reforms have largely been introduced to manage costs and increase State Pension coverage

To keep up with increases in life expectancy, the SPa rose from 65 to 66 in 2020 and will rise again from 66 to 67 between 2026 and 2028. These changes underpin the notion that rising longevity can be seen as part of the solution to system reform, not simply part of the problem. Encouraging people to work later can help them to preserve the value of their savings, put more aside, remain active, and support the wider policy objective of reducing economic dependency on the working population.

The flat rate new State Pension (nSP), introduced in 2016, also targets the financial sustainability of the pension system by lowering long-term liabilities for future taxpayers and representing a return to Beveridge-style principles on which the system was founded.[12] Alongside reforms which correct the growing imbalance between the size of working age and retired populations, further reforms have further sought to ensure greater levels of coverage by providing credits to people not in the workforce due to ill health, unemployment or caring responsibilities.

Overall, however, the composition of the workforce is changing as more people work up to and beyond SPa. So much so that commentators are questioning the value of traditional measures of population age structure, such as the Old Age Dependency Ratio (OADR), in measuring economic dependency as being over SPa does not necessarily mean that someone is retired, nor that all working-age people are in employment. Rates of employment among older age groups are rising, particularly among women who are at increased risk of poverty in later life. The extent to which good, secure jobs are available to older people in the labour market will be an important measure for the Framework to examine in respect of pension adequacy over time.

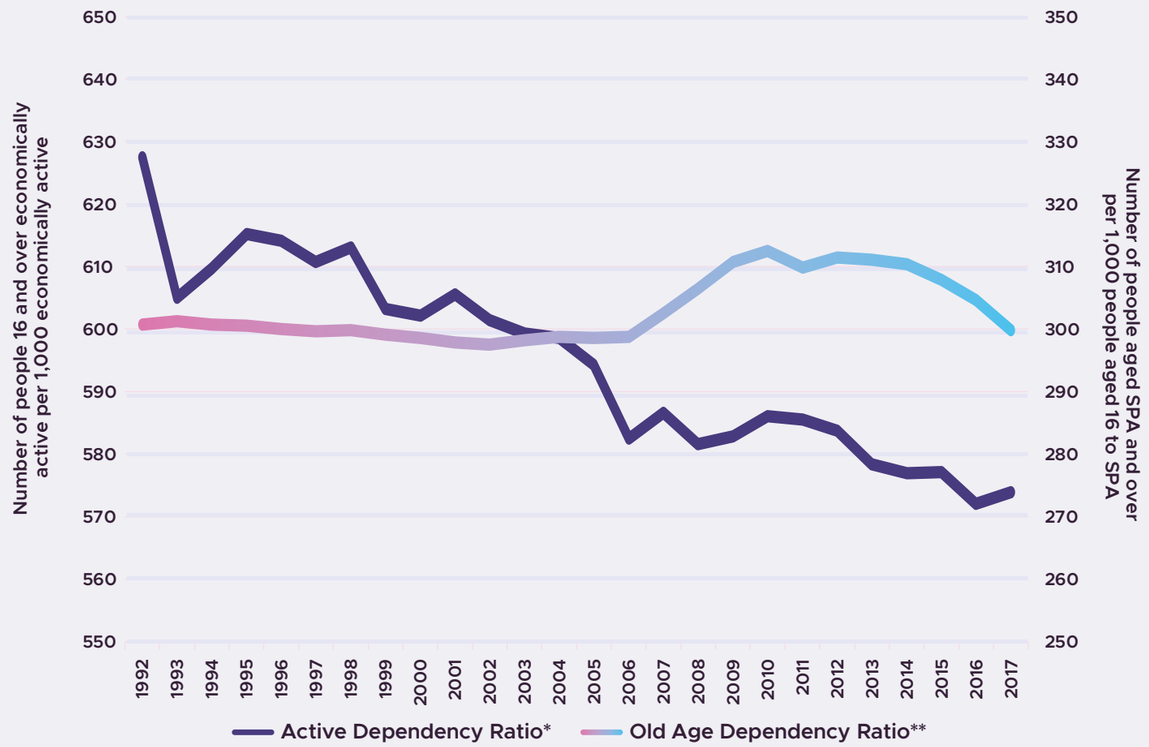
Measures such as the OADR, which include projected economic activity levels at older ages, may provide a useful picture of economic dependency as time goes on.

During the 1990s, the OADR remained at around 300 people over SPa per 1,000 people aged 16 to SPa, then rose above 300 from around 2007 to peak in 2010 before decreases reflected changes in the SPa for women (Figure 1.1). The size of the baby boom cohort delayed the effect of underlying long-term growth in longevity and declining fertility rates, but the OADR will now produce 30 years of very rapid increase as it looks set to increase to 361 by 2050.[13] Over the same period, however, the overall active dependency ratio fell from 627 economically inactive people over age 16 per 1,000 economically active people, to 573 - as labour market participation rates have gradually risen over time.[14] The framework will look at both measures.

Between 1992 - 2017, economic dependency showed an overall improvement despite the population becoming older

Changes in the proportion of economically active people over 16 and over State Pension age in the UK from 1992 to 2017

Figure 1.1: Active and OADRs in the UK 1992-2017



* Relationships between economic activity and dependency are complex, measures are not precise. People may be economically active but not entirely independent, or they may be economically inactive but not economically dependent. ** The decrease in the OADR from 2010 is caused by the rise in SPa for women which offset rising trends. The OADR is expected to rise to 361 in 2050 when planned future rises in SPa are incorporated. It is not a measure of economic activity. Source: ONS (2019) Living longer and old age dependency, what does the future hold?

[10] ONS (2019a)
[11] Bogetic, Z. et al (World Bank) (2015)
[12] Price, D. (2008)
[13] The Pensions Commission (2004)
[14] ONS (2019a)

In spite of these changes, the State Pension, along with other forms of support including pension credit, is expected to remain the primary source of retirement income for much of the population earning below the median income level.[15]

Over time, a growing share of retirement income has been paid from private pensions and a smaller share from State Pension and benefits. The proportion of income that pensioners received from State Pension and benefits fell from 55% in 1997/8 to 49% in 2019/20.[16] However, this trend towards increased dependency on private pensions as a share of income could be set to reverse in years ahead, as more people reach retirement both without DB, and without sufficient DC savings to make up the shortfall. Continued high rates of dependency upon State provision for as many as half of all pensioners will therefore mean that decisions regarding future levels of the State Pension will impact both how much people need to save, and the standard of living they can expect in later life.

Pensioner poverty fell to a 30-year low in 2013, but has begun to rise over the past five years[17]

Pensioner poverty fell significantly from 39% for single women, 38% for single men, and 22% for couples in 1994-5 to 20%, 14% and 11% respectively in 2014/15.[18] The changes occurred as retirement incomes rose faster than earnings, more people retired with generous DB income, and retirement age benefits increased faster than working age benefits. However, pensioner poverty has begun to increase since 2015, and shifts away from DB schemes, accompanied by lower contribution levels, will increase the prospect of lower retirement incomes in the future.

Despite pensioner poverty levels reducing over time, however, a significant proportion of people in the UK are unlikely to reach retirement with a minimum or personally acceptable level of income (Figure 1.2). The Independent Public Service Pensions Commission identified that the State Pension, supplemented by pensions contributions of 8% of relevant earnings, would deliver around half the level of savings needed to meet satisfactory retirement incomes for most individuals.[19] This will be explored in detail in the Framework.

Figure 1.2[20]

The UK is currently on course for a quarter of people approaching retirement being unlikely to receive even a minimum income and nearly a half failing to meet a personally acceptable level of income in retirement. Fewer than one in 10 can expect to live a comfortable life in retirement based on the Pensions & Lifetime Savings Association's (PLSA) retirement living standard targets.

Of the 11 million people in the UK between the age of 50 and SPa:

- Around 3 million will not receive a minimum income
- Around 5 million will not receive a personally acceptable income
- Around 10 million will not receive a comfortable income

Those earning at median levels or below, women, people from BAME (Black, Asian, Minority Ethnic) groups, carers, disabled people and the self-employed are more likely to be in the groups not meeting adequacy levels throughout retirement.

Those approaching retirement with lower levels of DB pension entitlement may also struggle to achieve adequate retirement incomes. This group is set to expand in future with the decline of DB provision in private sector workplaces and will affect Generation X and younger Generations more than those reaching retirement in 2021.

Widespread inequalities that persist in society, many of which have been highlighted and exacerbated by the global pandemic, risk being perpetuated in retirement.

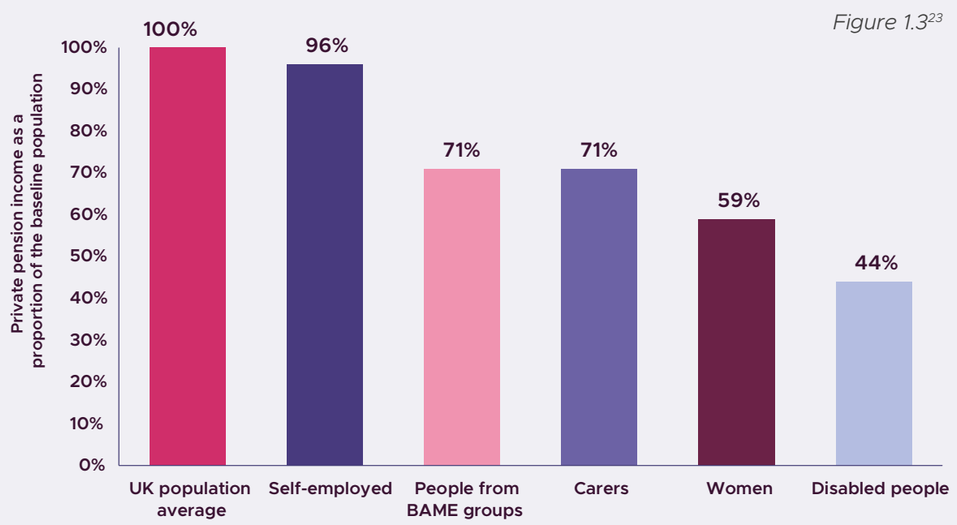
The global pandemic brought unprecedented financial challenges for millions of people, and the people who suffered financially during the crisis are those most likely to experience disadvantages in their long-term preparation for retirement. There have long been significant inequalities in retirement provision in the UK, and although automatic enrolment is working to reduce some existing gaps, it does not extend uniformly to groups most at risk of poverty and insecurity in later life. These groups include, but are not limited to, women, particularly single mothers and divorced women, the self-employed, part-time workers, BAME groups, people with disabilities, and carers.[21] (Figure 1.3)

A key objective of the Framework will be to track changes in labour market behaviours and social conditions to understand how they interact with pension outcomes to increase or decrease inequalities in later life. It will also take into account the policy instruments that are available to offset differences, especially gender differences, in paid work, earnings and unpaid work as well as the extent to which vulnerable groups are protected through redistributive benefits.[22]

Underpensioned groups have lower private pension income than the UK average

Private pension incomes as a proportion of population average by underpensioned group, aged 65+, 2018

Figure 1.3[23]



[15] Silcock et al (PPI) (2019)
[16] Adams, J. & Luheshi, S. (PPI) (2021)
[17] Measures of pensioner poverty are not precise as they do not include extra daily living costs associated with disability or old age, even though the benefits paid to cover these costs are counted as income
[18] JRF (2021)
[19] DWP (2017)
[20] Source: Hurman, N., Jethwa, C., Pike, T. & Silcock, D. (PPI) (2021)
[21] Gould, S. (2021)
[22] Arza, C. (2016)
[23] Wilkinson & Jethwa (2020)

What changes have happened in the private pension system?

The private pensions landscape is also undergoing a transformation as private sector DB schemes and their guaranteed incomes have been in decline for several years.

Many DB schemes in the private sector have closed to new and active members, unable to sustain the costs associated with providing guaranteed, inflation linked income for life in the climate of low interest rates, low investment returns and rising longevity. As a result, many private sector DB schemes are now approaching their endgame scenario with solutions such as insurance buy-outs and bulk annuity purchases, having turned their attention away from new member and accruals and towards ways in which they can continue to provide member benefits whilst minimising the costs and risks to the sponsor.

Unfunded public sector DB schemes remain open to new members and accruals, with members benefiting from employer contributions of around 20%, double the typical rate for large companies in the private sector.[24]

In 2021, 5.6 million people were employed in the public sector.[25] Over recent years, the gap between public and private sector pension provision has grown significantly as DB arrangements in the private sector are replaced by DC schemes and lower benefits from the employer. At the same time, public sector DB schemes remain open, offering employer contribution rates that are significantly higher than private sector. Participation rates amongst employees are over 90% compared to 73% in the private sector with the biggest differences in coverage typically observed at lower income levels due to differences in eligibility criteria.[26]

The sustainability of unfunded DB public sector pensions, which face the same challenges of rising costs and low interest rates as those in the private sector, is likely to come under increased scrutiny in years ahead and will be included within the scope of the Framework. At present, there is a lack of clarity over the real annual cost of public pensions. A recent Government consultation on how the annual cost of public sector pensions should be measured is likely to produce greater discussion over how public sector DB pensions can be made more sustainable in order for public sector pension schemes to be maintained in the future.

The decline in private sector DB pensions has been accompanied by an equally rapid expansion in membership of DC pensions.

By June 2021, 10.5 million people had been enrolled in DC pension schemes thanks to the introduction of automatic enrolment in 2012. By 2041, there could be more than 15 million active DC savers overall and up to 10 million savers in master trust schemes. Significant reforms to bring younger, low-income and part-time workers into scope for workplace saving are already under review.[27] However, the number of jobs in which employees did not qualify for automatic enrolment on account of their age or earnings has also continued to grow rapidly, reaching 10.1 million by June 2021. It is likely that the number of individuals impacted is lower than this because some will hold multiple jobs. A further 4.4 million workers do not qualify for automatic enrolment into workplace pensions, or the associated benefits of employer contributions, on account of their self-employed status.[36]

Average DC saving levels are relatively low as a result of people being automatically enrolled and accruing initially small pension pots, but they are now growing.

