Summary
- The UK has moved up the rankings of the Mercer CFA Institute Global Pension Index, largely due to automatic enrolment (AE).
- However, it was downgraded for having freedom and choice at retirement; which raises the question, what defines a good system?
- Each index, institution and individual will have their own opinion but there is consensus that AE has been a policy success in the UK.
- Now more focus needs to be put on expanding the breadth of AE, focusing on more collective schemes that pool risk, and strengthening communications.

UK pension system: On cloud nine

A recent global pension index has seen the UK's pension system move up the rankings to take ninth place. While this is something to celebrate, the UK still has a lot of work to do to reach the top. Natalie Tuck reports

The UK has one of the largest pension markets in the world but in recent years its pension system has stagnated in the mid-to-high teens of global pension rankings. In 2021, however, the UK jumped six places to take ninth place out of 43 retirement income systems compared by Mercer and the CFA Institute – one of the most respected indexes.

Overall, the country was awarded a B grade and described as a "system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from a A-grade system".

What is good?

While global pension indexes are a good indicator of a country's standing among other systems, it is important to remember that the definition of 'good' differs between organisations and individuals. No two indexes are the same, and other experts will have differing opinions. For example, in the Natixis Investment Management Global Retirement Index 2021 the UK placed 18th out of 44 countries analysed.

It's noticeably lower than the Mercer CFA Institute index ranking, most likely because it focuses more on retirement itself, taking into account finances in retirement, as well as health, quality of life and material wellbeing.

LCP partner, Steve Webb, explains that it comes down to how you define good: "Mercer is perfectly entitled to have a view about what a good pension system looks like, but this means it tends to mark down national systems that don't fit its mould. An obvious example would be when it marked down the UK following the freedom and choice reforms because people now build up a pension pot rather than being forced to turn it into an annuity. I happen to think that makes the pension system better overall, but Mercer disagreed."

Indeed, Mercer senior partner, David Knox, says that the UK could improve its score by "restoring some requirement for part of people's retirement savings be taken as an income – that is, ensure the

focus is on retirement income not just accumulation".

Like Webb, Pensions and Lifetime Savings Association (PLSA) chair and Aviva managing director, workplace, Emma Douglas, also thinks that freedom and choice has been good for the UK: "If something hadn't been done, we would be having so much more outrage now… I think it has made people feel that their pension is their own money."

AE: A standout reform

While there may be disagreement on certain aspects of the UK's pension system, such as freedom and choice, there is a policy success that experts, and indexes, do agree on – automatic enrolment (AE).

According to Knox, AE was one of the main factors for the UK's improvement on the Mercer CFA Institute index: "The first thing to note is the UK score is improving due to the introduction of AE; the consequential increase in coverage; the increase in contribution rates and the subsequent increase in the level of assets, when expressed as percentage of GDP."

It is not just Mercer that acknowledges its success. Webb, who was Pensions Minister during a large part of the policy's rollout, says: "We've gone up in the rankings because of AE – roughly 10 million people are newly saving for a pension – and because mandatory contribution rates have been increased to 8 per cent of qualifying earnings."

But why has it been so successful? Douglas explains that its success is driven by regulation: "Auto-enrolment used regulation, used that behavioural finance nudge principle, absolutely in favour of people. It was such a game changer."

It's not just the UK that appreciates its own success; Ireland having seen how well the policy has worked in the UK, is looking to replicate that success itself. Irish Association of Pension Funds CEO, Jerry Moriarty, says: "Looking from an Irish perspective where we have been speaking about AE for so long without actually getting it in place, the success of AE in the UK has been very impressive.

"While you could argue about some of the detail and whether contributions are adequate, the fact that millions of people are saving for retirement who otherwise wouldn't have is a very impressive achievement. I do think we could really do with a similar approach in Ireland and just get it started."

UK shortfalls

On the flipside, those working in the UK pensions sector tend to agree that the UK's biggest issue is on pensions adequacy when compared with other countries. For example, Douglas highlights Australia as a "great pension system" as it has enough money being contributed. She notes, however, that it "hasn't solved everything" because there are issues with what to do at the decumulation stage.

"I think what I'm worried about most *[in the UK]* is that we're going to end up with a lot of people retiring on far less than what they thought they would end up with. It is that generation in the middle – some of Generation X and older Millennials – who won't have had AE for the whole of their career but they probably won't have DB either and they are very unlikely to have property to fall back on. There is going to be a generation that is not going to have very much money at retirement and I think that is going to be a massive shock."

When asked what the UK needs to improve on, PTL director, Richard Butcher, replies: "Adequacy, fundamentally. AE was great, but the AE amount of contribution was never designed to provide somebody with an adequate income in retirement. It was only designed to get them a certain way there with private saving theoretically filling up the gap. Private saving isn't filling up the gap. What we need to do is, over the longer term, increase the level of AE contributions if we're going to have people receiving an adequate income in retirement."

A 2017 review of AE set out several ways to widen and broaden the AE policy, which Douglas backs implementing. "We really should be thinking about removing that lower earnings limit so that people can join from the first pound; it would help a lot of the part-time workers, many of whom are women. We know that the gender pension gap is a massive issue so that would really help with some of the unfairnesses in the pension system."

