Institute and Faculty of Actuaries

14 July 2026

Response of the Institute and Faculty of Actuaries to the Second Pensions Commission: Interim Report

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 34,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers. Actuaries are big-picture thinkers who use mathematical and risk analysis, behavioural insight and business acumen to draw insight from complexity. Our rigorous approach and expertise help the organisations, communities and governments we work with to make better-informed decisions. In an increasingly uncertain world, it allows them to act in a way that makes sense of the present and plans for the future.

The IFoA warmly welcomes the interim report from the Second Pensions Commission and encourages the Commission to consider prioritising the following:

Automatic enrolment: We recommend an increase in the level and breadth of automatic enrolment, to cover earnings from the first pound and employees from age 18. We also support an increase to minimum auto-enrolment contributions but phased and targeted at particular earnings bands to ensure lower earners do not contribute more at the expense of an adequate standard of living, and to minimise the risk of opt-outs on affordability grounds. Increasing auto-enrolment savings is the most significant lever the Commission can pull.

Stability and establishing trust in pensions saving: We are calling on the Government to prioritise a joined-up pensions policy across Government departments and regulators, aimed at creating a stable pensions savings and pensions tax regime. This will increase trust in pensions saving, incentivise higher and wider saving, and avoid the damage that results from periodic speculation about changes to the regime.

Guided retirement: We support the introduction of guided retirement but strongly believe defaults should include longevity and inflation protection. We also recommend that Retirement CDC is introduced alongside guided retirement to ensure a full suite of guided retirement options is available from day one and to provide savers with alternatives to annuity purchase and drawdown.

State Pension: We recommend that changes to State Pension Age are considered carefully for their impact on individuals. We do not support an *automatic mechanical* link to average life expectancy, although average life expectancy is certainly a key factor to consider in any review of State Pension Age. We would also welcome adjustments to the (currently unsustainable) triple lock. As the basic foundation for all retirement incomes, the State Pension must be sustainable first and foremost, and at least inflation-linked.

Target replacement rates (TRRs): TRRs need reviewing. They must be realistic and multi-dimensional and should include the new reality that many pensioners will be renting in retirement. Getting TRRs right is key for incentivising saving, getting appropriate policies implemented, and measuring the Commission's success.

We would be delighted to meet with the Commission to discuss this response further.

Chapter 1: Strong Foundations Facing Long-Term Pressures

The Commission is the right mechanism

1.1 **The IFoA strongly supports the decision to reestablish the Commission. An independent body capable of building cross-party and cross-industry consensus is the right mechanism for addressing the UK's long-term pension adequacy challenge.** Our own work, Beyond the Next Parliament, identified short-termism in pensions policy as a structural risk. We are pleased to see that concern reflected in the Commission's approach.

1.2 The reforms that followed the first Pensions Commission — the new State Pension, the triple lock and automatic enrolment — fundamentally improved retirement outcomes for millions of people. However, these achievements should be the baseline, not the ceiling.

1.3 The pension system now needs a further boost and must also adapt to economic and fiscal realities that did not exist in the mid-2000s.

1.4 We support the establishment of an independent oversight body, a Pensions Advisory Commission, to carry out regular reviews of the system, as called for by the first Pensions Commission.

Policy stability is essential

1.5 **Repeated change, or speculation about change, to pension rules and pension tax rules is directly damaging to saving behaviour.** When people cannot trust that the terms of pension saving will remain stable, they are less likely to save.

1.6 Any reform programme coming out of this Commission must be capable of commanding cross-party support on basic principles. The principles should also be easily understood and therefore acceptable by savers.

1.7 Pensions policy is interconnected across a deep and wide regulatory framework. Governments and regulators consistently underestimate how long it takes to implement systematic change, and savers underestimate the period over which saving needs to take place to ensure good outcomes. The Commission's recommendations must include realistic implementation timescales and a plan to engage and educate existing and new savers over a lengthy period.

Cross-departmental coordination must improve

1.8 **DWP, FCA, HMT and HMRC must work much more closely together.** Pensions operate under multiple regulatory regimes. The current structure and inconsistent remits allow live policy problems to fall between departments. Too often one department develops and launches a policy without the full involvement and coordinated support of another.