Thanks to the increase in minimum contributions, all employers having staged and pots having some time to increase in value, median pot sizes have begun to increase, having initially fallen from when automatic enrolment was introduced.[28]

Over time, the median DC pension pot at SPa could grow from around £38,000 (for those aged 55 to 64 in 2021), to around £63,000 (for those aged 35 to 44 in 2021) over 20 years, assuming that those currently contributing to a pension fund with their employer continue to do so.[29]

Despite the expected growth in asset values over time, however, there are widespread concerns that current average contribution levels, which are typically set at around the default minimum threshold of 8%, will not be enough for everyone to receive an adequate income in retirement.

The value of assets in DC workplace pensions is growing rapidly, with total assets under management in 2020 estimated to be in the region of £470 billion.[30]

The Framework will seek to examine how employee and employer behaviour and Government policy will affect the aggregate value of DC schemes in the future. Under a conservative scenario which assumes that current trends continue, assets could grow to £995 billion in 2041. However, the aggregate value of assets is sensitive to economic performance. If the market performs very poorly, DC assets could stagnate, reaching around £732 billion by 2041. In a very positive market performance scenario, DC assets could grow to around £1,307 billion by 2041.[31] The role of investment returns are crucial in growing and preserving retirement savings, and with 99% of savers remaining in their default investment fund, a key area of focus going forwards will be the extent to which these funds are generating value for money for savers.

14.5 million*

The number of jobs for which people in work did not qualify for automatic enrolment on account of age, earnings or self-employed status by June 2021

*The number of individuals affected is likely to be lower as some will have multiple jobs.

£995 billion

The aggregate value to which assets in workplace DC pension schemes could grow by 2041, up from £470 billion in 2020, assuming that current trends continue.

How is the overall design of the system changing?

Savings pots are replacing income streams in retirement

Alongside the existing option for savers to take a quarter of their pension as a tax-free lump sum as they approach retirement, new rules introduced by pension flexibilities in 2015 also allowed people to withdraw their pension pot as cash, and without drawdown limits. They marked the end of compulsory annuitisation and produced vast reductions in the number of people buying a secure income with their savings.[32] In turn, they also greatly increased sales of drawdown products and levels of dependency on personal savings.

However, the outcomes of pension freedoms are highly uncertain and will be a key area of focus for the Framework. The past compulsion to buy an annuity had the economic effect of creating a market free of self-selection bias, but concerns are being raised around behaviours and the need for individuals to engage with complex financial decisions at retirement. The risks that people make poor decisions, remain invested in underperforming funds or are exposed to pension scams has increased. Individuals in automatic enrolment schemes in particular are unlikely to have engaged with their pension saving, as the policy was designed to rely on inertia. Although work is underway to develop solutions to these challenges, it is not clear whether they will be appropriate for future cohorts of retirees, who may require different levels of individual help and support to current retirees.[33] The Framework will examine how engagement initiatives, financial advice and choice architecture are changing to see how they might influence outcomes in the future.[34]

The focus of regulation is shifting towards ensuring that people are making informed decisions about their whole pensions as choices have become complex, particularly for those who have multiple DB and DC pensions payable at different ages.

As the savings market shifts to a focus on DC, regulation is playing an increasingly important role in helping savers to achieve good outcomes. As funded private pensions, and therefore financial markets, play a growing role in financial security, new problems are created for public policy. Despite changes to risk-sharing arrangements, Governments have not entirely defaulted on their policy commitment to pension adequacy, nor to the associated implications for poverty that poor adequacy outcomes might have.[35] Shifts do, however, create the need for regulators to moderate the relationship between pensions and financial markets in order to protect savers from harmful outcomes and ensure that schemes do not default on their promises.[36]

In the case of DB, much of this regulation relates to the valuation models used to establish whether a scheme has sufficient funds to meet its commitments. In the DC world, however, there is greater risk for the individual, greater need for engagement and greater uncertainty of outcomes. As a result, regulation which seeks to protect savers from poor outcomes associated with asymmetry of information, poor value for money and pension scams amongst other examples, is undergoing rapid change. The impact of new regulation and regulatory approaches will be a key feature of the Framework and underpin the choice of indicators in the "Protecting Consumers", which is a sub-objective of Fairness.

The Framework is also designed to incorporate new and emerging concerns in the pension system as they develop

As both a forward- and backward-looking resource, which is based on the principles of the pension system rather than its processes, the design of the Framework will allow flexibility to incorporate and identify new themes going forwards. Where system level changes emerge over time, the Framework will adopt measures and information as they become available.

Themes which are expected to emerge in the future include how the rising cost of living and growing levels of inequality will impact standards of living among pensioners, and how labour markets will adapt as people work to older age. High levels of public debt are likely to put sustained pressure on welfare and benefits, and questions will prevail over how the system can remain resilient in the face of the challenges that undoubtedly lie ahead. The global pandemic and 2008 financial crisis have shown that whilst some challenges can be anticipated, others will be unexpected. The long-term security of people's retirement income will depend upon the ability of the pension system to smooth out the effects of these changes over time.

An important area of emerging policy focus across Government and industry is responsible investment, in which environmental, social and governance (ESG) factors play a key role.

The concept of sustainability is one that is increasingly important in all walks of life and is also becoming heavily embedded within the management of pensions and investments. Responsible investing refers to investment strategies which place value on the positive impact that investments can make upon society, as well as the financial returns they can generate. An increasingly common way to deliver it is through integrating ESG factors into investment processes, the purpose of which are also to protect against financial risk. The increased focus on responsible investing and ESG is discussed further in the supporting paper on Sustainability Concepts and Content. The Framework will incorporate measures relating to ESG investing and disclosures in the sustainability objective, and it will aim to incorporate further analysis relating to responsible investment in the future.

Finally, non-pension wealth will be included in the Framework, as funding retirement is more reliant on savings and income from outside the pension system than ever before

Measures of pension adequacy typically relate to levels of income that savings can be expected to generate throughout the duration of retirement. However, adequacy also relates to financial resilience and the ability for people to mitigate against unsustainable living costs, withstand short-term financial shocks or fund a lump sum purchase. Typically, the resources needed achieve this will come from outside the pension system in the form of non-pension savings such as Individual Savings Accounts (ISAs), additional income such as earnings in retirement, and home ownership, which can provide both protection against having to pay rent in later life, and a source of equity in times of need. These factors will be included in the Framework along with inheritance, which can offer a substantial boost to savings and is growing on average with each successive generation as wealth, particularly housing wealth, is passed between families.

[24] HM Treasury (2021)
[25] ONS (2021c)
[26] ONS (2021a)
[27] DWP (2017)
[28] Wilkinson, L., Adams, J. & Silcock, D. (2021)
[29] Wilkinson, L., Adams, J. & Silcock, D. (2021)
[30] The Investment Association (2021)
[31] Wilkinson, L., Adams, J. & Silcock, D. (2021)
[32] Silcock, D. et al (2019)
[33] Currie, G. (PLSA) (2019)
[34] LCP & Aviva (2021)
[35] DWP (2013)
[36] Mabbett, D. (2021)

Chapter Two:
Framework Design

This chapter describes the overall design of the Framework, outlines its content and provides and overview of how it can be used

STRUCTURE

1. The arrangement of and relations between the parts or elements of something complex

The main aims of this chapter are to:

- Outline the objectives of the UK Pensions Framework and its contribution to the field of pensions research
- Define the Framework structure and explain the rationale for the choice of objectives, indicators and content
- Describe key features of the Framework to demonstrate how it can be used to support policy analysis

Introduction

The purpose of this chapter is to set out the motivation for a new UK Pensions Framework, the context in which it has been developed, and details of what to expect in the first full analysis of the system due Q4 2022. It addresses the following questions:

- Why is the Framework being developed?
- How will the Framework be used?
- What does the Framework look like?
- How was the Framework designed?
- What other considerations or limitations are there?

The scope of the Framework will cover elements of the pension system relating to:

- **State Support:** The State Pension and means-tested benefits
- **Private Pension Saving:** Public sector Defined Benefit (DB), private sector DB, private sector Defined Contribution (DC)
- **Non-pension retirement wealth:** Home ownership, non-pension savings, earnings
- **Non-pension retirement costs:** Household debt, spending, housing costs, social care

Why is the Framework being developed?

A dedicated UK Pensions Framework can bring together analysis from across the pension system to build a picture of how changes are impacting retirement provision over time

The far-reaching impacts of changes in the UK pension system discussed in Chapter One highlight the many challenges and uncertainties that lie ahead for UK savers. They emphasise the notion that many questions remain unanswered. For example, how are people choosing to use the freedoms that were introduced in 2015? Will we continue to see sustained trends towards longer working lives? What could rising inflation mean for future pensioner poverty?

Pension systems do not exist in a steady state.[37]

At present, the UK pension system is perhaps mid-way through a series of steps from being a system characterised predominantly by State and employer-sponsored DB pensions, to a largely DC-based system in which the role of the State in retirement income is proportionately reduced.

For policymakers to know that individuals are able to save for a retirement that meets both their needs and their preferences, and that outcomes are sustainable and distributed in a fair way, it is critical to observe and analyse how these steps develop over time. It will also be important to examine the drivers of change, along with the way in which short and long-term outcomes might differ among actors and individuals.[38]

At present, there is no single resource to document and report on how widespread changes in the UK pension system are transforming the way in which people prepare for and live through later life.

In recent years, a number of analytical frameworks and surveys have been designed for the purpose of understanding and comparing pension systems. They are largely designed to:

1. Provide a conceptual framework from which to explain, compare and develop different pension system principles and designs;[39]
2. Provide a way to compare several dimensions of pension systems between countries over time. Objectives typically include factors relating to adequacy and sustainability, with various other considerations such as affordability, integrity or efficiency;[40] or
3. Provide a way to track detailed developments within a single dimension of the pension system such as adequacy, inequality or market developments.[41]

Other research is typically designed to carry out detailed, one-off current state analysis to inform policy recommendations such as the Pensions Commission; or examine elements of the UK pension system in the context of broader policy or market analysis such as the Office for Budget Responsibility (OBR) Report, or the Investment Association Annual Survey.

The goal of the UK Pensions Framework is to provide this resource by bringing together analysis from across three important dimensions of the UK pension system – adequacy, sustainability and fairness. Together, they are known as the Framework's objectives, because they each represent an important goal in the delivery of the pension system's overarching objective – providing financial security in later life. It proposes ways to measure each of the dimensions and track them over time, considers them from the perspectives of different actors in the system, and brings all these components together to show how they interact.

The search for a perfect or perfectly self-regulating pension system is an impossible undertaking, as the study of pensions is an inexact science [42]

The Framework does not seek to determine what an ideal pension system should aspire to look like, nor make specific recommendations in respect of how to improve. Patterns of economic, demographic, institutional and political constraints will change over time, as will society's preferences. This means that what might represent success in the pension system under one set of circumstances, will differ under another.

The reasons for these differences are complex. Of particular significance, however, are the relationships between policy functions that can bring about interactions, competing objectives, trade-offs, unintended consequences and political opposition, which exist at almost every level in the pension system and make coordinated reforms challenging to implement. The relative weight that society and policy makers attach to different objectives and outcomes also plays a key role in determining reform choices. Any number of factors could affect this, including ideology, economic climate and crises, social risks, and competing demands for public resources from other policy areas.

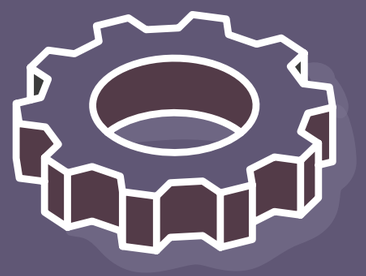
Instead, the aim of the Framework is to identify what can be improved by thinking about what the system trying to achieve, and the mechanisms it is using to do so. It brings together these findings to present an objective system overview of where the system is working well and where it is coming under strain. Focusing on where tensions may be the product of interactions or trade-offs between competing objectives can then inform discussion of how solutions might be structured to address them.

[37] Barr, N. & Diamond, P. (2006)
[38] OECD (2020)
[39] The most notable being the World Bank Pension Conceptual Framework of 2008
[40] Example framework series include the OECD Pensions Outlook, Pensions at a Glance and Pension Markets in Focus series, the Allianz Global Pension Report, and the Mercer CFA Institute Global Pension Index
[41] Examples include the DWP Framework for the analysis of future pension incomes, Scottish Widows Women and Retirement series, the PwC Pensions Support Index, the Global Pension Assets Study, the PPI DC Future Book, and the PPI Under-pensioned Index
[42] Borsch-Supan, A. (2014)

How will the Framework be used?

1

Analyse direct and indirect impacts of change

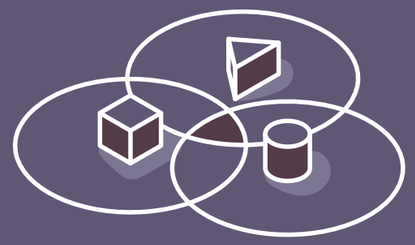


The UK Pensions Framework will support linear analysis of single objectives, such as the impact of population ageing on sustainability, and multidimensional analysis across objectives, such as how automatic enrolment reforms might impact adequacy and fairness for individuals, and sustainability for employers and the State.

By designing the Framework around three objectives, the analysis aims to reflect the notion that pension outcomes are the product of interactions that take place in multiple dimensions. Interactions and trade-offs will be an important feature of the research because the way in which policies relate to each other can differentiate outcomes between one group and another. Without considering the consequences that fall outside of a target policy area, there is also a risk that evaluation findings could produce a biased picture of what policy interventions have actually attained.

2

Track how and why outcomes differ among population groups over time



As well as high-level patterns and trends, the Framework will look beyond population level averages and into underpensioned groups to identify where pension gaps are narrowing or widening across the system, or where new gaps are emerging.

3

Examine how outcomes differ among actors in the system

Interactions and trade-offs which take place between actors in the pension system can also impact the extent to which the system is able to meet its overall objectives. Interactions between four groups will be considered to structure discussion and consider how the roles and responsibilities of each group are changing over time: individuals, employers, the pensions and financial services industries, and the State.

