



# The UK pensions battlefield

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**CSFI panel**  
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# What is a pension?

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- Pensions have two functions – same name, not same
  1. Social welfare – state role – original idea
  2. Long-term savings vehicle – private provision
- Confusion and muddled thinking
  - Employers took on social welfare in 20<sup>th</sup> Century
- Increasing private pensions supposed to offset state cuts
  - 21<sup>st</sup> Century employers won't do social welfare
- State and private pensions both falling



# Demography and pension history

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- Pensions helped baby boomer employment 1970's/1980's
- Industrial restructuring, early retirement, generous pensions led to unrealistic expectations
- Baby boomers now reaching pension age after 2010
- Not enough young people to fund future pensioners
  - Labour shortages, long-term economic decline – this is a crisis!
- Policy focused on pension savings and equity markets
- Not enough thought for retirement policy



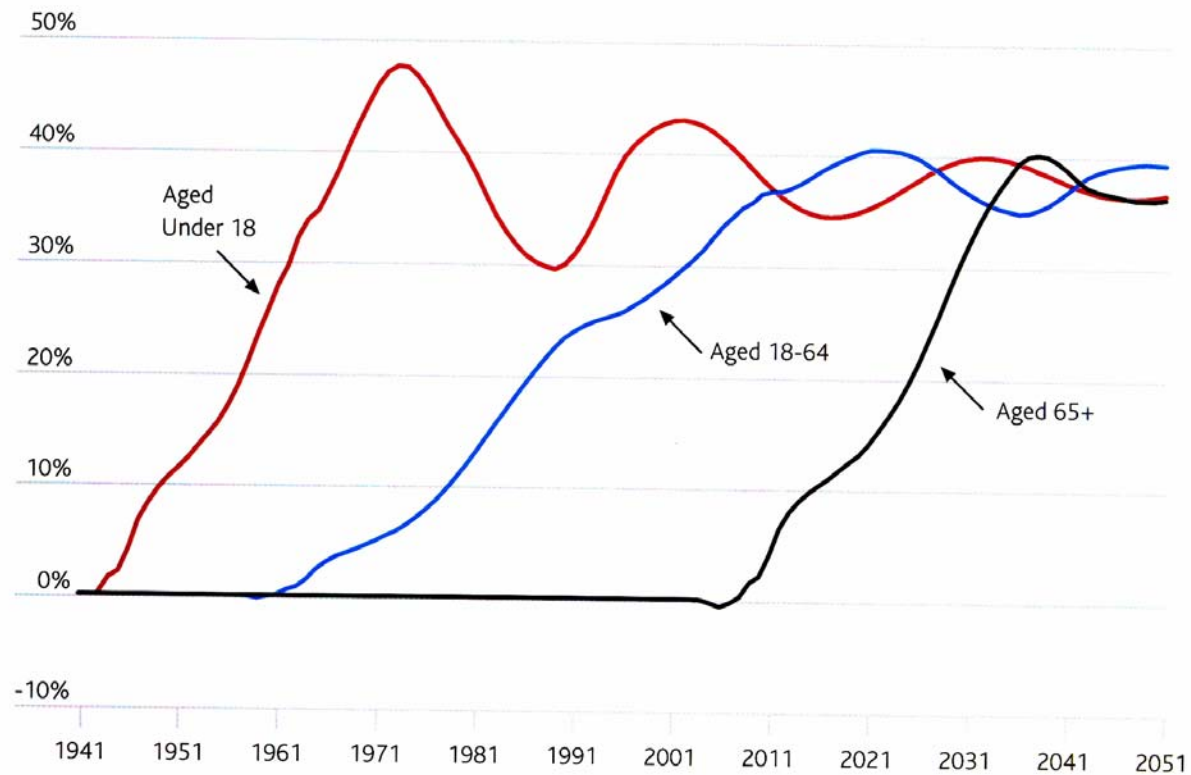
# Policymakers fail to understand

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- Asymmetrical regulation – easy to borrow, difficult to save
- Short-sighted policies promoted unsustainable growth
- Official view: pensions not in crisis now, may be in future
- Wrong: pensions in crisis now, ***pensioners*** in crisis soon
  - Social unrest and economic decline
- Culture of self-reliance and saving->debt and dependency
  - Short-sighted policies promoted unsustainable growth
- Demographic boost ending – demographic drag coming