1.9 The extension of the dual-department pensions minister role is a step in the right direction. However, structural coordination must go further: the treatment of defined benefit surplus and the development of decumulation-only collective defined contribution schemes are both current examples where misalignment between departments is causing practical harm. The launch of Pensions Freedoms is another example that is having an adverse impact on outcomes today.

The DB-to-DC shift is the defining structural change

1.10 **The shift from defined benefit to defined contribution in the private sector is the most consequential structural change since the first Commission. It has created a significant and growing disparity between public and private sector pension outcomes**.

1.11 Public sector workers continue to accrue defined benefits. Most private sector workers face much lower retirement incomes than those of previous generations. The Commission should explicitly take this structural divide into account when assessing aggregate adequacy data.

Long-term fiscal sustainability requires transparency

1.12 **The State Pension and unfunded public sector schemes are major unfunded commitments[1]. The broader long-term fiscal position implied by current tax levels is not sustainable under current spending commitments. The Commission should address this as part of its proposals**[2].

1.13 The OBR's long-term fiscal reports have consistently confirmed that current State Pension commitments cannot be met under current tax revenues and likely growth assumptions. There is no plan for how the shortfall will be bridged as the population ages and the worker-to-retiree ratio falls, but to the extent that State benefits are unsustainable, the Commission's recommendations will need to work harder to fill the gap.

1.14 The Commission should consider, at a very high level, what a transparent, fair and politically durable adjustment mechanism for State benefits would look like (while recognising that the detail of any tax changes will be for the governments of the day to determine). From an actuarial perspective, it may be feasible to pay for certain pensions out of future taxes and contributions, however, the inter-generational transfer is not sustainable without a stable worker to retiree ratio, and the Commission needs to recommend an economically and politically plausible path to meeting those future liabilities.

Housing is a component of retirement adequacy — but pension assets should not fund housing

1.15 **The IFoA supports the Commission's recognition that housing is part of the retirement adequacy problem**. For low-income individuals, private rental costs may represent a more acute threat to financial security than the size of their pension pot. And for low-income retirees, private rental costs could represent a substantial proportion of their pension income. Similarly, mortgages, especially those starting late and continuing into retirement, could also have a significant impact on income needs.

1.16 **From an actuarial perspective, the private renting pensioner population faces highly uncertain costs of living in retirement, which are not well matched to their likely incomes.** Sustainable solutions would need to give greater certainty over long-term rental costs, such as increasing the supply of socially-controlled rented accommodation so that retirees can access secure tenancy with predictable costs.

1.17 **Using pension assets to fund housing deposits would be counterproductive.** More money chasing a broadly fixed housing stock would tend to raise prices without reducing rents, with a risk of depleted pension pots alongside concentrated wealth in housing.

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[1] For example, see ONS's Unfunded public sector pension liabilities: Pension entitlements (AF.63).

[2] Office for Budget Responsibility: Fiscal risks and sustainability. July 2026. See chart 5.5 and ss 20-22 and 5.26-5.30

Retain marginal rate income tax relief

1.18 **The IFoA's clear position is that marginal rate income tax relief on pension savings should be retained, and the Government should foster a stable tax environment for pension savings, to improve trust in the system.**

1.19 The annual speculation about changes to pensions tax (often regarding a move to flat rate relief) mischaracterise how pension taxation works. It also serves to damage trust in the system and prompts poor decision-making by savers. It is a fact that the current system defers tax to the point of payment (EET: exempt-exempt-taxed) rather than providing a pure relief. Tax is paid when the pension is drawn; it is deferred, not forgiven.

1.20 Superficially, a shift to flat rate relief may sound attractive, however, it would create immediate administrative and legal complexity, and there is **no practical easily understood way to operate upfront flat rate relief alongside taxed-at-payment benefits.** The challenge is particularly acute for defined benefit schemes (now largely open to new entrants and accrual only in the public sector), where individual contribution amounts are not straightforwardly defined or quantifiable. The Government would need to be very mindful of the effects of any pensions tax changes to its own highly paid public sector workers, e.g. doctors.

