COUNTRY SPOTLIGHT | UNITED KINGDOM

Protecting UK pensions

Longevity and the proportion of GDP needed to pay for government retirement provision in the UK has resulted in a dramatic rise in the state pension age. This could wash away the traditional transition from work to retirement and leave many with a financially precarious old age

WRITTEN BY MAREK HANDZEL

In July this year, the UK's Work and Pensions Secretary, David Gauke, announced that the state pension age was to rise from 67 to 68 from 2037, seven years earlier than had originally been planned.

The news was not unexpected. Firstly, a report on the matter released in March by Sir John Cridland, the former director-general of the Confederation of British Industry, recommended an earlier increase. Secondly, the new minority Conservative government found itself in a financial pickle following the surprise General Election in May.

In return for propping up Theresa May's minority administration, Northern Ireland's Democratic Unionist Party (DUP) demanded that she keep the so-called state pension triple lock: a guarantee to increase the state pension every year either by a minimum of 2.5 per cent, the rate of inflation, or average earnings growth, depending on which of the three is highest. During the election campaign the Conservatives had talked openly of dropping the expensive promise. Having now preserved it, the only option in the age of austerity was to postpone the date from which people can receive it.

The UK's state pension age has undergone a huge overhaul since 2010. Rising from 60 to 65 for women between then and 2018, it has also been pencilled in for future increases to 66, 67 – and now 68 – for both men and women.

Old Mutual Wealth's head of retirement policy, Jon Greer, says that the government's latest decision to change the timetable for increasing the state pension is proof that it is taking a gradually declining role in supporting retirement income.

"A combination of increases in life expectancy, and the growing number of retirees relative to the working age population, means that individuals will have to save harder for their own retirement," says Greer.

The demographic group immediately affected by the decision is that of workers aged between 39 and 47. The Pensions and Lifetime Savings Association's director of external affairs, Graham Vidler, recently referred to this group as the "sandwich generation". He argued that they were at the most risk of inadequate private saving: not only had they not had the same access to defined benefit pension funds as

THE GOVERNMENT'S APPARENT SLOW WITHDRAWAL OF STATE SUPPORT HAS NOT GONE UNNOTICED AMONG THE GENERAL PUBLIC

their parents, but they were also too old to experience the full benefits of automatic enrolment.

Vidler called on the government to pick up another one of Sir Cridland's recommendations – providing access to a midlife financial check-up. This could help people who need to work longer before they receive their state pension make "smarter financial choices to boost their savings," he said.

Impact on the pensions system

But it is not just the "sandwich generation" that is of concern. The government's apparent slow withdrawal of state support has not gone unnoticed among the general public, according to The Society of Pension Professionals' president, Hugh Nolan.

"We do get a sense of people saying that they can't rely on the government to provide them with a decent pension," he says.

"So my suspicion is that this will increase people's awareness of pensions and get them to save a bit more. On the grounds that if they want to retire at 65 rather than 68, then they'll think, 'I need to put a bit more aside for myself'.

However, he says, there is also a risk that some people will throw their hands up in horror and say: 'Forget it, I'm just going to die'.

Realising that they cannot rely on the government for a decent pension income, and throwing in the towel on their own prospects of being able to support themselves in retirement, these people will stick their heads in the sand and just hope for the best, predicts Nolan.

"So there will be the two groups. People who have a bit of money and are financially savvy will probably put a bit more aside. And the ones who have nothing at all, who need to save the most out of everyone, will be the ones who don't do anything at all."

This could also create a further class divide, says Nolan.

"Middle class professionals who sit in an office doing a job might well carry on working and saving until they're 68, whereas your working class people who are doing physical jobs are going to find that more physically challenging."

Uncertainty

The Pensions Management Institute's technical consultant, Tim Middleton, has noticed another possible trend that could create a dangerous rupture in the savings space. He says that the Institute has already noticed a pronounced trend of people decumulating early, particularly within defined contribution schemes.

"If that's going to continue, then

PEOPLE APPEAR TO BE PLANNING FOR A PHASED RETIREMENT

they're going to be less likely to think about pensions as something for old age, and more something that they access in middle age.

"Pushing the state pension age back is going to divorce private saving from state pension provision, and that could create some problems later on," he warns.

Part of the reason for early access of pension pots, made easier by the previous government's relaxing of the rules, is that the UK public has very little confidence in the integrity of its pension system.

"We only very recently had announcements about the deficits affecting DB pension schemes, and that's likely to encourage moods of cynicism over the capacity of occupational schemes in particular to honour benefit promises to members," says Middleton.

His argument is backed up by a recent poll conducted by The People's Pension, a master trust pension provider, which found that 52 per cent of UK adults expect that their financial situation will not support their desired lifestyle in retirement. It also estimated that more than eight million adults under the state pension age expect to work part time to support themselves once they retire.

Speaking about the results in August, The People's Pension's director of policy and market engagement, Darren Philp, said that the concept of people completely stopping work and relying on their pension savings had been consigned to history in the UK.

"Instead, people appear to be planning for a phased retirement, where they may choose to work part-time, or surviving on sources such as an inheritance or property," he said.

The fact that so many people are resigned to a partial retirement is something that the pensions industry needs to tackle, says Middleton.

"We need to restore public confidence. And to persuade them that this is a system that provides for them in their old age," he says.

Future rises

Whatever happens in the private space, the disconnect between state provision and people's financial needs in old age is, as matters stand, set to grow in the UK.

Nolan says that with the existing state-of-play, the share of GDP needed to pay for state pensions is going to have to go up from 5 per cent to 7.1 per cent over the next 40 years. Healthcare and social care are also estimated to account for another 5 per cent increase in GDP.

"The ageing population is likely to be costing an extra 7 per cent of GDP over the next 40 years, which is a frightening prospect," he says.

To reverse this drain on the public purse, Nolan says that some very difficult discussions about taxation may have to take place if the state pension age is to not go over and beyond 70.

"We either have to start cutting back on pensions and making people retire later, or we have to start making people pay substantially more tax to be able to cover the costs."

By Greer's reckoning, this will be an unpalatable scenario for any future government. The only solution to reduce costs, therefore, is to deal with the triple lock, once the DUP are out of the main political picture.

In place of it, Greer believes that the government should consider a smoothed earnings link, as recommended by the UK's Parliamentary Work and Pensions Select Committee last year.

"This allows growth in pensions to continue, but when earnings fall behind price inflation, an above earnings increase could apply until either earnings growth catches up with inflation, or for as long as the pension remains above a previously established limit compared to average earnings.

"When this happens, it would revert to earnings. This would ensure that the state pension rises in line with earnings, rather than faster than earnings, and also protect pensioners when earnings fall." ■