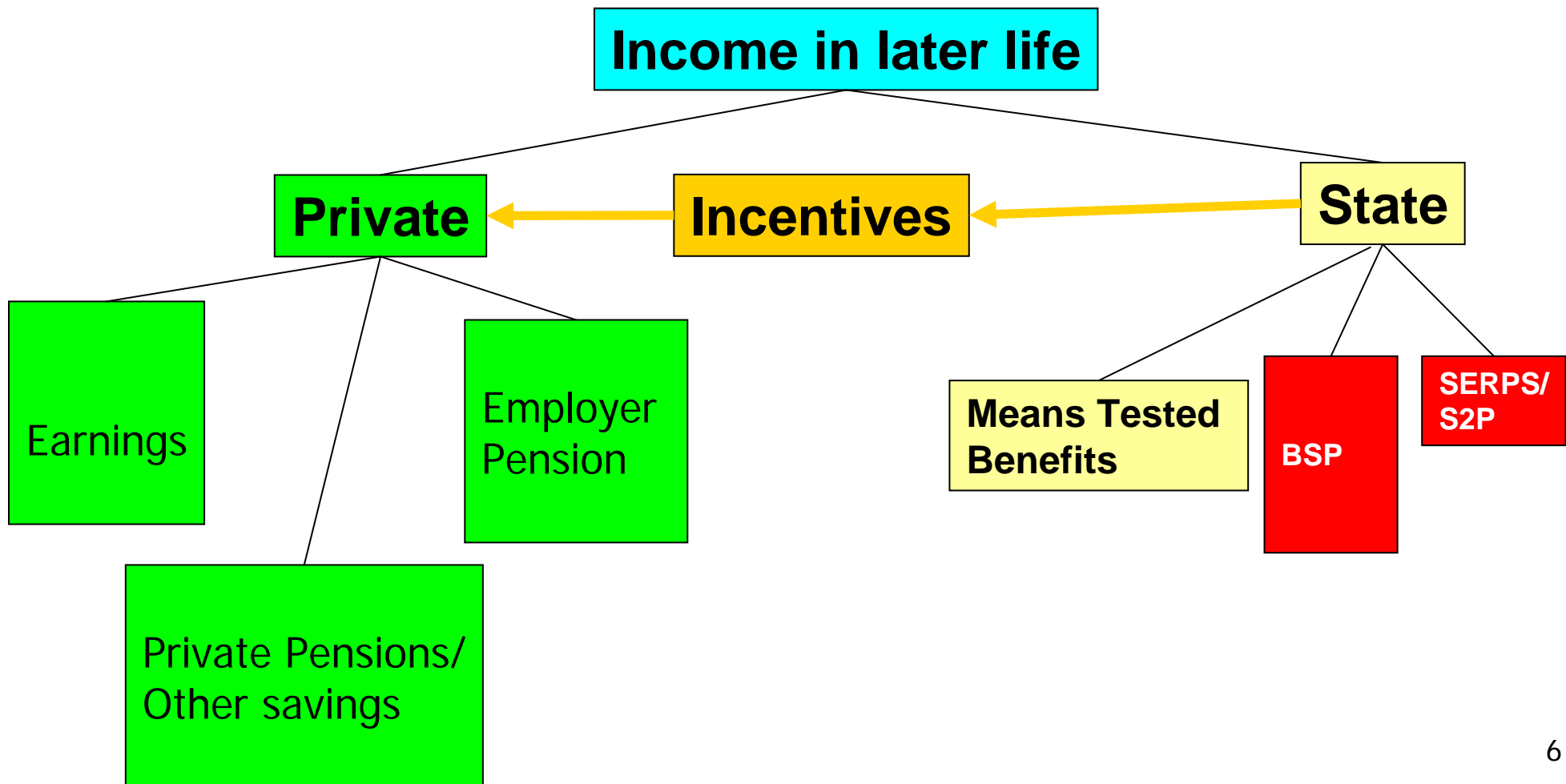
# Demography: threats+opportunities

% change in UK population size



Source: Pensions Commission analysis based on a synthetic model of the England and Wales population

# Theory: reduce state welfare costs, increase private income





## Problems to sort out

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- UK State pension too low, too complex
- Means-testing of around half of all pensioners in pension credit undermines private pensions
- Private pensions in trouble – don't trust a 'locked box'
- Mass market not saving, especially not in a pension
  - Employers cut back, scandals, need to restore confidence
- Risk/difficulty of saving worse than risk/difficulty not saving
- Umpteen reviews and policy changes haven't worked



# Traditional employer pensions

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- Final salary schemes in terminal decline
- Schemes raided by employers and Government
- Employers see pensions as company 'cost' not 'benefit'
  - Average job tenure 5 years – not lifelong employment
- Traditional pension costs rise 5%pa (inflation, mortality)
- Public sector pensions aristocracy
  - Recognise true costs – wake up to reality!