1.21 While higher earners do receive larger absolute benefits under the current regime, this reflects the deferred-tax logic, not a stand-alone design feature. We strongly recommend that the Commission should not treat the central issue of retirement income adequacy as a distributional problem to be solved by restructuring the tax base. This is not the way to increase the propensity to save or to improve the public's trust in locking away pension savings until retirement.

1.22 If the Government desires, over time, to reduce the pensions tax relief given to higher earners this can be done through the existing system, for example, through reducing the maximum tax-free lump sum available to those with the biggest pension rights. However, it would be very important to do this in a way that clearly protects expectations for the rights people have already built up and that does not disincentivise voluntary pension saving or damage trust in the system.

Counter damaging speculation on tax-free lump sums

1.23 **Annual pre-Budget speculation that the Government is about to remove or reduce tax-free lump sum rights on pensions already accrued causes direct damage to confidence in pension saving and damage to individual pension savers' outcomes**.

1.24 A stable, long-term pensions tax framework is critical to giving people the confidence to save over the very long time-horizons that pensions require.

1.25 The Government does not need to pre-empt Budget decisions. It should, however, make clear as a standing principle (and one that has, in fact, long been honoured in pensions) that whenever pensions tax rules change, transitional measures protect individuals' pre-existing accrued rights, including rights to tax-free lump sums. That statement of principle would substantially reduce the harm caused by speculation, without constraining future policy options.

Chapter 2: Measuring Retirement Outcomes

Use multiple measures — no single metric is adequate

2.1 **The IFoA supports a multi-measure framework. No single metric can capture the full retirement adequacy picture**.

2.2 Absolute adequacy (avoiding poverty) and relative adequacy (maintaining pre-retirement living standards) are genuinely different problems. They require different measures and different policy responses. They must not be conflated.

The State Pension is the primary tool for absolute adequacy

2.3 **For the large majority of lower earners with a full State Pension record, the new State Pension already provides a meaningful income floor.** The adequacy challenge for this group is primarily about housing costs and care services, not private pension savings.

2.4 For middle and higher earners the State Pension provides a clear foundation on which they can build, as was intended.

2.5 Policy interventions aimed at improving private pension saving will have least impact on those most at risk of absolute poverty. The Commission should be explicit about this when targeting policy levers.

Target replacement rates are useful for middle earners but have four important limitations

2.6 **Target replacement rates (TRRs) remain the most practical guide to relative adequacy for middle and higher earners**. However, their limitations must be explicitly acknowledged in the Commission's framework.

2.7 **Limitation 1 — Housing costs.** A TRR expressed as a percentage of pre-retirement earnings does not take into account the stark differences in needs (and assets – since housing also potentially provides equity release options) between those with and without housing costs continuing into retirement, even when the ratio is nominally met by both groups. This is a material risk for increasing numbers of retirees who will not own their homes.

2.8 **Limitation 2 — Underlying goals.** TRRs imply that people need an income in retirement that is a certain proportion of their working life income, however, this is not how most people think. What people want is to avoid a drop in their living standards on ceasing to work. For the lower income groups, their retirement income needs might be no lower than their working life needs (which already might not be fully met). For higher income groups the gap between their working life income and retirement needs will depend on how much of their earlier income was saveable and how much their costs in later life drop as a result of no longer needing to pay for mortgage, childcare, commute etc. With the shift in working patterns since the first Commission, some of these lifestyle changes may also have become less distinct. TRRs, at best, are an approximation to that underlying income desire, and highly sensitive to housing costs.

2.9 **Limitation 3 — Investment and inflation uncertainty.** Standard TRR analysis relies on deterministic economic assumptions over a retirement lasting 20 or more years. There tends to be an over-focus on incomes *at* retirement and not *throughout* retirement. Measures that do not incorporate uncertainty and variability should be treated with caution. In particular, since the first Commission, with the demise of DB benefits and the rise of flexible retirement products as a result of Pensions Freedoms, the balance of risk management has swung towards savers, rather than employers, needing to manage these risks. A static TRR focussing at the point of retirement could be counterproductive.