4

Simulate the effect of socioeconomic or policy scenarios on the pension system

In addition to conducting current state and time series analysis, the Framework can provide a policy simulation tool to help estimate the impact of how risks, opportunities or uncertainties in the UK pension system might evolve over time. Policy simulation would allow the analysis of questions such as: What would happen if automatic enrolment eligibility criteria were to be lowered? What would happen if the medium-term outlook for inflation were to increase? How might an increase in employer contributions impact longer-term adequacy? An example of how the Framework can be used for policy simulation is included in Chapter Four.

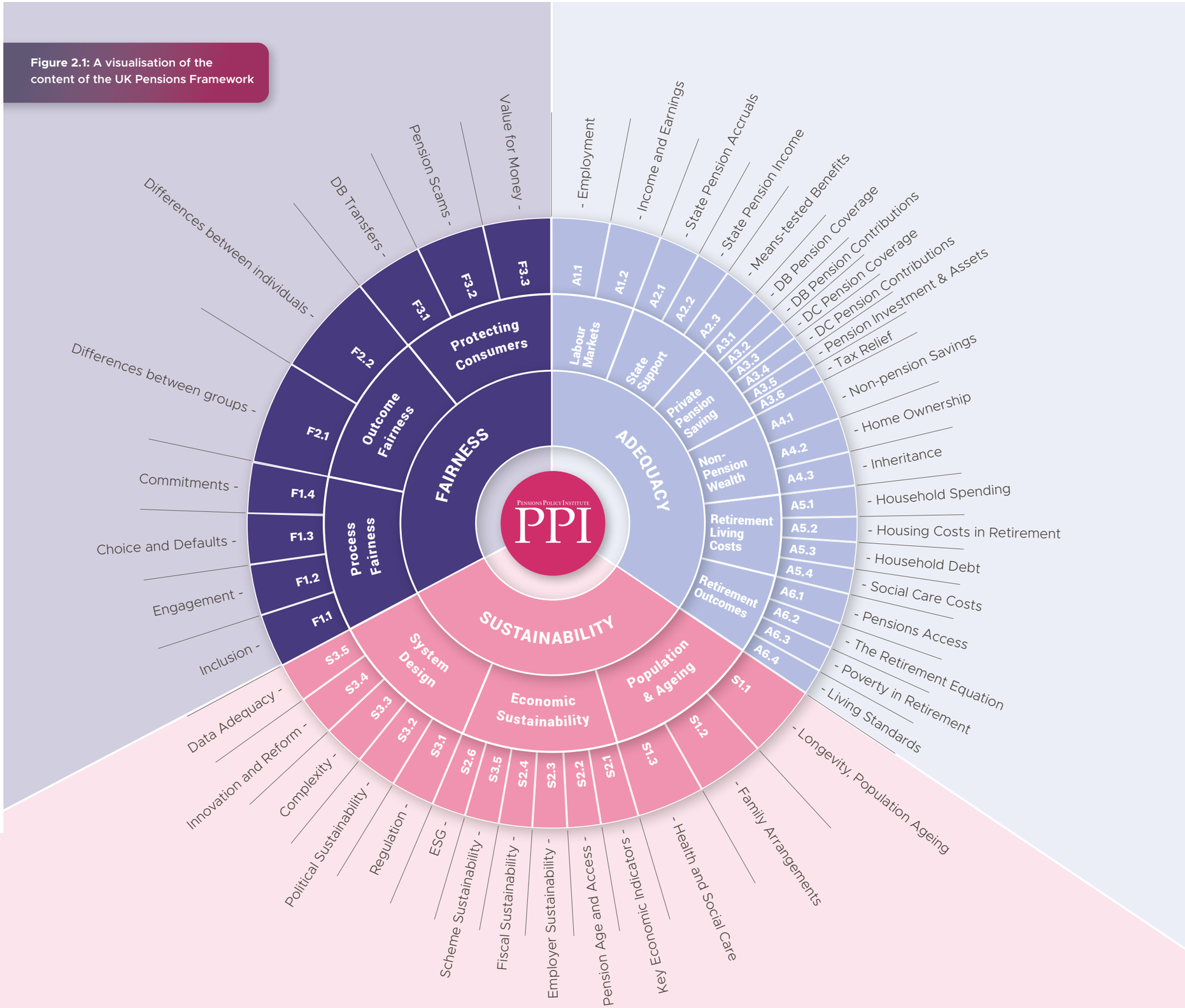
What does the Framework look like?

The UK Pensions Framework is organised around the objectives of adequacy, sustainability and fairness in the pension system, which overall determine the retirement security that people have in later life.

Each objective comprises a series of sub-objectives which reflect core components of the system. Within each sub-objective, a series of metrics have been identified to indicate the state and performance of the pension system. They are referred to as the indicators. They comprise both content indicators, which measure the shape and status of the system, and performance indicators, which measure its outcomes.

Findings from analysis across the Framework are brought together in a single chart which will use a consistent classification system to enable high-level comparison of strengths, weaknesses and changes in the UK pension system (Figure 2.1). Classifications are designed around a series of targets and parameters specific to each indicator which overall describe the extent to which it supports the relevant Framework objective. The chart is divided into three parts, each representing one of the main Framework objectives. The size of each part is not intended to reflect relative importance, as content will not be weighted in the early stages of the Framework. However, the option to do so will be kept under review. The case study provides a more detailed description of how the chart can be used.

Figure 2.1: A visualisation of the content of the UK Pensions Framework



The Framework reflects the wide range of influences that together determine retirement outcomes by including factors that relate both directly and indirectly to pensions.

The list of indicators in Figure 2.1 shows that the range of factors which influence pension outcomes extend far beyond the pension system. They include many factors which impact directly on system outcomes, such as A3.3 DC Pension Coverage and A3.4 DC Pension Contributions, as well as others which impact indirectly upon the system as variables which affect overall adequacy, sustainability and fairness. Indicator S1.1 Longevity & Population Ageing is an example. The indicator will be used to identify where demographic change is taking place that could impact the sustainability of the system and of retirement outcomes. This is because changes in how long people live can impact the amount of time spent in retirement and how the cost of retirement might change as a result. It forms part of sub-objective group S1: Population & Ageing, which sits under the overall Sustainability objective. The indicator will consider measures of population ageing such as the Old Age Dependency Ratio (OADR) and the Active Dependency Ratio (ADR), as well as measures of life expectancy and healthy life expectancy among different groups of the population.

How is the Framework designed?

Aligning the objectives of the Framework with the objectives of the pension system enables long-term, consistent analysis, even if the institutions and processes change within it

The Framework design is built upon two key principles:[43]

- Pension systems can have multiple objectives, not all of which can be fully achieved at the same time
- The weight given to each of these objectives by politicians and society will change over time according to socioeconomic circumstances, as well as societal norms

The structure of the Framework's analysis follows a clear logic. It begins by examining a series of indicators within each of the three Framework objectives, before considering the extent to which outcomes might lead to interactions or trade-offs elsewhere in the system. Findings across each indicator are then classified by the extent to which they support their respective objectives, before being grouped together to provide an overall insight into levels of adequacy, sustainability and fairness that exist in the UK pension system, both now and in the future.

Adequacy, sustainability and fairness reflect different objectives necessary for the pension system to deliver its overall goal of providing financial security in later life

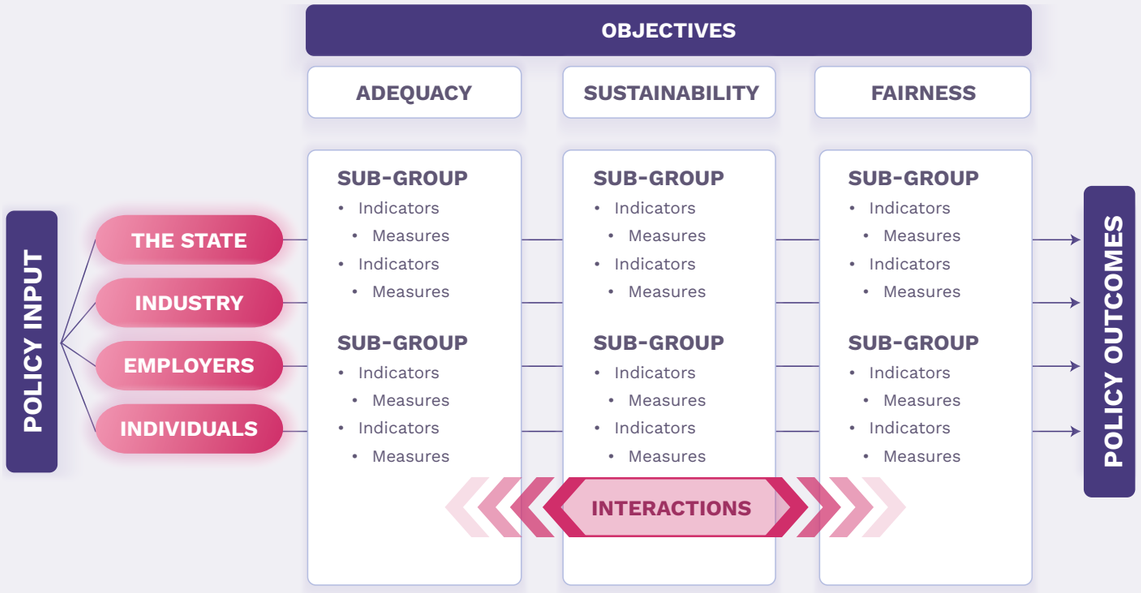
Together, the three objectives reflect the notion that the security of pension provision is determined across several different dimensions and over long periods of time. These objectives also aim to help make sense of how policy outcomes relate to each other in order to understand what changes could mean for longer-term financial security, behaviours and inequality in later life, and the extent to which individuals are prepared for retirement risks that are rising with each successive generation. In this way, measures in the Framework are not tied to institutions or processes in the system which could change over time. Rather, they enable a clearer long-term picture how policy decisions, socioeconomic change and development in the pensions industry are changing the balance between the three objectives through time.

Together, these objectives allow the Framework to address three key questions.

1. To what extent is the pension system supporting adequacy, sustainability and fairness as elements of delivering overall financial security in retirement?
2. How do policy levers and their interactions contribute to these outcomes?
3. How do outcomes vary among the different groups who participate in the system?

Figure 2.2 shows how the components of the UK Pensions Framework can be brought together to address these questions. First, the system can be examined in respect of each individual objective, taking into account associated impact on different actors in the system. Secondly, the extent to which policy levers and interactions contribute to these outcomes can be considered by looking at or simulating how relationships between indicators across the Framework are contributing to change over time. Thirdly, impacts for different actors can be aggregated across the Framework in order to identify overall constraints facing each group.

Figure 2.2: A schematic overview of the structure of the UK Pensions Framework



The overarching goal of pension systems is to support financial security in later life through poverty protection, consumption smoothing, insurance and redistribution

Recognising that processes in the pension system are not stationary, the criteria against which the UK pension system will be analysed are directly derived from its strategic objectives, rather than the institutions within it. This design reflects the notion, as discussed above, that pension systems are constructed from a series of ever evolving and continuously competing processes that operate in multiple dimensions.

Adequacy

Adequacy is a critical objective of welfare policy that can be used to determine the effectiveness of social protection. In the context of the pension system, the parameters around what makes an outcome adequate can be set in three different ways. These dimensions are discussed further in the Adequacy Concept and Content paper, but can be summarised as:

1. A **minimally acceptable level of income** and **protection against deprivation**
2. An **acceptable level of income** relative to an individual's earnings during working life
3. The **financial resilience** to withstand short-term financial shocks

In the Framework, adequacy means a clear and reliable system which enables people to plan for a retirement that provides them protection against poverty, some financial resilience, and the ability to maintain their living standards from working into later life. The objective comprises indicators relating to labour markets, State support, private pension saving and investing, non-pension savings and assets, retirement living costs and retirement outcomes.

Sustainability

Sustainability refers to the way in which risks that could compromise affordability, stability, efficiency and integrity are managed in the UK pension system.

In the Framework, sustainability means meeting the needs of the present without compromising the ability of individuals, stakeholders and future generations to meet their own needs.[44] Its components are discussed further in the

[43] Barr, N. & Diamond, P. (2008)

Sustainability Concept and Content paper, but overall include measures related to risks associated with populations and ageing, the costs of financing and resourcing pensions, and the way in which sustainability is embedded in system design through regulation, political consensus and complexity.

Pension reform has been described as the art of compromise between adequacy and sustainability.[45]

Developments in the pension system outlined in Chapter One highlight how, over the course of the past two decades, changes in the pension system have primarily targeted the economic sustainability and the alleviation of pensioner poverty. This includes both changes in the State pension system, such as increasing State Pension age (SPa) and the introduction of the new State Pension (nSP), and private, as DB provision has been replaced by DC. However, it is clear that improvements in sustainability have come, for many, at the cost of adequacy, which is also now a key concern for policy makers. At a very high level, these trade-offs reflect the myriad interactions which take place across the pension system.

Fairness

The final Framework objective has been chosen to reflect the notion that a compromise between adequacy and sustainability, which necessarily involves distributing costs and benefits unevenly among different groups, can only be achieved if the outcomes are deemed to be fair.

In the Framework, "fair" does not mean equal distribution of costs and benefits refers. Instead, it refers to the processes and factors that enable people to achieve outcomes that meet their needs and preferences equally in an inclusive system which engenders trust, protects people from risk in retirement and upholds the commitments that are made. The Framework derives its definition of fairness from the principles of equality of opportunity and equality of outcome, which are broadly applied to the concepts of:

1. **Process fairness:** Differences in the opportunity people have to access the benefits of the pension system and the way in which they are treated within it
2. **Outcome fairness:** Differences in the way that retirement outcomes are distributed among individuals and social groups

The concept of fairness and how it will be analysed in the system is discussed in greater depth in the Fairness Concept and Content paper. In addition to measures of process and outcome fairness, it will also consider the measures in place to protect people from harmful outcomes or poor decision-making.

What other considerations or limitations are there?

This is an ambitious project, what will be ready for 2022?