# Incentives

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- Need better and fairer incentives
- Currently only incentive is tax relief – costs £28bn pa
  - > 1/2 to top rate taxpayers - higher relief not paid to pension
- High earning men get most incentive and highest pension
- Pensions Commission says tax relief 'costly, poorly focused and not well understood'
  - matching payments could be 43% in £ for same cost
- Turner recommend keep tax relief and just explain better
- Costs are NOT a major disincentive



# Pensions Commission – evolution or revolution?

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- Should state provide just social insurance or extra too?
  - *Concluded state should provide extra*
- Questions considered about state pension: *compromises*
  - Flat rate or earnings-related? *bit of both*
  - Contributory or universal? *bit of both*
  - Means-tested or not? *bit less than now, still retain*
  - Earnings-linked or price-linked? *BSP earnings, S2P prices*
  - Contracting out? *keep some, get rid of some - £8bn!*



# State reforms give no long-term solution

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- State pension reform con trick – Titanic and deckchairs?!
  - Still lowest, most complex system: BSP, S2P, Pension Credit
  - Tie BSP to earnings – but S2P to prices!
  - Tinkering with contribution rules won't work
  - Pension credit undermines national insurance concept
  - Pension Credit undermines private pensions or earnings
  - BSP still to fall further before being raised!
  - Raise state pension age for all (except public sector?)
  - Keep contracting out for final salary schemes i.e. public sector
  - Give with one hand, take back with the other



# Personal accounts-opportunity or threat?

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- Opportunity
  - Industry may have far more assets to manage
  - Government can claim lots more people are saving
  - Government will save money on means-testing
  - Employers can cut pension costs!
- Threat
  - Level down: 3% minimum becomes maximum
  - Increase number of savers, but reduce overall savings
  - Suitability: PAs may just replace pension credit! 40% tax +
  - Low charges is not the most important point



# Private pension reform con trick

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- Personal accounts give means-tested benefit not pension!
  - Have to save over £30,000 to avoid pension credit
- What is intellectual case for employer compulsion?
  - Pension is part of your pay, why not mortgage?
- Increase number of savers, but reduce overall savings
  - Levelling down – 3% minimum to become maximum?
- Suitability a big potential problem if pension credit stays
  - Generic advice hopeless, admin nightmare, investment
- Pensions can't be 'undone', ISA's may be better?
  - Why doesn't industry refuse to co-operate?!
- What about annuities at the end



## Personal accounts to make crisis worse

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- Those currently in pension schemes will end up worse off
  - Employers currently contribute well above 3%
- 8% of 'band earnings' not enough, but people won't know
- Many non-savers will opt out, but those who don't will be very disappointed if means-testing penalties hit PAs
- How will generic advice cope with suitability, investment risk and annuities?
- Putting money in is important to politicians today, but getting pensions out is vital to individuals years later!



# Government criteria for reform

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	Government Proposals	Citizens pension Proposals
Hutton's 5 tests		
Personal responsibility	✓ auto-enrolment good	? clear message
Fairness	X still favour top earners	✓ universal
Simplicity	X still complex	✓ same for all
Sustainability	? need more change	✓ changes obvious
Affordability	✓ may be ok	✓ redeploy spending

BUT ... pensions not the whole problem



## But are we thinking correctly?

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- This is not really a 'pensions' problem
- It is a 'retirement' problem
- Can't sort out pensions without rethinking retirement
- Pensions are now too expensive because last too long
- Society can't afford 30 year pensions
- Public sector pensions – ostrich approach to accounting
- Pension and retirement policy lagged behind demography/health/working practices