2.10 **Limitation 4 — Distributional masking.** Median-based TRRs obscure the position of those most at risk — renters, the self-employed, those with interrupted careers. The Commission's data illustrates this risk clearly.

Housing costs should be reflected in adequacy measures

2.11 **The Commission should develop adequacy metrics that explicitly account for housing costs in retirement.** This is particularly important as home ownership rates among younger cohorts continue to fall and house purchases tend to come later in life, with mortgages more likely to be running into retirement.

2.12 A replacement ratio calculated without housing adjustment will systematically flatter outcomes for those least well-placed in retirement.

Chapter 3: Accumulation and Adequacy

Increase minimum automatic enrolment contributions — this is the single most important lever

3.1 **Recommending an increase to minimum contribution rates is the single most important policy action available to the Commission.** Due to the effects of compound returns, putting more money in and earlier, is the strongest lever to improve outcomes, and will likely have far greater impact on people's retirements than modest changes in investment costs or asset diversification. The current minimum rates are too low for most middle and higher earners to achieve adequate retirement incomes.

3.2 The case for phased increases is well-evidenced and well-known and there is also a common theme around the benefits of linking increases to increases in earnings. However, the longer any action to begin increases is delayed, the worse the outcome for future pensioners.

3.3 The Government already has powers[3] to implement the 2017 automatic enrolment review[4] — removing the Lower Earnings Limit offset and beginning enrolment from age 18. It should set a timetable for doing so immediately. However, we recommend considering any phased increase to auto-enrolment minimum contributions in the context of these changes, and also in the context of forthcoming changes to salary sacrifice, to ensure the burden placed on younger savers and lower earners in particular does not increase opt-outs and act as a deterrent to saving. See our further comments in paragraph 3.5.

Focus contribution increases on earnings above a threshold to protect lower earners

3.4 **Higher minimum contributions should not be applied uniformly across all earnings bands.** For lower earners, the State Pension already provides a relatively high replacement ratio. Requiring higher pension contributions from those who struggle with day-to-day costs of living may not improve their retirement outcomes. (Many low earners may benefit more from initiatives to help them build up more immediate and accessible savings.)

3.5 Phased increases should focus first on earnings above a defined threshold, concentrating the policy impact where the relative adequacy improvement and affordability is greatest.

Allow opt-down, not just opt-out

3.6 **Automatic enrolment should allow members to reduce contributions below the default rate while remaining enrolled.** Binary opt-out removes employer contributions and tax relief entirely. Opt-down preserves the benefit of continued saving while managing savers' cash flow constraints.

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[3] Pensions (Extension of Automatic Enrolment) Act 2023

[4] Automatic enrolment review 2017: Maintaining the momentum

3.7 The current all-or-nothing structure disproportionately harms lower-income workers who are more likely to need temporary flexibility.

Employer contributions should not be conditional on employee contributions for low earners

3.8 **Employees who cannot afford to contribute should not automatically forfeit their employer's contribution.** Low-income workers who opt out due to affordability lose twice — they lose both the employer contribution and the associated tax relief. For higher earners the conditional employer contribution is an incentive to save, but it is a penalty for those who cannot afford to save.

3.9 Low-income workers (earning below the lower level of qualifying earnings) lose out on employer contributions even if they participate in the employer's pension scheme. This issue is particularly acute for savers who have multiple low-paid jobs, none of which reach the qualifying earnings threshold.

3.10 The Commission should consider whether the structure of employer contributions can be redesigned to continue some benefit for those who are unable to contribute and for those who earn below the qualifying earnings threshold.

Short-term contract workers should not be excluded from auto-enrolment

3.11 Postponement of employers' auto-enrolment duties allows employers to reduce the administration costs that would otherwise be associated with short-term workers who are expected to stop working with them within a few months of joining. However, this can have a disproportionate impact on workers in sectors where short-term contract working is the norm. The Commission should consider the different impacts that postponement has on different employment segments.

Make pension terms visible at the point of recruitment and divorce

3.12 **Two specific reforms would improve engagement and reduce pension gaps at relatively low cost.**

3.13 First, pension terms should be clearly and consistently communicated in job advertisements and offers. Many employees do not consider or compare pension provision when choosing between employers. There is a role for Government here to use its weight to move employment market norms.