Despite the extensive research underpinning the design of the UK Pensions Framework, there is still a significant amount of work to do. The 2022 report will cover measures related to the indicators and objectives presented today. However, it is likely that some content and metrics will be adjusted over the course of the data gathering process in 2022, and over years ahead, as components and processes are refined. A summary of changes to indicators or measures will accompany each annual report, but every effort will be taken not to compromise the integrity of long-term comparability.

The primary purpose of the 2022 report is to act as a baseline for the UK pension system against which change can be assessed over time. From 2023 onwards, and when policy simulations are conducted to support policy research, analysis will be compared against the baseline to establish how the system is evolving. It will also look ahead to project how policy proposals or changes in saving, spending and labour market behaviours, as well as levels of State and employer support, might impact the ability of the system to meet its intended goals in future.

Reports will include analysis of cross-system trends and issues, as well as single dimension issues. Cross-system trends might include for example the impact of environmental, social and governance (ESG) factors on pensions as it develops, or the series of risks and decisions that people face on their journey through working life and into retirement. Single dimension analysis will discuss findings for each indicator, along with more information on the methodology underlying the conclusions, in order that specific areas of the pension system can be examined in detail. Key findings from each indictor will be aggregated to the sub-objective level, and again to the overall Framework objective level in order to provide a clear overview of the strengths and weaknesses in the UK system.

What data will the Framework use and how will issues around availability of data be managed?

The Framework will be constructed from secondary data. It draws upon a broad range of recognised sources including the Office for National Statistics (ONS) and the Financial Conduct Authority (FCA), as well as nationally representative surveys such as the Wealth and Assets Survey, The FCA Financial Lives Survey, The English Longitudinal Study of Ageing Survey (ELSA) and the British Household Panel Survey (Understanding Society). It will also, where appropriate, draw upon the findings of research conducted and published by research organisations including the PPI. Where modelling is carried out, methodology and assumptions will be provided.

"Data! Data! Data! I can't make bricks without clay!"[46]

The majority of data in the Framework is focused on measures of economic resources, drivers and outcomes. From a practical perspective, processes relating to the measurement of these indicators are relatively well-established. So too, are their strengths and weaknesses.[47]

Measures of scheme and saver level data or non-economic factors are less well-developed. In some cases, they are also subjective or non-representative in nature, particularly those which are self-reported.[48] Several limitations to data are therefore acknowledged:

- Data is not always collected in a comparable and easily aggregated way
- There is a lack of comprehensive data in respect of some indicators, such as the nature and level of scam activity or private spending on social care
- There is a lack of consensus on outcome targets

Issues around data adequacy will be addressed transparently in the Framework. To reflect its importance, indicator S3.5 Data Adequacy will summarise the extent to which the data needed to support meaningful analysis of the system is sufficiently and consistently available. It also aims to highlight where gaps could be addressed by industry, policy makers or future research.

[44] UN (1987)
[45] Borsch-Supan, A. (2014)
[46] From Sherlock Holmes in "The Adventure of the Copper Beeches"
In Fairness and the Assumptions of Economics, Kahneman, Knetsch & Thaler (1986)
[47] McKnight et al (2019)
[48] PSIG (2021)

How will indicators be classified?

Indicators will be assigned an impact classification based upon how measures within them relate to their Framework objective. However, problems around defining and measuring target outcomes are a recurring theme in social and economic policy analysis, particularly as policy initiatives can also have a catalogue of conflicting goals from which it may be hard to elicit intended outcomes.

Where possible, the Framework will classify outcomes against established targets. A good example is the use of the Pension & Lifetime Savings Association's (PLSA) Retirement Living Standards, which provide a series of targets against which retirement income can be measured as a proxy for adequacy. Where these are not available, outcome parameters will be designed using a combination of historical UK data and intended policy effects. In some cases, these could include both qualitative and quantitative assessment criteria. The steps taken to design classification criteria will be detailed in an annexe to the final report.

Will the Framework include non-pension factors that relate to retirement outcomes?

Yes. Although the focus of the Framework is on pensions policy, measures which focus predominantly or exclusively on financial security do not fully represent quality of life or living standards in retirement as non-financial factors such as social connections, health, autonomy and productivity also play a role for many people. Factors that will be analysed outside the pension system include home ownership, labour market behaviours, household spending, and the costs of health or social care either to the State or individual. However, discussion of these factors is limited largely to their implications for financial security in later life, and the extent to which they exacerbate, mitigate or replicate issues that pre-exist retirement outcomes. The aim of the Framework is to provide analysis of financial security in retirement, it does not aim to provide a comprehensive analysis of living standards.

Can the Framework be used as an index?

Not yet. The relative importance given to objectives and indicators in the Framework by policymakers, industry and individuals will differ over time. In many cases, adequacy will be the priority objective. However, the focus of the first report is to generate a baseline level of information against which future changes can be analysed. For this reason, developing a series of weights by which to adjust the emphasis placed on each indicator is not within the scope. Despite this limitation, the Framework has been structured in such a way that it can be adapted for use as an index in the future. This possibility will be assessed as the work develops.

Can the output be compared to results from other frameworks or countries?

No. The UK Pensions Framework is tailored to the shape and design of the UK pension system and society. In this way, its structural components differ from other analytical frameworks, even though some studies examine the same conceptual objectives (typically adequacy and sustainability). For this reason, a direct comparison of output should not be drawn with other research, and content cannot be generalised to other countries or systems. Although the experiences of other countries may be outlined to illustrate discussion, the Framework is not designed to support comparative analysis of the UK pension system against international pension systems and therefore may not be replicable in other contexts.

Will the Framework include values related to responsible investing as a measure of sustainability?

Not yet. In the first system report, the Framework will examine financially material implications of ESG and climate change. At present however, the extent to which pensions are contributing to the wider goals of economic development and generating positive value for society is very difficult to substantiate. For this reason, developments in policy, regulation and practises will be monitored over time and the decision of how best to include the societal value of pension resources will be carefully considered over time.

Chapter Three:
Framework Content

CONTENT

This chapter outlines the Framework definitions of Adequacy, Sustainability and Fairness, and provides an overview of indicators that will be used to assess them

The main aims of this chapter are to:

- Provide greater detail about how Adequacy, Sustainability and Fairness will be assessed in the Framework
- Propose a clear definition of what each objective means, and the criteria against which it will be analysed
- Present an overview of the rationale, content and current themes for indicator groups relating to each objective

Introduction

The purpose of this Chapter is to provide greater detail on how the Framework will measure Adequacy, Sustainability and Fairness in the UK pension system. For each of the three objectives, it includes:

- A definition of what the objective means in the context of the pension system, derived from a broad literature review.
- A series of one-page summaries which outline the content of each indicator sub-group, along with why they are important to analyse, and some of the measures which will be used to assess them.

The concepts underlying each objective, along with further information on why they have been adopted and how the Framework will interpret them are included in the following supporting papers: Adequacy Concept and Content, Sustainability Concept and Content, Fairness Concept and Content.

Indicator sub-groups of indicators are as follows:

Adequacy

- **Labour Markets:** Employment Rates; Income and Earnings
- **State Support:** State Pensions; Means-Tested Benefits
- **Private Pension Saving:** Coverage and Contributions, Investments and Assets, Tax Relief
- **Non-pension Wealth:** Non-Pension Savings; Home Ownership; Inheritance
- **Retirement Living Costs:** Expenditure and Debt; Renting in Retirement; Social Care Costs
- **Retirement Outcomes:** Transitions and Decumulation; Poverty; Income Maintenance

Sustainability:

- **Population and Ageing:** Population Ageing; Family Arrangements; Health & Social Care
- **Financial Sustainability:** Macroeconomic Indicators; Pension Age & Access; Employer Sustainability; Scheme Sustainability; Fiscal Sustainability; ESG
- **System Design:** Regulation; Political Sustainability; Complexity; Innovation and Reforms; Data Adequacy

Fairness:

- **Process Fairness:** Inclusion; Engagement; Choice & Defaults
- **Outcome Fairness:** Differences between population groups; differences between individuals
- **Protecting Consumers:** Value for Money; Pension Scams; DB Transfers

ADEQUACY

1. The fact of being enough or satisfactory for a particular purpose

A clear system that enables people to plan reliably for a retirement which provides protection against poverty and the ability to maintain their living standards from working into later life.

Clear

A system which helps people to understand what a good retirement looks like and how to achieve it.

Reliable

Confidence that the savings people put aside today will generate sufficient income to meet costs throughout retirement.

Poverty

A system which offers equal protection against the risks of poverty and deprivation as people approach and live through retirement.

Resilience

Ability for people to withstand short-term financial shocks.

Living Standards

Support for a standard of living in later life that is comparable to that which is maintained with earnings in working life.

A1: Labour market dynamics

This group of indicators examines how differences in adequacy among current pensioners may be derived from labour market behaviours and earnings, and how changes could lead to differences in adequacy outcomes in the future.

The two key components of this sub-objective are employment rates and earnings. Despite not being directly part of the pension system, they are critical part to analysis on account of the UK's traditional, employment-based and earnings-related pensions model. The model relies on uninterrupted careers and linear wage growth for adequate outcomes to be produced, meaning that where inequalities in the labour market exist, inequalities in retirement savings will follow. This leaves millions of people facing financial risk in later life.[49] The gender pensions gap, for example, is around twice as big as the gender pay gap, reflecting the cumulative impact of differences in working patterns between men and women.[50]

In similar trends, longer working lives, digitalisation and globalisation offer opportunities for growth and development, but they also increase the number of people in self-employed and non-standard work, or unstable working conditions. On average, these workers earn less than traditional employees on an hourly and yearly basis, with women, BAME people and other at-risk groups most vulnerable.[51] Increases observed in employment among older age groups for over ten years were reversed during the pandemic. They will also be a key focus of the framework as pension ages rise and DB retirement income declines.[52] At older age groups, women are more likely on average to be out of work before SPa than men and are also at higher risk of poverty.

Employment indicators can further aid analysis of the extent to which the pension system incentivises or disincentivises labour market behaviours; whilst affordability of pension saving is directly linked to earnings. Earnings also underpin the fabric of the UK pension system and welfare state through indexation and benchmarking mechanisms such as the triple lock, automatic enrolment eligibility and means-tested benefits. A heavier lower tail in the earnings distribution curve, as is seen in the UK, implies increased adequacy risk and need for poverty relief.[53]

A1.1 Employment Rates

Changing patterns in the proportion of people from different social groups in standard and non-standard types of employment; impact of incentives for early retirement derived from replacement rates and changes in net pension wealth achieved from working additional years

A1.2 Income and Earnings

Average earnings, real earnings over time, income distribution and inequality among population groups

A2: State Support

This group of indicators considers the role of the State Pension and means-tested benefits in providing a minimum level of income, and protection against poverty respectively.

Although State Support only comprises one sub-objective group for the framework, it is particularly relevant to adequacy considering the significant proportion of people for whom State support is the primary source of income in later life. Around half of all retirees in 2020 were dependent upon State support for 40% of their retirement income or more, with 20% of the population dependent upon it for 80% of their income in later life.[54] The value of the State Pension compared to other macroeconomic indicators such as earnings and inflation is fundamental in determining the standard of living that many are able to achieve.

The value of the State Pension and means-tested benefits in relation to other measures of adequacy including the MIS and RLS targets will be considered over time, as will other economic benchmarks and uprating mechanisms including earnings and inflation. Of interest will be the extent to which self-stabilisation mechanisms such as indexation and the triple lock can help to minimise the need for decisions and interventions in the State Pension system, or the extent to which the rules themselves are subject to changing circumstances.[55]

Measures relating to eligibility to, and take up of, means-tested benefits in retirement will seek to understand the extent to which people are protected from poverty in later life. The take up of means-tested benefits is an issue of current concern, as a significant minority of older people may be entitled to income which affords them greater levels of adequacy, but do not claim the means-tested benefits.[56] The value of these payments will also be considered relative to other indicators, and in particular to working age benefits, between which a significant gap has opened in recent years. Finally, State support is particularly sensitive to demographic change, meaning that changes in the proportions of people contributing to, and eligible for the State Pension, will become increasingly evident as population ageing impacts the system over time.

A2.1 State Pension accruals

Changes in the proportions of people contributing to and eligible for State Pension and means-tested benefits

A2.2 State Pension income

Value of State Pension income in relation to adequacy targets and macroeconomic indicators

A2.3 Means-tested benefits

Eligibility to, and take up of, means-tested benefits in retirement; value of means-tested benefits to working age benefits and macroeconomic indicators

A3: Private Pension Saving

This group of indicators will consider how changes in participation rates, contribution rates and investment returns across public sector, DB and DC pensions, along with the support of tax relief, are contributing to overall adequacy outcomes in the pension system.

Private pension wealth is growing as higher rates of DC participation and contributions produce growing aggregate and median pot sizes, and people approaching or living through retirement today continue to receive DB benefits. This section of the Framework will track workplace pension participation rates, which impact more highly on adequacy outcomes than other forms of saving because they allow individuals to access the benefits of both tax relief and employer contributions. It includes public sector DB, private sector DB and DC pensions.

Indicators will also examine changes to individual and employer contribution levels across all pension types, which, in DC, have clustered around minimum since the introduction of automatic enrolment.[57] As well as the extent to which adequacy may be impacted by changes in future contribution rates, indicators will examine how policies designed to increase them could impact affordability and prompt changes in savings behaviour, such as opting out.

Tax relief and investment returns will be included to track how they can help grow the value of pension savings and preserve long-term adequacy. Of particular relevance will be the performance and governance of default funds, in which more than 90% people enrolled in master trust / multi-employer schemes are invested.[58] Many of these funds remained resilient to the extreme market volatility brought about by the pandemic thanks to long-term investment horizons and diversified portfolios.

[49] Gould, S. (2021)
[50] Arza, C. (UN) (2015)
[51] OECD (2019)
[52] Crawford & Karjalainen (IFS) (2020)
[53] Syed et al (ONS) (2016)
[54] DWP (2021)
[55] Borsh-Supan (2014)
[56] Price, D. (2008)

A3.1 and A3.2: DB and DC Coverage

The proportion of people saving actively into DB (including public sector) and DC pensions. Indicators are separated in order to avoid conflating results through averages. Opt-out rates, proportions of workers not eligible for workplace pension saving.