The gender pensions gap is indeed a global problem, but the Mercer CFA Institute index highlighted the UK as a country that has similar employment rates amongst women and men, but a significant gender pension gap.

The index report highlighted "design features" in pension systems that tend to aggravate this issue. It noted that eligibility restrictions in some pension arrangements require a minimum income or a minimum number of hours to be worked, with the UK being one of those countries. The index report stated

that 23 per cent of employed women and 13 per cent of employed men in the UK do not meet the minimum income requirement to join a pension scheme.

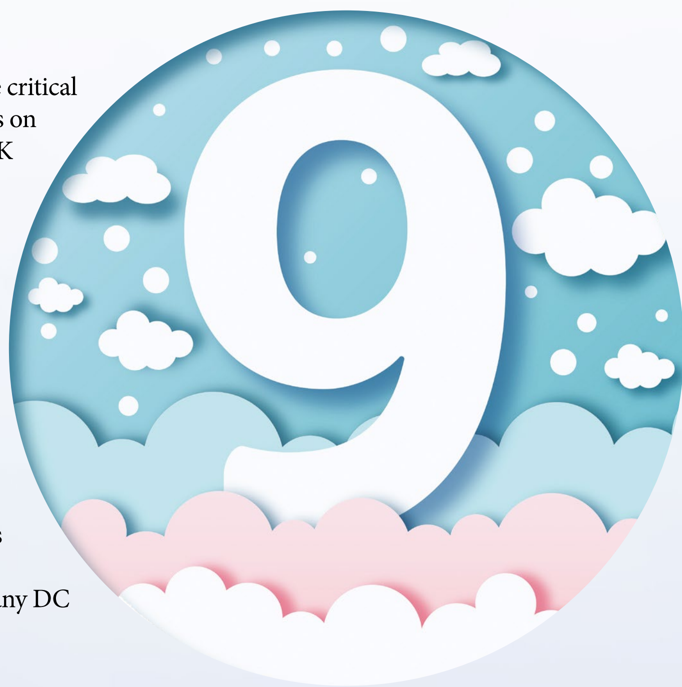
Douglas thinks that other recommendations from the review would also help to close this gender gap: "Joining from 18 rather than 22 would also be brilliant because those early years contributions are again really helpful to women who might be taking some time out later."

There is also the question of contributions. It is widely agreed that the current minimum of 8 per cent is not going to be enough for most to secure an adequate income in retirement. Many believe that 12 per cent is an ideal contribution, but that this should be done gradually.

"The PLSA's view is that we would love it to get to 12 per cent and be split more equally between the employer and employee – so 6 per cent each. We would look to get to that gradually. I think also at 12 per cent, we will need to make sure that there's some mechanisms in place so that we avoid over saving for those people who are lower earners and are likely to remain low earners for the rest of their working lives," Douglas says.

With the UK battling Covid-19 with the rest of the world, and the added impact of Brexit, Butcher says that now is not a good time to be increasing employer costs. "I think it's sensible to have that deferred until say the second half of this decade. But we need to increase contribution rates if we're to get people having an adequate income in retirement. At the moment we're unlikely to, and it's really only the residual DB liabilities that are still sitting in the system that are keeping retirees solvent."

However, others are more critical with the UK's lack of progress on pensions. Webb says: "The UK government lacks a sense of urgency; DB is dying rapidly, but DC is not rising rapidly enough to take its place…. when the Department for Work and Pensions does a 2017 review of automatic enrolment but keeps saying it is not going to be implemented until 2025 you can see that there is no urgency in getting to grips with the woefully inadequate level of contributions into many DC pensions."



CDC: Waiting in the wings

One of the countries that regularly ranks as one of the top performing pension systems is the Netherlands; the Mercer CFA Institute index ranked it in second place, only behind Iceland, in 2021.The country is a trailblazer for collective-style pension schemes, such as collective defined contribution (CDC) schemes, which pool members' money into a single fund. The schemes allow members to share the risks of investing and longevity and achieve lower costs from economies of scale.

The UK government has just announced that its own CDC legislation will come into force on 1 August 2022, with Royal Mail looking to be the first company to introduce such schemes; could this be the boost that the UK needs to its pension schemes? The UK has a relatively individualised pension system compared to others and Webb believes a collective system could help members benefit from greater scale and more risk pooling and sharing.

He also points out that the UK is looking to consolidate the large number of pension schemes into far fewer schemes, including economy-wide master trusts. This is also an area where Douglas, who despite initially having some reservations about the concept, can see CDC working in the UK.

She thinks it could play a part in the decumulation stage, as an alternative to annuitisation, paying an income post-retirement. However, she worries about its place in the UK as, like in the Netherlands, it is often operated at scale.

"I think you do need either a massive employer like Royal Mail or an industry collective, or of course what we are now seeing as the big pension schemes in the UK, a master trust. There is certainly something to look at there. I do worry that it maybe does not work as well if people are constantly changing jobs and switching in and out of it because what is your transfer value, how do you calculate that fairly? There is a lot to think about, there is a lot to work through of the mechanisms of how it would work but I do think now it is something that we need to investigate more fully to see what place it has in the UK."

Written by Natalie Tuck