3.14 Second, pension sharing on divorce remains poorly understood and inconsistently applied. Better information and stronger default processes would materially improve retirement outcomes, particularly for women. We support the Ministry of Justice's view that the court should specifically be required to give consideration to pensions accrued during the marriage and pension needs when making financial orders[5].

Investment returns matter — but member interests must remain primary

3.15 **Better investment governance and scheme consolidation are appropriate policy goals, albeit not the primary levers. Mandatory direction of investment into specific asset classes is not an appropriate policy goal**.

[5] A fairer end to relationships. Consultation, 5 June 2026.

3.16 Small differences in annual investment returns compound into large differences in pension pots over 40-year accumulation periods. We support efforts to improve returns through better governance and value-for-money frameworks.

3.17 We do not support any approach that requires pension schemes to invest in particular assets for purposes other than in the interests of their members. The primary purpose of a pension scheme is to provide financial security to members. Secondary purposes can be pursued by pension schemes if their trustees or managers wish and if they do not materially conflict with that primary purpose. Government can set incentives to influence scheme investment towards its chosen goals, but asset class allocation and individual investment decisions should not be directed – nor threatened to be directed – by the Government. Such considerations or threats are immediately damaging to savers' trust in pension saving.

Self-employed pension saving requires targeted, differentiated action

3.18 **The decline of pension saving among the self-employed is one of the Commission's most important identified challenges**. The policy response must differentiate between different groups within the self-employed population.

3.19 For low-paid self-employed workers, the State Pension may already provide a reasonable income floor. Mandated saving may not be appropriate for this group. The priority should be ensuring they qualify for the full State Pension and that it is there for them when they need it.

3.20 For platform workers who are substantively employees but are classified as self-employed, the Commission should recommend clarification of employment status and extension of employer obligations where appropriate.

3.21 For higher-earning self-employed workers, the decline in their pension saving is well documented and has previously been reviewed. Various ideas have been put forward in previous reviews, but none implemented[6]. It is time for the Government to take action, as every year of under-saving contributes to worse retirement outcomes for this group. For example, the Government should use the annual tax return process to create default nudges towards pension saving — for example, a straightforward option to reduce a tax payment being paid by directing a portion of profits into a pension.

Chapter 4: The Participation Gap

Life events cause permanent pension damage

4.1 **A period of parental leave, part-time working or delayed contributions can reduce lifetime retirement income.** In September 2024, the IFoA launched the first phase of a campaign entitled "How much could you lose?", igniting a national conversation on pension gaps and the hidden costs of life's decisions on retirement income. The Phase I modelling revealed startling truths: a six-month parental leave, a switch to part-time work, or delaying pension contributions by just five years can reduce the value of an individual's expected pension pot by tens, or even hundreds, of thousands of pounds.

4.2 Building on this, Phase II released in September 2025 went deeper – illuminating the human stories behind the numbers. Partnering with Ipsos, ethnographic research was used alongside filmed interviews to understand not just what the gaps are, but why they persist and how they shape people's lives.

[6] See, for example, Chapter 4 of Automatic enrolment review 2017: Maintaining the momentum

Women face the largest participation and accumulation gaps

4.3 **The gender pensions gap is one of the most urgent challenges the Commission faces.** Women are disproportionately affected by every factor that reduces pension accumulation: lower pay, part-time working, career breaks for caring, and the financial consequences of divorce.

4.4 NI crediting reforms following the first Commission improved State Pension outcomes for women. The private pension gap remains large and is not closing at pace.

4.5 The Commission should address both accumulation-side factors (earnings triggers, the Lower Earnings Limit, employer contribution structures) and engagement-side factors (divorce, recruitment transparency, education and awareness).

The State Pension age review must protect those who cannot work to the current SPA

4.6 **Any increase in State Pension age (SPA) will cause most harm to those who are least able to support themselves financially before reaching it and those who are least likely to receive State benefits for long.** Aggregate life expectancy data should not be the primary driver of SPA decisions.