A3.3 and A3.4: DB and DC Contributions

Average individual and employer contribution rates by employment type, sector and income group, rates of take up of additional employer contributions where data is available. Gaps in total net remuneration for workers with and without pensions. Expected level of contributions required to meet adequacy targets by income group and employment type.

A3.5 Investments and Assets

Investment returns, portfolio diversification, total assets, proportion of savers invested in default funds. Charges will be covered under sustainability, value for money in fairness.

A3.6 Tax Relief

Value to savings, distribution by income band, interactions with employment,

A4: Non-pension savings and assets

Non-pension wealth is a major element of financial adequacy in retirement. Although it may be found in many different forms, this group of indicators will focus on three key sources of non-pension wealth: non-pension savings, home ownership and inheritance.

Having retirement savings outside the pension system can help people to top up other sources of income to an adequate level and achieve a better standard of living, or to become more resilient to financial shocks and short-term spikes in need. As well as levels of saving, the framework will briefly consider how people hold non-pension savings, such as bank accounts, Individual Savings Accounts (ISAs) or investments, in order to understand the extent to which their value could be at risk of erosion from inflation. This is particularly relevant to people who may choose not to spend or invest the tax-free lump sum they take from their pension at or ahead of retirement.

Owning a home rather than renting in retirement will also impact adequacy, as it reduces housing costs and the income needed to maintain living standards in later life. It can also allow people to release income to top up their pension, or equity to manage a change in circumstances such as the onset of health problems, widowhood or divorce. Despite rising rates of home ownership among the older population, home ownership and housing wealth are falling among younger age groups, meaning that without a significant reversal in trends, future pensioners could face higher living costs in retirement and be less likely to be able to access housing equity in times of need than those in retirement today.[59]

Inheriting wealth, particularly housing wealth, from families could however help young people to top up retirement income or fund a lump-sum purchase. Trends suggest that inheritances are likely to be larger for younger generations when compared with lifetime incomes than for their predecessors, thereby indicating a growing impact on adequacy outcomes.[60] Whilst in some cases the expectation of receiving an inheritance may affect the amount people choose to save today, leaving an inheritance is also a factor in decisions people make around how to manage their pensions and spend their savings. Inherited wealth can also increase inequalities between those with richer and poorer parents.

A4.1 Non-pension savings

Levels of non-pension savings including ISAs, cash and liquid investments, including wealth distribution by age and income group. Savings as a proportion of overall wealth.

A4.2 Home ownership

Trends in home ownership and housing wealth, equity release and the proportion of people with rental or mortgage costs in later life.

A4.3 Inheritance

Average inherited wealth as a proportion of lifetime income, inheritable wealth, distribution and interactions with pension saving and decisions

A5: Retirement Living Costs

This group of indicators covers elements that together make up some of the main expenses people are likely to face in retirement. It includes household spending, housing costs in retirement, household debt and the cost of social care.

The way in which people spend their pension savings is evolving due to increases in longevity and the length of retirements, the amount of savings people reach retirement with, and changes in the variety and levels of consumption at different stages in later life. These indicators will examine how adequacy could be impacted by changes in what people need to pay for in later life, and how their costs are distributed over time.

Consumption patterns vary between households. For some, they take a traditional "U" shaped form of higher costs in early and late retirement with reduced spending in the middle as participation in leisure activities declines; for others, it may peak and trough over time, gradually decline or remain even. The impact of consumption patterns on adequacy is determined by the demands that people have on their savings and the spending decisions they make - patterns in which will be examined by the Framework. For example, future pensioners are more likely to be in debt in retirement than older generations and may also be more likely to provide gifts or ongoing financial support to family members.[61] Those who reach retirement with rent or mortgage costs to pay will also have significantly less disposable income than owner-occupying pensioners, although this will depend upon levels of housing benefit.

Social care has implications for adequacy among those paying for care, and the growing number of people whose working patterns are affected by the need to provide care for family members themselves, as caring at older ages becomes more common.[62] Despite recent developments in social care policy, there is still uncertainty over the future cost of care, and reforms aimed at reducing its cost are unlikely to be felt for a number of years. The cost of social care to the state is examined in indicator S1.3.

A5.1 Household Spending

Household expenditure, patterns in consumption as a proportion of household income, gifts

A5.2 Housing Costs in Retirement

Proportion of people renting or paying off mortgages in retirement, rent and mortgage costs as a proportion of retirement income, levels and impact of housing benefit on living costs

A5.3 Household Debt

Proportion of people reaching retirement with debt, levels and types of household debt

A5.4 Social Care Costs

Estimated average cost of social care to self-funders, proportion of people facing different levels of care costs (none to "catastrophic"), impact of means-tested threshold or cost caps

[57] ONS (2018b)
[58] Wilkinson et al (PPI) (2020)
[59] Ministry of Housing, Communities & Local Government (2020)
[60] Bourquin, P., Joyce, R. & Sturrock, D. (2021)
[61] Silcock et al, PPI (2018)
[62] Silcock et al, PPI (2018)

A6: Retirement Outcomes

This sub-objective covers some of the most important Framework indicators in order to demonstrate the overall impact of system components on the adequacy of outcomes that people have in later life. It includes accessing pensions, the retirement equation, poverty and living standards in retirement.

One of the biggest differences between current and future pensioners will be the way in which they access and use their pension savings. The impacts of pension freedoms, announced in 2015 to release people from the requirement to purchase an annuity, and their implications for adequacy will be a focus of the Framework. Pension freedoms are producing many benefits. As yet, however, little is known about how people will cope with managing drawdown accounts as they age, and in particular how they will manage overwhelming decisions needed to mitigate against longevity, market and inflation risk. These shifts will be reviewed in the Framework, along with how uncertainties over the role of annuities, interaction between pension freedoms and the benefit system, and ease of taking tax free cash might affect adequacy prospects for growing numbers of pensioners retiring with DC pensions or transferring in from the DB system.[63]

Overall adequacy will be measured both by levels of poverty, or minimum income standards, and by the PLSA RLS. Outcomes will be examined from a number of perspectives including gender, ethnicity, income, socioeconomic and age groups. In respect of age groups, particular emphasis will be placed on understanding what differences in the age at which people leave the labour market, coupled with differences in levels of means-tested benefits, could mean for levels of adequacy among people before and after SPa.

Finally, in order to develop a picture of the overall direction of adequacy in the UK pension system, the Framework will bring together data from across a series of indicators to show how the overall costs associated with retirement are changing in relation to overall income over time. This is known as the 'Retirement Equation'.

A6.1 Pensions Access

Annuity sales, DB transfers, rates of full DC withdrawals, decumulation journeys and drawdown products, interaction with benefits system

A6.2 The Retirement Equation

Average retirement costs (by group and need) v. average retirement income over time

A6.3 Poverty in Retirement

Poverty rates and MIS by age, gender, ethnicity, region, and marital status (single/couple)

A6.4 Living Standards in Retirement

Proportion of people meeting and expected to meet retirement income targets by decile and population groups

[63] Webb, S. (2021)

SUSTAINABILITY

1. The ability to be sustained, supported, upheld, or confirmed.

A stable, secure and affordable system which allows the needs of the present to be met without compromising the ability of others to meet their own needs

Stable

A reliable system which keeps pace with changes and risks inside and outside the pension system

Secure

Protection for retirement savings and income against a range of demographic, economic, market, political and ESG risks over time.

Affordable

A system which opertates within the constraints of its finances and at a “credible and serviceable” position over the long term.

Compromise

A system which balances the need to provide adequacy and sustainability over populations and over time, according to the needs and preferences of society.

S1: Population and Ageing

This group of indicators covers factors which impact the size of the older population, the length of time people spent in retirement, and the implications of population ageing for the cost and provision of health and social care services.

Population ageing, which is brought about by rising life expectancy and falling birth rates, means that more people are spending longer in retirement than ever before. As a result, it has contributed to almost a twofold increase in the relative amount of age-related spending on health, social care and pensioner welfare in recent decades. Age-related spending is set to rise to 14.2% of the UK's Gross Domestic Product (GDP) in 2024-25, up from 7.3% in 1966-67, of which pensioner welfare accounts for 3.4% and 5.8% of GDP respectively.[64] Over the same period, the proportion of the population aged 65 and over has risen from 12.7% in 1966-7, to a projected 19.9% in 2024-25.[65] Health and care are expected to represent 8.4% of GDP in 2024-25, up from 3.9% in 1978-79, and over 44% of all day-to-day public spending compared to 27% in 1999/2000.[66] Although population ageing has been occurring for several decades, it is accelerating as the Baby Boomer generation enters retirement and has been the biggest driver of pension reform around the world.

These indicators will consider how population ageing, including measures of life expectancy and dependency ratios, are contributing to changes in pensions and the security that people are able to achieve in later life. They will, where possible however, look beyond traditional measures of dependency to examine economic activity in order to reflect the notion that not everyone over State Pension age (SPa), or 65, is necessarily "dependent", and not everyone under SPa is necessarily active. Indicators will also look beyond average measures of longevity to consider how different cohorts, or socioeconomic groups within the same cohort, can have different life expectancy and therefore different pension durations. Measures will further consider the notion of healthy life expectancy, or the age to which people can expect to live in good health. Healthy life expectancy is a key source of inequality and will impact the extent that people are to have longer working lives, as well as the growing costs of health and social care. Whilst the cost of social care to the State is further included in these indicators, the cost of social care to individuals is covered under adequacy indicator A5.4. Finally, changes in family and household arrangements will be examined including the proportion of people living alone in later life, a known risk factor for poverty.

S1.1 Population Ageing

Longevity and healthy life expectancy by population groups, dependency ratios

S1.2 Family Arrangements

Household composition, proportion of older people living alone, as couples or with family

S1.3 Health and Social Care

Costs of health and social care to the state as a proportion of GDP and public spending

S2: Financial Sustainability

This group of indicators will consider a range of risks that can impact financial sustainability in the UK pension system for the State, pensions industry and employers, as well as the effects of policy and industry reforms to address them.

Ongoing changes in population ageing, macroeconomic shocks or trends, labour market shifts, ESG and climate risks are all factors that can raise concerns over financial sustainability for stakeholders in the pension system, even if the system itself is fiscally balanced.

For policy makers, ensuring long-term fiscal sustainability requires continual forecasting of future revenues and liabilities, socioeconomic trends and environmental factors in order that planning can be adapted accordingly. Current and future growth in the ever-evolving UK welfare system is being driven by cost of pensions, including tax relief, and pensioner benefits, which can no longer be offset by reducing spending in other areas.[67] Some of the reforms designed to tackle these issues include increasing SPa, the flat rate new State Pension (nSP), and replacing final salary public sector pensions with career average alternatives.

For funded Defined Benefit (DB) pensions and annuity providers, the scarcity of options to hedge or diversify longevity risk, along with lower-than-expected investment returns, changing economic and labour market conditions, and legislative requirements have led to scheme closures and consolidation as providers look for ways to continue to maintain member benefits, whilst minimising the costs and risks to the sponsor. Over 400,000 people have seen their schemes fail and are now receiving or set to receive compensation from the Pension Protection Fund (PPF). In both the Defined Contribution (DC) and DB system, financial sustainability is also linked to scale, as well as charges, or in some cases the cross-subsidisation of charges, and regulatory constraints. For employers, the cost and complexities of providing and administrating pensions needs to be balanced with investment in jobs and growth, and also requires consideration of the value placed in pensions by the employer and employee as a long-term reward for performance.

S2.1 Macroeconomic Indicators

Interest rates, GDP, economic growth, inflation, public debt

S2.2 Pension Age and Access

SPa, normal minimum pension age (NMPA), access age exceptions

S2.3 Sustainability for Employers

Contribution rates including employers paying above default minimum, administration costs

S2.4 Sustainability for Pensions and Financial Services providers

Scheme size and Assets Under Management (AUM), rates of consolidation, PPF and protection for members if schemes fail

S2.5 Sustainability for the State

Revenues and liabilities including cost of State pensions, pensions welfare and tax relief

S1.5 ESG

Pension fund and corporate disclosure requirements, stewardship codes

S3: System Design

The design of the UK pension system and welfare state is based in a traditional social order of the past, which featured stable families and stable long-term jobs, both of which are being replaced by non-traditional arrangements, as well as high levels of employment. The Framework will consider how policy and industry responses to changes to these areas, as well as other types of socioeconomic and demographic change, are affecting sustainability in the pension system through innovation and reform. This could incorporate factors such as new products, policies and developments designed to target adequacy, sustainability or fairness, or new technologies designed to cut costs, generate economic value or improve awareness.

Maintaining sustainability in the pension system also depends upon more than increasing funding or reducing benefits. Complexity can, for example, add to layers of administration and costs for employers and providers. It can also lead to too much choice for people, which can increase the risk of poor decisions or the need for mechanisms to regulate options. Greater sustainability can be achieved by reducing complexity to lower costs and improve outcomes.

Sustainability can also be further supported by regulation and supervision, designed to ensure that parties are performing required functions and protecting the interests of stakeholders equally. Regulation addresses market imperfections; stimulates competition and efficiency; promotes long-term outlooks; compensates for asymmetries in information between providers and savers; and

[64] OBR (2021)
[65] OBR (2021), ONS (2019b)
[66] Zaranko, B. (2021)
[67] Gardiner, L. (2019)

controls the potential for moral hazard.[68] It can also promote the collection of information and monitoring of systems to support review, analysis and innovation. At the same time, a fragmented regulatory framework or excessive regulation which is complex or costly to implement or enforce can undermine compliance and, in turn, sustainability. Poor data is also a significant barrier to improving pension design and outcomes. Lack of data is a key problem for employers and providers too, who typically have little of the information they need about people's wider saving or employment patterns to support an appropriate selection of investment products or retirement pathways.