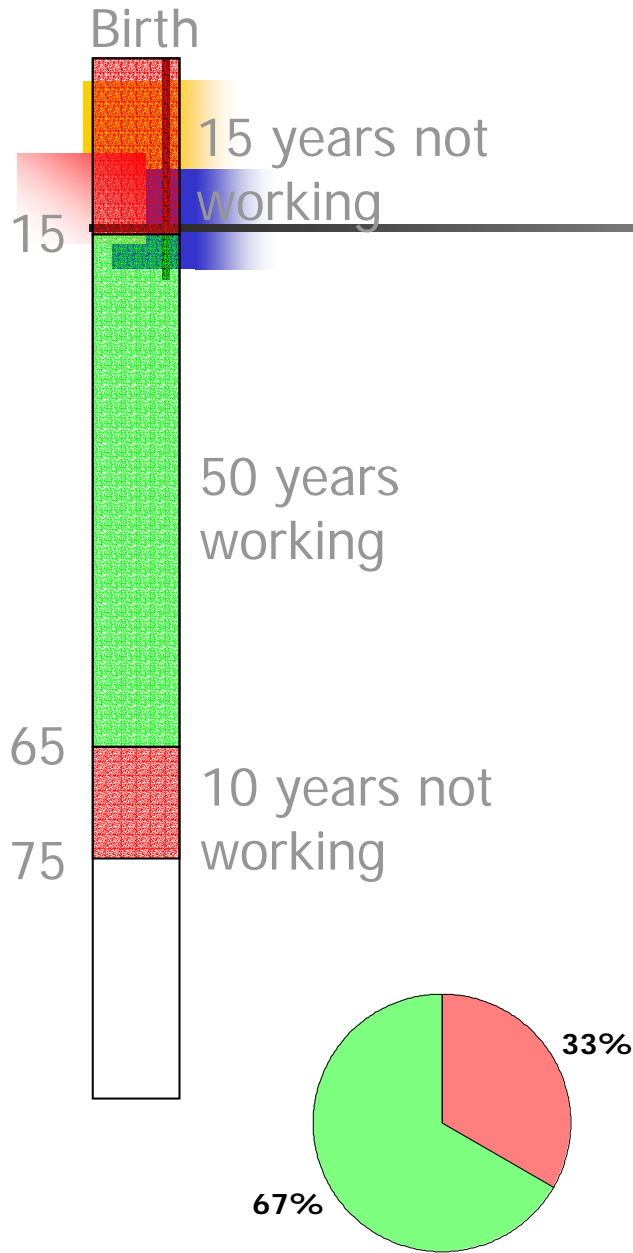


# Pensions alone can't solve the pensioners crisis

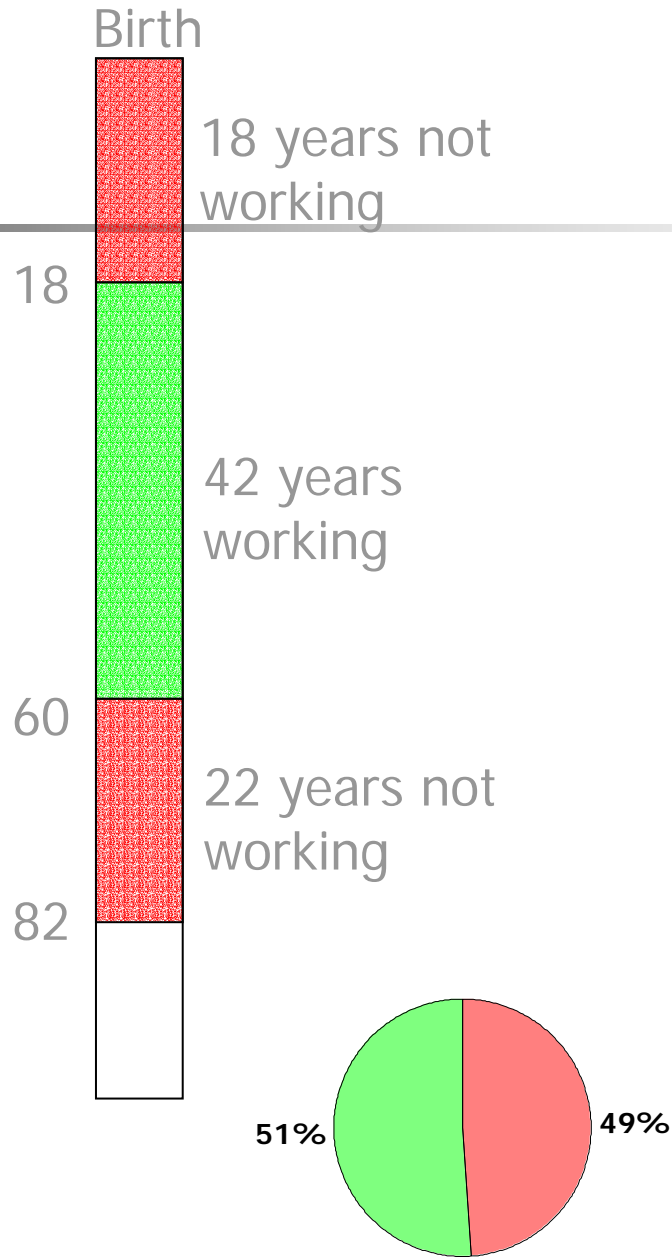
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- Must rethink retirement – journey not destination
- New phase of life waiting to be enjoyed – ‘bonus years’
  - Working mums with young kids
- Cut down gradually - part-time working, job sharing
  - 2-3 days working, 4-5 days off
- More leisure and more money to enjoy the leisure
- Better for individuals, employers and the economy
- This is the employer role in 21<sup>st</sup> century
  - Age discrimination must not stop at 65