4.7 **Recommendation: alongside any increase to SPA, introduce an ill-health qualifying criterion for early access to the State Pension (or, to keep the mechanics of the State Pension simple, consider an alternative benefit of similar amount).** This would allow the SPA to rise while protecting those who would be most adversely affected. It would recognise that some people's health means they reach the end of their working life earlier than others. The criterion should be based on individual health circumstances, not population averages. To command broad public support (and noting that in general those with greatest pension and other income/wealth are least likely to be in adverse health) we suggest that it would not be means-tested. There is a cost to this additional provision, but it might be the price to pay to delay State Pension age for those who are able to continue to work or who can afford to retire before SPA.

4.8 We do not support an automated mechanical link between longevity improvements and the SPA. Such a mechanism could produce volatile or counterintuitive outcomes and would be likely to have a disproportionate adverse impact on those with below-average life expectancy. Life expectancy and healthy life expectancy are not reliable indicators of how many people are able to work at particular ages. Nor does an average indicator deal with the real needs of individuals who have reached the end of their working lives earlier than others.

4.9 Any SPA changes should be gradual and free of cliff edges, with due regard to equality impacts.

The triple lock is neither sustainable nor clearly purposeful in its current form

4.10 **The triple lock has significantly increased the value of the State Pension, which is a positive outcome and in line with the original intention. However, the mechanism was intended as a catch-up rather than a longer-term mechanism and is clearly not indefinitely sustainable**.

4.11 Under the current mechanism, future State Pension levels are *inherently unpredictable* relative to average earnings and prices. The long-run upward pressure on working-age people — asked to fund ever-higher State Pension costs while facing higher SPAs themselves — is a genuine intergenerational fairness concern.

4.12 **Recommendation: reframe the triple lock.** We do not advocate abolishing it. We recommend reforming its three limbs so that it can still be called a "triple lock" in the original spirit, but with a revised mechanism that has clearly stated objectives, is transparent about the outcome it is designed to achieve and is affordable and predictable over the long term. For example, a new triple lock might review the level of the State Pension each year so that it:

i. Increases each year in line with price inflation.
ii. Increases further, if necessary, to maintain a (sustainable) target proportion of average earnings.
iii. Does not go down even when prices go down.

Chapter 5: Decumulation as a Driver of Adequacy

Guided retirement defaults must guarantee income to death — this is the core test

5.1 **The IFoA supports the introduction of guided retirement duties for DC funds in the Pension Schemes Act 2026. In our view, a genuine "regular income in retirement" (as is required by the Act) must last until the member's death and broadly maintain its real value**.

5.2 These two requirements — longevity coverage and inflation protection — should not be viewed as optional enhancements. A product that runs out of money, or that loses purchasing power over the course of retirement, has not delivered a regular income in retirement.

5.3 We are concerned that product development in this space may not have longevity and inflation protection sufficiently in mind. The Commission should recommend further regulatory clarity on what a default decumulation product must achieve.

Longevity protection means protection for the longest lived

5.4 Genuine longevity protection requires an income that lasts for life, including for the majority who will live into their 80s and 90s and the (growing) minority who will live to higher ages. It is a short-sighted presumption to plan as if longevity doesn't matter to individuals. The bills do not stop once a pensioner reaches a certain age. Even the minority who live beyond 100 have spending needs (perhaps increasingly so with the need for care).

5.5 Focussing on individuals' life expectancy obscures the point that almost any pensioner may reach a higher age, whatever the life expectancy at retirement was for people in their circumstances – there are always the "lucky" and there are many of them. Life expectancy is an average not a maximum, and broadly half of people are expected to outlive their life expectancy – an obvious point to some, but in our experience an underappreciated one.

Inflation is the overlooked risk in guided retirement

5.6 **A nominally-valued income that lasts to death is not enough. Persistent inflation over retirement can substantially erode a fixed income stream.** This risk is not yet adequately reflected in the current guided retirement framework, and it is a risk that savers themselves may not appreciate until it is too late.

5.7 **Genuine longevity protection requires inflation protection. Inflation is a longevity risk.** A nominal income that lasts but has been eroded by inflation has not "lasted" if the individual's needs have not declined as quickly as inflation has eroded their purchasing power (an unlikely coincidence).