S3.1 Regulation

Alignment of interests, market competition, asymmetry of information, fragmentation

S3.2 Political Sustainability

Stewardship of the pension system, long-term decision making

S3.3 Complexity

Market and regulatory fragmentation, choice, administrative burdens

S3.4 Innovation and Reform

Evolution of products, technologies, processes and reforms in response to system needs

S3.5 Data Adequacy

Gaps, comparability, quality of data across schemes and savers

[68] Hinz, R. & Stewart, F. (World Bank) (2019)

FAIRNESS

Impartial and just treatment or behaviour without favouritism or discrimination

An inclusive system which engenders trust, provides fair benefits for all, protects people equally from risk in retirement and upholds the commitments that are made within and between generations.

Inclusion

Making access to pension incentives, products and services available to everyone, along with the support people need to understand them

Trust

A system wich gives people belief in its purpose, along with the confidence and motivation to work towards individual and common goals

Outcomes

Ensuring that people are protected equally from the risk that their standard of living might fall in retirement

Protection

Safeguarding people against risks inside and outside the pension system, whilst supporting them to make good choices from working life into retirement

Promises

Upholding commitments that underpin the integrity of the pension system within and between generations.

F1: Process Fairness

Differences in the opportunity that people have to access the benefits of the pension system and the way in which they are treated within it.[69]

Process fairness is a key element of the overall fairness objective because it is a driver of fair outcomes. When processes are deemed to be fair, people are more likely to interact positively with the system and changes which are brought about within it. It can also build and maintain confidence and legitimacy,[70] as well as secure commitment to rules and objectives.[71]

Process fairness indicators examines inclusion, engagement, default architecture and policy commitments in the context of equal opportunity, individual autonomy and freedom of choice. The extent to which processes are equal within the pension system is complex. Active decision makers generally prefer less process fairness over having their actions constrained.[72] In contrast, low process fairness can leave some individuals vulnerable to unfair or harmful outcomes and inequalities. In reality, the extent to which processes are equal is highly dependent on the policy area and process in question. Choice architecture, or the use of defaults such as automatic enrolment, are becoming more widely used to moderate many of these processes.

Issues around inclusion frequently arise when considering process fairness. Inclusion is essential to tackling savings and investment gaps,[73] and refers to differences in the extent to which individuals can benefit from certain outcomes on account of eligibility and other criteria. A good example of this is the difference in the treatment of tax relief in net pay and relief at source arrangements, or some automatic enrolment qualifying rules. Engagement is also another consideration, given its power to influence positive long-term change and tackle the asymmetry of information that exists between savers and financial services organisations.

F1.1 Inclusion

Variation in the extent to which individuals have awareness of and access to pension incentives, products and services that meet their needs, and the support to understand them

F1.2 Engagement

Changes in the provision and use of guidance and advice services, as well as information provided by State, DB and Defined Contribution (DC) providers

F1.3 Choice and Defaults

Where choices are available, the proportion of people opting for default options and the difference in outcome compared to active decision making

F1.4 Policy Commitments and Implementation

Differences in how rules are announced or enforced between groups or over time

F2: Outcome Fairness

This group of indicators examines how differences in the way in which retirement outcomes are distributed among individuals and population groups can put some people at greater financial risk in later life than others

Outcome fairness refers to the under or overrepresentation of groups or individuals when examining overall levels of poverty, and the extent to which people are able to generate a level of savings sufficient to maintain their standard of living through from working life into retirement. These indicators bring together a range of information from across the Framework in order to build a picture of the drivers and outcomes of later life experiences among at-risk groups, with a particular emphasis on women, BAME people, carers and those with disabilities, as well as those in non-traditional or self-employment.

Analysis will also consider where inequalities that originate in working life are replicated in retirement, and where risks exist that could be mitigated or exacerbated by pension policy and system design. For example, policies such as increased pay gap reporting and the widespread provision of National Insurance credits are designed to narrow pension savings gaps, and reduce the likelihood that inequalities are compounded over time. However, others such as automatic enrolment eligibility criteria may be exacerbating inequalities because those most likely to be ineligible for workplace pension saving on account of working patterns are also those at greatest risk of poor outcomes in retirement. Closing these gaps is an important consideration for fairness in the pension system.

The Framework will also consider how pension outcomes differ among individuals when major life events occur such as divorce, illness and death. The way in which pension benefits are shared when couples separate, transferred and taxed when the saver passes away, and vary in the event that an individual has to stop work due to ill health can differ on account of factors such as the type of pension people have or the age at which event occurs. These differences can impact on financial security in later life either for the saver or for their family, sometimes putting people already vulnerable to inequality at even greater risk. For example, married women accumulate up to five times less total pension wealth than married men, but around 70% of couples do not discuss pensions at all when they divorce. Of those who do, only one in seven will actually result in pension sharing. Single women are already at greater risk of poverty in later life than men or couples, and these risks are likely to be compounded by these differences, particularly as one in seven women over 60 is divorced.[74]

F2.1 Differences between population groups

Pension wealth gaps by age, gender, ethnicity, employment status including self-employed, carers and those with disabilities, marital status, poverty gaps, and differences in the proportion of people expected to maintain living standards in retirement

F2.2 Differences between individuals

Pension sharing on divorce, treatment of pensions at the onset of ill health or after the death of a member

[69] Brockner, J., Wiesenfeld, B. & Diekmann, K. (2009)
[70] Rawls, J. (1972)
[71] Kirchler, E. (2007)
[72] Brockner, J. Wiesenfeld, B. & Diekmann, K. (2009)
[73] The Wisdom Council (2019)
[74] Buckley, J. & Price, D. (2021)

F3: Protecting Consumers

This group of indicators will examine trends across three risks that savers face to their retirement savings and actions taken by schemes and regulatory bodies to manage them: DB transfers, pension scams and value for money.

These risks reflect the notion that policy has an important role to play in fairness. It can help to moderate the relationship between pension outcomes and financial markets, and secure an appropriate degree of protection for consumers from detrimental outcomes or from others who "deliberately exploit their weaknesses".[75] Among the institutions responsible for maintaining and enforcing complex rules to protect people are Government, regulators, and trustees.

Two of the risks, DB transfers and pension scams, relate to circumstances whereby people either opt to transfer DB rights into DC arrangements, or are fraudulently persuaded to part with their savings. In both cases, activity has evolved and increased since the introduction of pension freedoms in 2016. Poor decisions can threaten the financial wellbeing of individuals, as well as the wider integrity of the pension system and are becoming a growing source of concern. Since 2016, over 210,000 people have transferred a combined £80bn in DB pension rights into DC arrangements. Although transfers can offer benefits in some cases, without the right guidance and support in others, people risk making decisions that could be detrimental to later life outcomes by giving up guaranteed income. In the case of pension scams, activity is likely to be significantly underreported.[76] 43% of people aged over 65 believe they have been targeted (but not necessarily the victim of) scammers, and an estimated £10bn has been lost to pension scams over time with average losses per person of around £91,000 in 2017.[77]

The third risk relates to the concept of value for money, a priority issue for Government and regulators. Value for money looks beyond the costs and charges that might erode the value of savings over time, and asks what people are getting for the money they pay. Where higher charges result in better investment returns for example, it might be worth paying more. Some of the main drivers of good value for money include suitable investment strategies, reasonable costs and charges, and efficient services and administration. As well as value for money, this indicator will also examine trends in DC scheme consolidation in order to track the extent to which scale could contribute to efficiency of costs

F3.1 Value for Money

Policy initiatives, investment returns, charges and charge caps, scheme consolidation

F3.2 Pension Scams

Reported and estimated number and cost of pension scams, prevention initiatives and policies which improve provision for victims of scams including tax amnesty

F3.3 DB Transfers

Number and value of DB transfers; affordability and availability of advice, process regulation

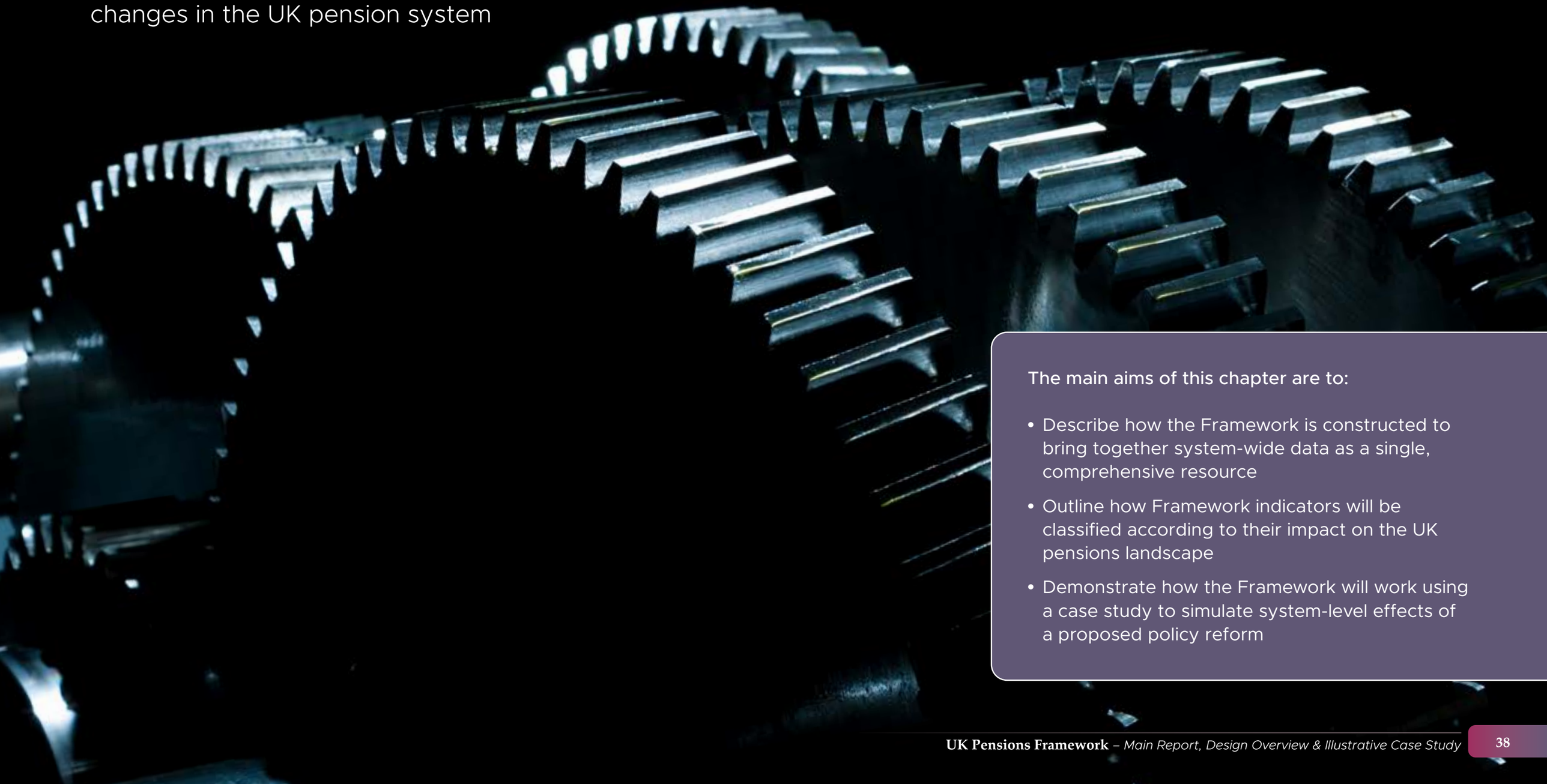
[75] Kahneman, 2013, p. 413
[76] House of Commons Work and Pensions Committee (2021); PSIG (2021)
[77] Wilkinson, L. (2020)

Chapter Four:
Illustrative Case Study

This chapter uses automatic enrolment reform as an illustrative case study to show how the Framework can be used to compare changes in the UK pension system

CASE STUDY

1. Serving as an example or explanation. Typically utilises one or two instances of an event to show what a situation is like.



The main aims of this chapter are to:

- Describe how the Framework is constructed to bring together system-wide data as a single, comprehensive resource
- Outline how Framework indicators will be classified according to their impact on the UK pensions landscape
- Demonstrate how the Framework will work using a case study to simulate system-level effects of a proposed policy reform

Introduction

This chapter provides an illustrative overview of how the UK Pensions Framework could be used to examine the potential impacts of a policy change on the UK pension system. The same format can be used to document the changes that take place in the system year on year.

The case study is illustrative only. It does not constitute an assessment of the current or projected state of the pension system and should not be treated or referenced as such. A full analysis of the system will be conducted ahead of the 2022 report, during which time indicator measures and parameters will be defined, and data collected. The chapter aims to answer the following questions:

- How will the output be constructed?
- How will indicators be classified and presented?
- What will the case study examine?

How will the output be constructed?

An overall picture of the UK pension system can be developed by bringing together data from across all three objectives into one single, comprehensive resource

The process of constructing the Framework output comprises four stages:

1. **Indicator analysis:** Data is collected across a variety of measures and sources in order to develop conclusions over the short and long-term impacts of outcomes relating system objectives.
2. **Trade-off Analysis:** Indirect impacts, side-effects and trade-offs associated with indicator measures are analysed to identify interactions that take place either between components of the system, or between stakeholder groups of the system. For example, tax relief could support adequacy by boosting the value of savings whilst also compromising fiscal sustainability on account of costs.
3. **Indicator Classification:** Each indicator is classified by the extent to which they provide support for the overall system objective, adjusted for trade-offs, according to the framework definition of the objective and parameters set.
4. **Cross-system Analysis:** Indicator conclusions and classifications are aggregated by sub-group, and then by overall Framework objective in order to inform a cross-system perspective of the UK pension landscape.

How will indicators be classified and presented?

The overall goal of analysis in every indicator is to ask: What does it mean for the pension system?

Each indicator will analyse a range of measures with an important overarching purpose in mind: understanding how outcomes relate to objectives from the perspectives of individuals, institutions, interactions and stakeholders in the complex UK pensions landscape.

Using a range of data and evidence, every indicator will be classified by the extent to which outcomes provide support for adequacy, sustainability or fairness using a series of six predetermined parameters, or targets where available. Parameters are tailored to each indicator using the Framework's definitions of each objective. A more detailed discussion on the concepts and content of each objective is provided in supporting papers on Adequacy, Sustainability and Fairness.