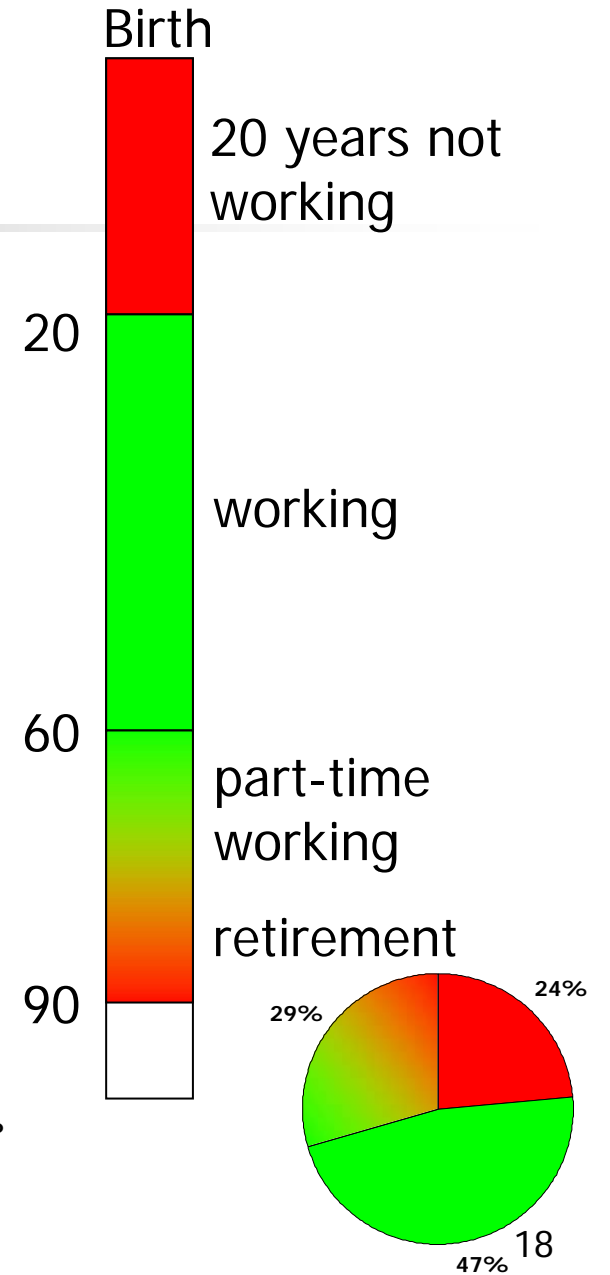
# 1950's



# Now



# Flexible Working





## The future? Radical rethinking

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- State pays everyone at pension credit level £130pw
  - Social welfare, basic minimum, fair, no annuity
- Clear message: without private income you get £130pw
- Safe to sell private pensions again - be suitable
- Can private sector in UK rise to the challenge of providing attractive savings vehicles for mass-market?
- Better investment options for DC pensions
  - Structured, guaranteed, age related, other assets etc.
- Lifetime savings accounts, manage savings over life-cycle
- Government write annuities + mortality/longevity bonds
  - More natural place for longevity and inflation risk



# Conclusions

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- Rethinking pensions and retirement for 21<sup>st</sup> century
- Need radical state pension reform
- Personal accounts dangerous, could make things worse
- Putting money in is important to politicians today, but getting pensions out is vital to individuals years later!
- Industry refuse to co-operate – remember stakeholder?!
- Suitability and levelling down are real dangers, don't sleepwalk into another mess