5.8 The empirical observation that real spending tends to decline somewhat in very old age does not justify designing defaults with no inflation protection at those ages. The decline in spending reflects choices and circumstances; it should not be designed in as a feature from the start. The decline in spending needs will also be more modest for those for whom more of their income is spent on essentials rather than discretionary activities at the earlier post-retirement years – the essential bills do not stop in retirement, however long it lasts.

5.9 Where the State Pension is relied upon as the primary inflation hedge for private pension income, this implicitly assumes that private pension income in later years does not need to retain its real value and can be substantially reduced as retirees age. We do not consider this serves future retirees well.

5.10 Pensioners do not necessarily need full guaranteed inflation protection. However, inflation is an open-ended risk to which they are exposed, and increasingly so over the long term. Therefore, while an income that increases at 3% per year provides more protection than a flat rate income, it still leaves serious exposure to the possibility that inflation is markedly higher.

5.11 To emphasise this point we set out the range of residual purchasing power a flat rate pension would have had for a range of periods[7] since 1948. For example, over the different 25-year periods since then a flat rate pension at age 60 would typically have lost three-quarters of its purchasing power by the time the individual was 85. Even in the best scenarios, their purchasing power halved. In the worst case, each £1 at age 60 was worth just 12p at age 85. The effects can be material even at shorter durations, and more extreme at older ages.

Residual RPI purchasing power over n years: range since 1948

	5	10	15	20	25	30	35	40	45	50
Minimum	47%	27%	19%	15%	12%	10%	8%	7%	6%	5%
Lower quartile	75%	55%	33%	20%	14%	11%	9%	7%	6%	6%
Median	83%	68%	56%	45%	26%	14%	10%	8%	7%	6%
Upper quartile	87%	75%	64%	50%	42%	34%	25%	15%	8%	6%
Maximum	90%	78%	67%	58%	51%	44%	33%	25%	17%	9%

5.12 The past is not necessarily a guide to the future, and the above figures are heavily influenced by the high inflation of the 1970s. However, retirees in the 1950s and 1960s were unlikely to have anticipated the inflation they experienced in the 1970s – our point is that the unexpected happened and their living standards suffered severely.

5.13 Default decumulation products should be designed with a presumption of broadly maintaining purchasing power. To plan a flat rate income is to plan for declining living standards. As individuals will naturally be tempted by a higher non-increasing income – the regret may come later – the IFoA believes guided retirement requirements need to counter this temptation.

Retirement CDC is needed

5.14 **Index-linked annuities set the gold standard for inflation and longevity protection, but they are seen to be expensive, and the value of the guarantees is not well understood.** Relatively few people choose to buy them.

5.15 **Retirement Collective Defined Contribution (RCDC) once introduced will provide a practical route for a default product that can provide both longevity and inflation protection, likely at a more acceptable cost to members**.

[7] For each n-year period completed between 1948 and 2026 we calculated the residual purchasing power at the end of the period compared to £1 at the beginning of the period. We used the Retail Price Index for January of each year, that index having a complete series back to 1948. There are therefore more 5-year periods (the last starting 2021) than 50-year periods (the last starting 1976).

5.16 Index-linked annuities are currently the only market option for individual DC savers to achieve inflation protection and pool their longevity risk. RCDC will provide an alternative option. RCDC pools members' savings, enabling investment in higher-return assets than would be appropriate for insurers offering an annuity, while sharing longevity risk across the membership. This structure can deliver better *expected* outcomes at lower cost than individual annuities for most DC savers. RCDC comes with targets and expectations rather than guarantees, but many retirees will perceive the lack of guarantees to be outweighed by the higher *expected* pension RCDC is expected to provide, relative to an index-linked annuity. Compared to a flat rate annuity, RCDC is designed to offer an affordable degree of inflation protection, backed by growth assets that, broadly and roughly speaking, would be expected to rise with inflation and allow a step up in annual increases, albeit with no guarantees built in. Individual drawdown could invest very similarly to RCDC, but it does not pool the longevity risk – users must therefore be very cautious in how long the income needs to last (an adverse outcome in itself) or risk it running out mid-retirement.