The six classification levels include:

L6	Strong support for system objective with sustainable outcomes
L5	Good support for system objective with somewhat sustainable outcomes
L4	Somewhat supports objective, somewhat sustainable outcomes
L3	Somewhat fails to support objective with some prospects for improvement
L2	Poor support for objective with few prospects for improvement
L1	Fails to support objective with poor prospects for improvement

The Framework uses a schematic overview to highlight high-level impacts and policy trade-offs in the UK pension system

The following three charts comprise an illustrative case study of how a potential change in UK pensions policy might impact upon the pension system.

- Figure 4.1: Acts as a baseline measure to illustrate how the UK pension system might be presented following system-wide analysis in 2022
- Figure 4.2: Shows which indicators and objectives might be positively or negatively impacted as a result of the proposed policy change, or of changes year on year.
- Figure 4.3: Shows how the UK pension might look after the policy proposals were implemented. The same figure can be used to illustrate differences between two annual reports, for example 2022 and 2023

Some important points about the indicator chart format should be noted:

- The outer ring of the chart shows individual indicators. In early stages of the Framework design, each indicator is given an alpha-numeric references which relates to (A) the Framework objective group and (2) the sub-objective group in which they belong. A full reference table of indicators and alpha-numeric codes accompanies each chart. In this example, indicator group A2 relates to the State Support component of Adequacy.
- Each indicator is classified by level of impact against the Framework objective. Classifications are coded in an accessible red (negative) to blue (positive) schematic, and accompanied a their numeric classification in brackets.
- The middle ring of the chart shows sub-objective groups. Each sub-objective group is assigned an aggregate level of impact based upon component indicators. Where sub-objectives contain primary indicators, the classification will be given priority in determining the overall impact classification for the sub-objective.
- The inner ring of the chart shows the overall Framework objectives. Each Framework objective is assigned an aggregate level of impact based upon component sub-groups.
- At this stage, Framework components are not weighted. It is acknowledged that this implies that all components are of equal importance or relevance, and that this is not the case in the UK pension system. The question of how to account for relative importance across indicators will be addressed as data is compiled over the course of 2022.
- Each chart is accompanied by a brief description of the chart highlights. Once again, this narrative is illustrative only, it is not based on validated analysis and does not constitute an actual assessment of the UK pension system.

What will the case study examine?

The case study is designed to simulate the potential effects of policy recommendations from the 2017 Automatic Enrolment Review

Automatic enrolment was introduced in 2012 to rebuild the UK's savings culture and enable future generations to achieve security in later life.[78] It has resulted in more than 10 million individuals being enrolled into workplace pension schemes, many of whom were underserved or excluded from workplace pensions in the past. In 2017, a review of the system took place with the objective of identifying how to build on its success for the future. The outcome was a package of proposals and reforms aimed at increasing access to workplace pensions and improving adequacy through higher contributions. Specifically, the review recommended that Government should:

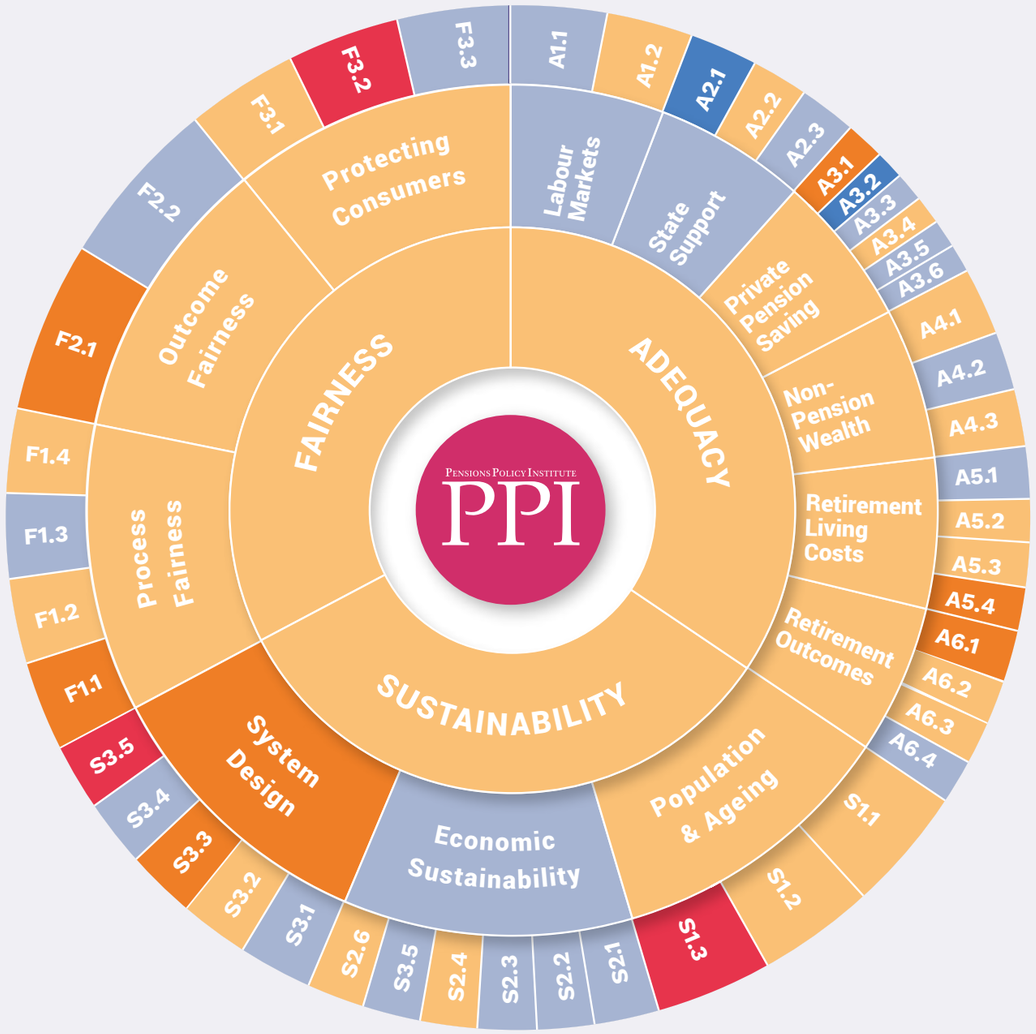
- Lower the age threshold for automatic enrolment from 22 to 18 in order to enable more people to save, regardless of who their employer is or the sector in which they work
- Remove the lower level of qualifying earnings limit (LEL) so that contributions are calculated from the first pound earned. The LEL is set at £6,240 in 2021-22.

This is the subject of the illustrative case study. The case study replicates the steps that would be taken in a policy simulation or year-on-year comparison of outcomes in the UK pension system. First, the impact on measures within each indicator are projected. Second, the new indicator classification is determined. Third, new indicator classifications are compared to the baseline analysis in order to identify changes and trade-offs, before being compiled into an overall picture of the system. It should be noted that:

- A colour key is used to illustrate uprating and downrating based on the combination of benefits, risks and costs estimated. The change in classification level is also denoted by +1, +2 for positive changes, -1, -2, for negative. Indicators with no colour denote no change.
- Not all changes in measures will result in an uplift or downgrade in indicator classifications, but all significant findings will be reported

[78] DWP (2017), p.3

The 2022 illustrative baseline analysis figure suggests that improvements in important measures of economic sustainability have somewhat compromised adequacy in recent years, resulting in uneven distribution of trade-offs across population groups and an increasingly complex system.



L6	Strong support for system objective with sustainable outcomes
L5	Good support for system objective with somewhat sustainable outcomes
L4	Somewhat supports objective, somewhat sustainable outcomes
L3	Somewhat fails to support objective with some prospects for improvement
L2	Poor support for objective with few prospects for improvement
L1	Fails to support objective with poor prospects for improvement

The UK pension system shows a mixed picture of adequacy. Pension coverage has been increased by automatic enrolment overall but remains low across a significant minority of people on account of eligibility (F1.1, A3.4). Low coverage disproportionately affects groups already vulnerable to risk in retirement, including women, family carers and self-employed workers (A3.3, F1.1).

Among the shrinking number of people retiring or retired with Defined Benefit (DB) income, income maintenance is relatively adequate (A6.4). Among more than half of Defined Contribution (DC) savers, however, contributions are lower on average than is considered necessary for a secure retirement (A3.4). Retirement costs are coming under pressure from falling home ownership (A4.1), rising household debt (A5.3), and continuing uncertainty over long-term costs of social care to individuals and families (A5.4). Adequacy is generally supported by low unemployment, but reforms have tightened links between pensions and jobs at a time when trends in non-linear and self-employment are increasing (A1.1) and earnings remain under pressure (A1.2). Some of these changes reflect shifts towards longer working lives, and the needs of older workers and family carers will be an important focus going forwards. State Pensions (A2.1) and means-tested benefits (A2.3) remain the primary source of income for many people in later life. They broadly meet their target objectives of replacing a minimum level of income and insuring against poverty respectively, although recent falls in pensioner poverty are beginning to reverse (A6.3).

ADEQUACY L3		
A1: Labour Markets L4		
L4	A1.1	Employment
L3	A1.2	Income and Earnings
A2: State Support L4		
L5	A2.1	State Pension Accruals
L3	A2.2	State Pension Income
L4	A2.3	Means-tested Benefits
A3: Private Pension Saving L3		
L2	A3.1	DB Pension Coverage
L5	A3.2	DB Pension Contributions
L4	A3.3	DC Pension Coverage
L3	A3.4	DC Pension Contributions
L4	A3.5	Pension Investment & Assets
L4	A3.6	Tax Relief
A4: Non-pension Wealth L3		
L3	A4.1	Non-pension Savings
L4	A4.2	Home Ownership
L3	A4.3	Inheritance
A5: Retirement Living Costs L3		
L4	A5.1	Household Spending
L3	A5.2	Housing Costs in Retirement
L3	A5.3	Household Debt
L2	A5.4	Social Care Costs
A6: Retirement Outcomes L3		
L2	A6.1	Pensions Access
L3	A6.2	The Retirement Equation
L3	A6.3	Poverty in Retirement
L4	A6.4	Living Standards

Sustainability shows a clear division between economic sustainability and system design, as demographic pressures continue to persist. Economic sustainability has improved as longevity, investment and adequacy risks are transferred away from employers (S2.3) and the State (S2.4) and towards individuals in order to address the upward pressure that population ageing is placing on public spending (S1.1). However, public spending is also under continued pressure from the rising costs of health and social care to the State (S1.3). Incremental system reforms have led to growing complexity in the system (S3.3), which in many cases present a barrier to political stability (S3.2) and trust (F1.4) as well as costs to providers (S3.5) and employers. Significant challenges around data are also identified across the system (S3.5).

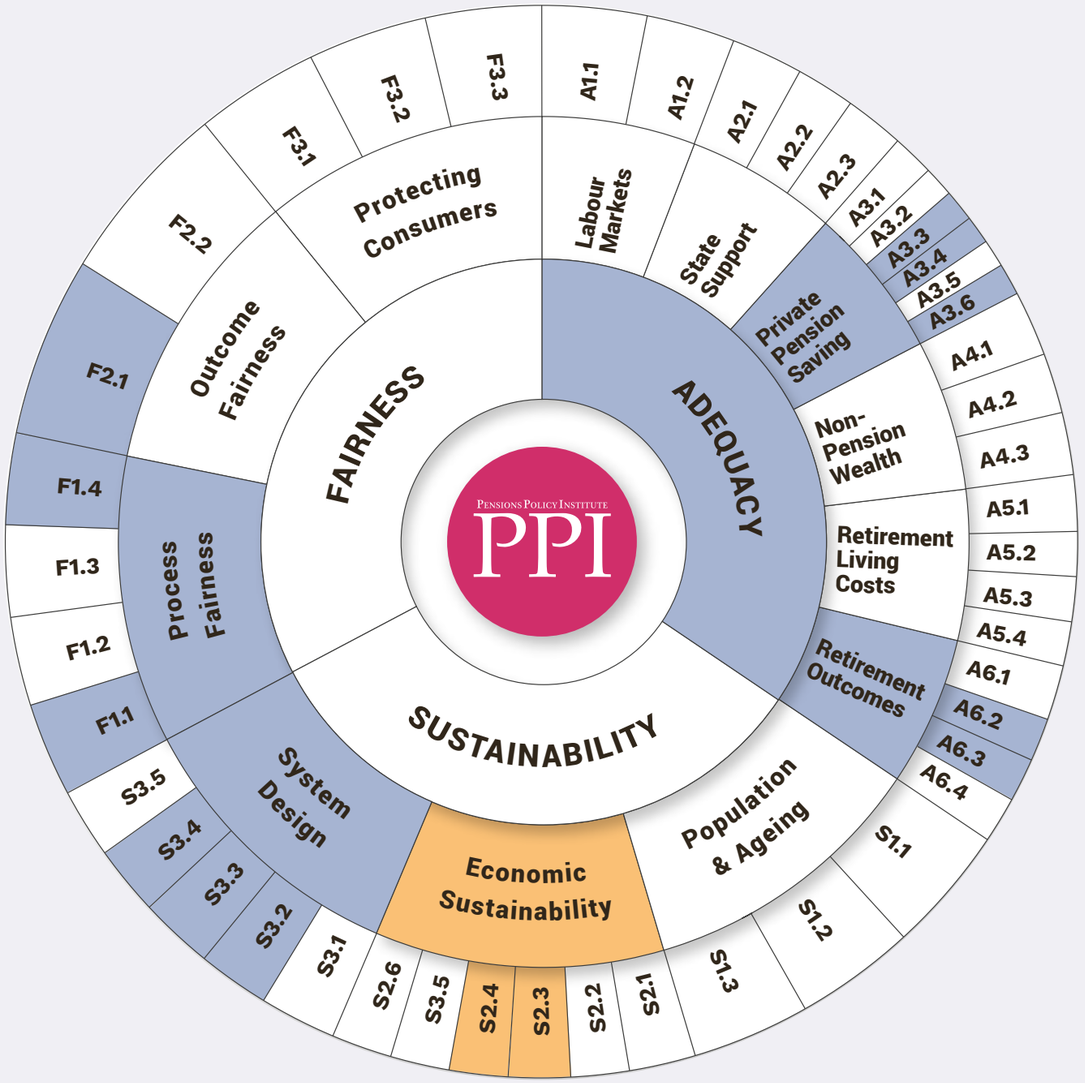
Fairness outcomes reflect the trade-offs between adequacy and sustainability that are being felt unevenly across population groups, and lags in process fairness reflect the rapid rate at which change has taken place across the system. Inclusion remains an issue for many at-risk groups (F1.1), and some groups would benefit from greater levels of engagement (F1.2) or changes to options and defaults (F1.4) as they face increasingly complex decisions on how to access their pensions (A6.1). The need to protect savers from some of the harmful outcomes associated with poor decisions is also growing (F3.1, F3.2, F3.2).

