

# Funding the Future

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*This is a guest post on pensions from regular commentator Clive Parry, who has had a long career in financial services-related issues. In it he explores some alternative thinking on pension provision:*

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Pensions are complicated. At a micro level it makes sense to accumulate assets today that can be exchanged for the services we will need (healthcare, personal care etc.) when we get old. But this fails if the assets we accumulate cannot be exchanged for what we will need and at a macro level, this is a real risk. With ever growing numbers of elderly will there be sufficient workers prepared to labour in the care industry to look after them all - however much "wealth" the older folk have accumulated? Yes, but only if the investments made today are delivering the right things - real things.... not just shuffling paper in a huge Ponzi scheme.

So, this is the BIG challenge that we face on pensions and Richard has written extensively about this. Fundamentally it is about mobilizing resources *productively* and whether it's directing "tax advantaged" savings to useful investment or debunking the "we can't afford it" myth it is all about doing the things that we can and need to do today so that we and our children can survive/prosper tomorrow.

What follows has more modest aims. How can we offer ordinary people a safe and secure income in old age.

Let's consider 3 groups.

\* Many folk will never accumulate savings or significant pension entitlements over their lives. Either they are in low paid work or do not work at all. For this group the answer is simple - a decent State Pension.

\* Some folk are sufficiently wealthy that they can save a lot and take a risk with a large chunk of their savings. For them it is about passing wealth to children and the luxuries of life. This group will always save and the tax relief offered could be better deployed elsewhere.

\* In the middle there is a huge group who see the State Pension as inadequate and can

make provision. Their objectives are to achieve a reasonable standard of living in old age with a high degree of certainty.

The first thing to say is that a decent State Pension would make this middle income group much less worried about providing for their old age. It would (probably) mean higher taxes for them but this would be offset by lower private pension contributions.

Next, this group splits into 2 sub groups. Those with Defined Benefit (DB) Pension schemes and those in defined contribution (DC) schemes.

Those in DB schemes know that they can expect a decent steady income in retirement linked to their salary and the number of years worked... which is great. The problems with this are

- \* The risk your company goes bust and can't pay the pension
- \* It's complicated if you move jobs quite a bit..... and impossible if you are self employed.
- \* The company delivering the pension is exposed to huge investment risks... So, by and large, the only employer that can offer a DB scheme these days is the Government.

DC schemes hold no risk to the employers, employees have their own pension "pot" so are not exposed to the employer going bust.... which is great. But (crucially) they are exposed to investment risk - will their portfolio of assets deliver a secure and decent pension?

This group of people are fortunate enough to be able to save but, in the absence of a more generous State Pension, are worried about what their savings might deliver. There is plenty of advice out there but none of it offers any certainty and it is rarely impartial.

One answer is to allow people to purchase today an inflation-linked forward starting annuity. Allow a (say) 30 year old to invest £1 today to receive a real terms, guaranteed income when they reach 67. What £1 will buy you will depend (mainly) on index-linked gilt yields and mortality rates but the calculation is relatively straight forward (if you are an actuary). It will vary as market interest rates vary and as the 25 year old ages but at any point in time the theoretical income is known. Now, there are issues related to early death, partners/dependents etc. but are no worse than we currently see. The real problem with offering this product is that hedging the risk is fiendishly complicated and expensive for insurance companies.... so they do not offer it.

However, the Government is uniquely well placed to take this risk - indeed, from a risk perspective it is little different that the risk associated with issuing Index linked gilts. Periodically they could issue a table that would specify by age what income could be purchased based upon market interest rates. As a matter of policy Government could choose to enhance this to encourage savings or "smooth" things during volatile periods. The infrastructure to deliver this product is available via NEST and (possibly) NS&I and it would be at very low cost (which might annoy City Fund Managers).

I think this idea would offer low cost, safe incomes in retirement for many and could be implemented quite easily. It could run alongside existing options for savers so no compulsion.... just a safe cheap way to save for old age.