5.17 RCDC is not currently under consideration for contract-based arrangements. This limits access for savers in the retail market, including the self-employed and employees in contract-based occupational schemes. There should be a pathway for these savers to access RCDC.

5.18 **Recommendation: set a clear timetable to enable RCDC schemes to be established so they come into force with guided retirement requirements.** Put on the menu as a default option within the guided retirement framework (along with an appropriate communications strategy to ensure employers, trustees and savers understand the risks and opportunities of RCDC). Develop a pathway for contract-based pension savers to access RCDC with a clear timescale.

Three system-level barriers must be resolved for guided retirement to work

5.19 **Guided retirement cannot succeed without resolving three cross-cutting regulatory and system-level issues. These require a clear government vision of the DC retirement journey, and coordinated action by Government departments and regulators.**

5.20 **HMRC rules must be adapted for RCDC.** Without changes to the HMRC framework, RCDC schemes cannot be established at scale within the guided retirement structure. CDC designs must not only be theoretically allowed but practical within the registered pension scheme framework. This is a blocking issue for the development and success of RCDC.

5.21 **Statutory benefit illustrations must reflect the member's actual default pathway.** Where a member's default produces a particular income shape, illustrations that model a different shape create confusion and undermine engagement. But it is also misleading to present illustrations of an income at retirement age that is guaranteed to erode over the individual's retirement.

5.22 Statutory illustrations[8] could return to the former use of index-linked annuity assumptions, *not* because many savers will buy them (this is why the standard shifted to flat-rate in recent years) but because it provides an off-the-shelf well-understood benchmark of an income that could be expected to be sustained in real terms throughout retirement with a high degree of certainty. Flat-rate, high initial income illustrations perpetuate the concept that flat-rate pensions are the preferred, or even recommended, products. We support member choice, but it must be in the context of meaningful communications.

5.23 Giving a strong steer towards some degree of inflation protection in guided retirement defaults would be one way of reconciling the tension between a standard approach to benefit illustrations and the different potential default designs. Most designs would be expected to deliver the saver higher incomes than the index-linked annuity illustration, through taking greater investment, inflation or longevity risk and/or by

[8] Statutory DC benefit illustrations are regulated by DWP legislation but calculated and presented according to Financial Reporting Council (FRC) standards.

forgoing guarantees. While any mismatch between pre-retirement illustrations and the intended defaults is not ideal, we think it is better to have a benchmark that includes guarantees and longevity and inflation protection, that savers can compare alternative options against in order to see the impact of taking on additional risks to increase that income. (We consider it unlikely that many savers would switch to buying index-linked annuities (because the initial rates of income are comparatively low) but if properly communicated savers would enter retirement with some understanding of the trade-off).

5.24 **Pensions dashboards must be designed to handle multiple defaults coherently.** Where different trustees select different default income shapes for the same individual, dashboards will present an incoherent overall picture unless this is addressed proactively. Given that most DB pensions not yet in payment[9] involve some degree of inflation protection, a DC illustration involving some increases in retirement more easily and realistically sits alongside them than a flat rate illustration.

Remove tax barriers to financial advice at decumulation

5.25 **Savers with substantial DC savings benefit significantly from regulated financial advice at the point of decumulation. The direct cost of advice is currently a barrier**.

5.26 **Recommendation: remove tax obstacles to paying for holistic financial advice** — whether by employers, trustees, or individuals directly from their pension savings. The assets to pay for proper advice are often there, but not in savers' bank accounts. The public benefit of proper financial planning will outweigh the modest tax loss.

5.27 Decumulation is the point at which decisions are most consequential and least reversible. Advice at this stage should be more accessible, not less.

[9] Pensions Dashboards will only illustrate benefits not yet in payment. Although some DB pensions accrued before 6 April 1997 do not provide increases in payment, this is a dwindling proportion of non-pensioners' benefits and will decline rapidly over the next 20 years. Given savers are likely to use Dashboards information for planning purposes, we believe it essential that Dashboards illustrate a "safe outcome/high cost" scenario as a starting point for the reasons described in paragraph 5.23.