SUSTAINABILITY L3		
S1: Population & Ageing L3		
L3	S1.1	Longevity, Population Ageing
L3	S1.2	Family Arrangements
L1	S1.3	Health and Social Care
S2: Financial Sustainability L4		
L4	S2.1	Key Economic Indicators
L4	S2.2	Pension Age and Access
L4	S2.3	Employer Sustainability
L3	S2.4	Fiscal Sustainability
L4	S2.5	Scheme Sustainability
L3	S2.6	ESG
S3: System Design L2		
L4	S3.1	Regulation
L3	S3.2	Political Sustainability
L2	S3.3	Complexity
L4	S3.4	Innovation and Reform
L1	S3.5	Data Adequacy

FAIRNESS L3		
F1: Process Fairness L3		
L2	F1.1	Inclusion
L3	F1.2	Engagement
L4	F1.3	Choice and Defaults
L3	F1.4	Commitments
F2: Outcome Fairness L3		
L2	F2.1	Differences between groups
L4	F2.2	Diffs. Between individuals
F3: Protecting Consumers L3		
L3	F3.1	DB Transfers
L1	F3.2	Pension Scams
L4	F3.3	Value for Money

Figure 4.2 shows that automatic enrolment reforms would likely have a positive impact on adequacy and sustainability, but at some cost to economic sustainability

Figure 4.2: Simulated effects of the impact on framework indicators of proposals to remove the automatic enrolment LEL and qualifying age criteria



An illustrative policy simulation suggests that removing the LEL and age qualifying criteria for automatic enrolment would likely contribute to improved adequacy, with the greatest benefits being seen amongst the most vulnerable groups. However, it would come at a cost to economic sustainability on account of implications for the State and employers.

The overall effects of proposed automatic enrolment reforms are mixed. Removing the LEL could have a positive impact on adequacy and fairness because it would likely increase pension pots for DC savers (A3.4), with individuals in the lowest income deciles seeing proportionately greater increases in average retirement income. Data from the Automatic Enrolment Review suggests that proposals could yield an increase in savings of over 80% among the lowest earners, and 40% among median earners - bringing in an extra £3.8 billion in savings annually.[79] There is an expectation that changes could improve coverage by incentivising those in multiple jobs to opt in to workplace pension schemes in order to benefit from employer contributions for every pound they earn in every job, up to the upper earnings limit (A3.3). However, the extent to which the same rules could also prompt people to opt out of workplace saving should also be considered. Removing age qualifying criteria could improve coverage by bringing younger savers earning over £10,000 within scope of eligibility rules, with the option to opt in at lower earnings levels. However, reforms are still required to address differences in net pay versus relief-at-source schemes, which currently mean low earners in net pay schemes may not receive tax relief and could have to pay 20% more for their pensions than those in relief-at-source arrangements (F1.1).

ADEQUACY +1		
A1: Labour Markets System		
	A1.1	Employment
	A1.2	Income and Earnings
A2: State Support		
	A2.1	State Pension Accruals
	A2.2	State Pension Income
	A2.3	Means-tested Benefits
A3: Private Pension Saving +1		
	A3.1	DB Pension Coverage
	A3.2	DB Pension Contributions
+1	**A3.3**	DC Pension Coverage
+1	**A3.4**	DC Pension Contributions
	A3.5	Pension Investment & Assets
+1	**A3.6**	Tax Relief
A4: Non-pension Wealth		
	A4.1	Non-pension Savings
	A4.2	Home Ownership
	A4.3	Inheritance
A5: Retirement Living Costs		
	A5.1	Household Spending
	A5.2	Housing Costs in Retirement
	A5.3	Household Debt
	A5.4	Social Care Costs
A6: Retirement Outcomes +1		
	A6.1	Pensions Access
+1	**A6.2**	The Retirement Equation
+1	**A6.3**	Poverty in Retirement
	A6.4	Living Standards

SUSTAINABILITY		
S1: Population & Ageing		
	S1.1	Longevity, Population Ageing
	S1.2	Family Arrangements
	S1.3	Health and Social Care
S2: Financial Sustainability –1		
	S2.1	Key Economic Indicators
	S2.2	Pension Age and Access
–1	**S2.3**	Employer Sustainability
–1	**S2.4**	Fiscal Sustainability
	S2.5	Scheme Sustainability
	S2.6	ESG
S3: System Design +1		
	S3.1	Regulation
+1	**S3.2**	Political Sustainability
+1	**S3.3**	Complexity
+1	**S3.4**	Innovation and Reform
	S3.5	Data Adequacy

FAIRNESS		
F1: Process Fairness +1		
+1	**F1.1**	Inclusion
	F1.2	Engagement
	F1.3	Choice and Defaults
+1	**F1.4**	Commitments
F2: Outcome Fairness		
+1	**F2.1**	Differences between groups
	F2.2	Diffs. Between individuals
F3: Protecting Consumers		
	F3.1	DB Transfers
	F3.2	Pension Scams
	F3.3	Value for Money

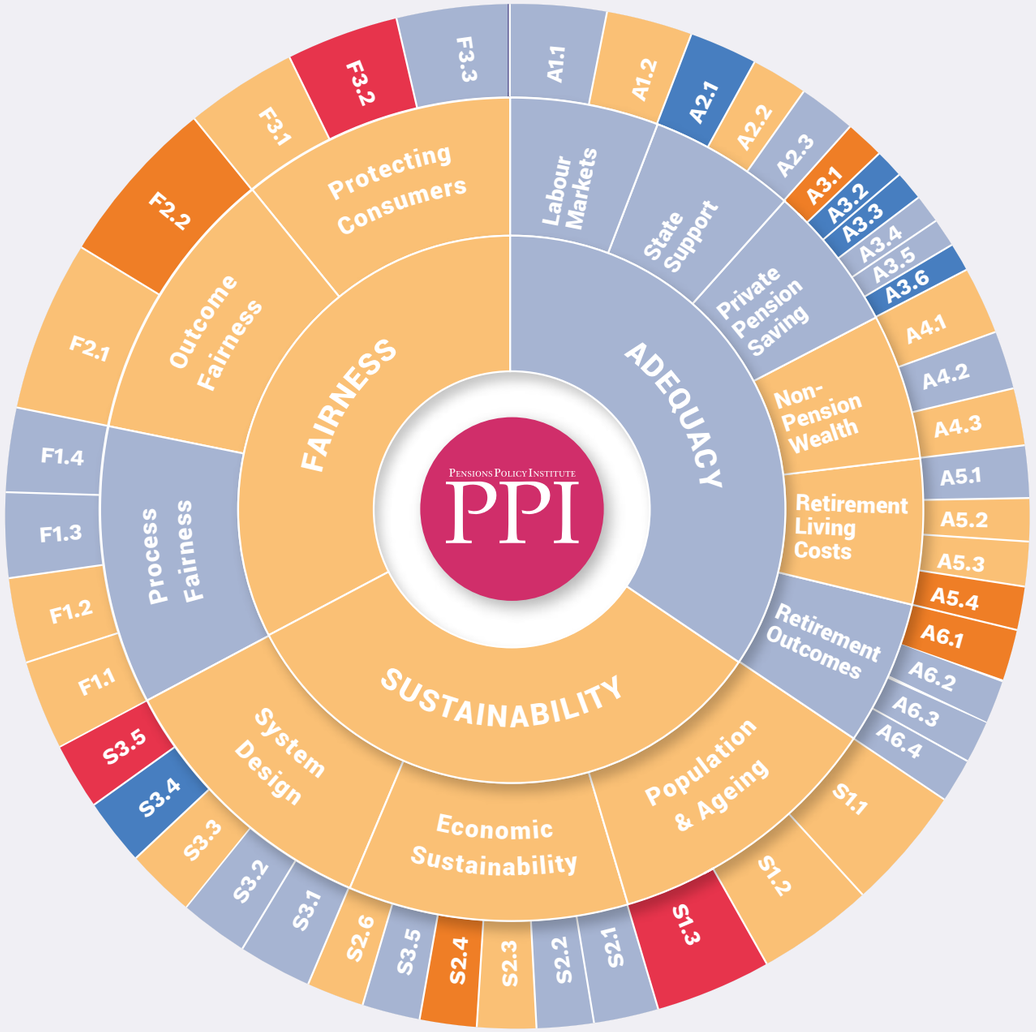
Despite the benefits to adequacy, reforms are not without significant cost to both employers (S2.3) and the State (S2.4), who would need to share the cost of improved retirement outcomes along with individuals themselves. Employers face competing challenges for resources from ongoing reforms associated with the National Minimum Wage (NMW) and National Living Wage (NLW), which could, in turn, exert short-term pressure on affordability and earnings gaps. Proposals are likely to benefit the UK's longer-term fiscal position on account of the expectation that increased levels of private saving, particularly among low-income groups, will reduce future dependency on means-tested benefits. However, the cost of tax relief is likely to rise quickly over the short term and place additional burden on public spending going forwards.

Further benefits include simplified messaging and processes, which overall impact positively on system design by reducing complexity (S3.3) and engendering political sustainability (S3.2) by demonstrating commitment to system improvements (S3.4), particularly for at-risk groups. However, the overall scale of improvements does not sufficiently offset wider concerns over levels of inclusion and adequacy to significantly uprate associated indicators such as inclusion, coverage and contributions. Greater improvements in adequacy and fairness could be achieved through further incremental reforms, such as the removal of the £10,000 earnings trigger, provision for self-employed workers and family carers, inclusion of pensions in divorce settlements, and measures to address the disadvantages for low earners in net pay schemes.

[79] DWP (2017)

Figure 4.3 shows that automatic enrolment reforms may counterbalance the uneven distribution of trade-offs which have accompanied shifts towards increased sustainability

Figure 4.3: Simulated effects of the impact on the UK pension system of proposals to remove the automatic enrolment LEL and qualifying age criteria



L6	Strong support for system objective with sustainable outcomes
L5	Good support for system objective with somewhat sustainable outcomes
L4	Somewhat supports objective, somewhat sustainable outcomes
L3	Somewhat fails to support objective with some prospects for improvement
L2	Poor support for objective with few prospects for improvement
L1	Fails to support objective with poor prospects for improvement

Compared to the 2022 illustrative baseline analysis chart, automatic enrolment reforms could be expected to produce outcomes that favour improved adequacy in the UK pension system but place downward pressure on employers and fiscal sustainability in the short to medium term.

Outcomes are most likely to benefit at-risk groups, which overall produces improvements in process fairness, although wider issues associated with outcome fairness and the need to protect consumers remain important issues. If trends towards increased adequacy within the pension system were to persist, changes suggest that pressures on retirement income could increasingly come from to factors outside of the control of the pension system - such as household debt or the increased likelihood of renting in retirement, as well as labour market behaviours and earnings. Reforms also have a positive impact on system design, reducing complexity and its associated costs for individuals and employers, whilst also demonstrating a commitment to achieving an overall balance of adequacy, sustainability and fairness in the system that can enable better retirements for all.

ADEQUACY L4		
A1: Labour Markets L4		
L4	**A1.1**	Employment
L3	**A1.2**	Income and Earnings
A2: State Support L4		
L5	**A2.1**	State Pension Accruals
L3	**A2.2**	State Pension Income
L4	**A2.3**	Means-tested Benefits
A3: Private Pension Saving L4		
L3	**A3.1**	DB Pension Coverage
L5	**A3.2**	DB Pension Contributions
L5	**A3.3**	DC Pension Coverage
L4	**A3.4**	DC Pension Contributions
L4	**A3.5**	Pension Investment & Assets
L5	**A3.6**	Tax Relief
A4: Non-pension Wealth L3		
L3	**A4.1**	Non-pension Savings
L4	**A4.2**	Home Ownership
L3	**A4.3**	Inheritance
A5: Retirement Living Costs L3		
L4	**A5.1**	Household Spending
L3	**A5.2**	Housing Costs in Retirement
L3	**A5.3**	Household Debt
L2	**A5.4**	Social Care Costs
A6: Retirement Outcomes L3		
L2	**A6.1**	Pensions Access
L3	**A6.2**	The Retirement Equation
L3	**A6.3**	Poverty in Retirement
L4	**A6.4**	Living Standards

SUSTAINABILITY L3		
S1: Population & Ageing L3		
L3	**S1.1**	Longevity, Population Ageing
L3	**S1.2**	Family Arrangements
L1	**S1.3**	Health and Social Care
S2: Financial Sustainability L3		
L4	**S2.1**	Key Economic Indicators
L4	**S2.2**	Pension Age and Access
L3	**S2.3**	Employer Sustainability
L2	**S2.4**	Fiscal Sustainability
L4	**S2.5**	Scheme Sustainability
L3	**S2.6**	ESG
S3: System Design L3		
L4	**S3.1**	Regulation
L4	**S3.2**	Political Sustainability
L3	**S3.3**	Complexity
L4	**S3.4**	Innovation and Reform
L1	**S3.5**	Data Adequacy

FAIRNESS L3		
F1: Process Fairness L4		
L3	**F1.1**	Inclusion
L3	**F1.2**	Engagement
L4	**F1.3**	Choice and Defaults
L4	**F1.4**	Commitments
F2: Outcome Fairness L3		
L3	**F2.1**	Differences between groups
L4	**F2.2**	Diffs. Between individuals
F3: Protecting Consumers L3		
L3	**F3.1**	DB Transfers
L1	**F3.2**	Pension Scams
L4	**F3.3**	Value for Money

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