



Pension Provision in the 21st Century

ACCA lecture

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Overview

- What are pensions for?
- Pensions crisis and reforms
- Rethinking retirement
- Role of accountants
- Summary



Pension policy out of date

- World has changed since 1950's
- Pension system not suited to 21st century
- Must re-think pensions and retirement
- Burdens on employers too high
- Costs of pensions unsustainable
- Deal with reality



How to Think About Pensions

- What are pensions for?
- Pensions have two functions
 - 1. Social insurance for the elderly – state
 - 2. Savings vehicle for better living standards later - private
- These two functions have become confused
- UK pension model relies on state passing pension costs to private sector
- Contracting out and state pension cuts



Failure of UK model

- State pensions cut too far
 - Lowest and most complex pension system
 - Contracting-out not working well
- Private employers forced to do too much
 - Revaluation, indexation, spouse cover – huge deficits
 - Most final salary schemes closed, equities not delivered
- Costs and risk of private pensions too high
 - Private sector has not offset state cuts for most people
 - Majority of pensioners need pension credit
- Vicious circle
 - mass means-testing disincentivises private pensions in future
 - Pensions not 'suitable' for mass market



Pensions crisis

- Both state and private pensions need reform
- Private provision falling – both employer and personal
 - Stakeholder concept flawed (>80% of schemes empty)
- 75% of future pensioners will be on means testing
 - > 40% penalty in pension credit big disincentivise
- Scandals and loss of confidence
- Poverty and long-term economic decline



Role of employers in pensions

- Responsibility moving from HR to Finance director
- FD sees pensions company 'cost' not company 'benefit'
- Final salary schemes unsustainable (> 25% salary)
- Average job tenure 5 years, not lifelong employment
- Money purchase schemes have lower contributions
- Employers need better incentives



21st Century employer schemes

- Will not be defined benefit/final salary - 'pray-as-you-go'
 - FRS17 has forced employers to face up to cost issues
- Actuarial funding methods - failure of MFR – will SSFR be better?
 - Risks of inflation, duration and longevity – no safety valves
- Moving to money purchase world
 - If state prevents poverty, defined benefit less essential
- Money purchase more controllable for employer
 - Need economies of scale, not one by one
- A-day reforms
 - SIPPs, radical overhaul of all pension schemes



A-day next big pension reform

- Tremendous opportunities for some
- Clients must understand implications
- Over 50s exciting environment – unsecured pensions
- Investment freedom needs careful handling
- Best opportunities for those who don't actually need a pension, but want efficient investment vehicles
- Cost in tax relief could be billions of pounds



Fantastic for top earners

- Tremendous new opportunities – SIPP's etc.
- Clients must understand implications
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Examples of benefits for top earners, over age 50

- Put £78,000 into pension (SIPP)
- Goes to £100,000 after basic rate relief
- Take £25,000 tax free cash immediately
- Get £18,000 higher rate tax relief
- Leaves £75,000 to grow as unsecured pension
- £3,000 given up from original investment, receives £43,000 in exchange!



It gets better still...

- Reinvesting tax free cash a few times, double your money
- Reinvest £25,000, get more basic rate relief, take tax free cash again, get still more higher rate relief
- After a few reinvestments, double your money
 - >£109,000 in pension from original £78,000 investment
- No investment risk, just playing tax relief game
 - Total basic rate relief >£32,000, higher rate relief >£26,000
- Need very high income to support this, but still have fund to grow in future after getting the tax incentives



A-day not proper reform

- Fundamental change in nature of pension saving
- Pensions could be left till later in life
- Lifetime limit irrelevant for vast majority
- Urgent need for advice on suitability – but won't get it
 - Compulsion dangerous
- Most people don't understand tax relief
- A-day is huge change, but will it make things better for most people?



Radical reforms for 21st Century

- Clear separation of state and private pensions
 - State: welfare role + Private sector: savings role
- Citizen's pension
 - end S2P and contracting out
- New incentives for individuals and employers
 - matching payments, employer rewards
- Encourage workplace provision
 - economies of scale, access, employers a conduit



Compulsion dangerous

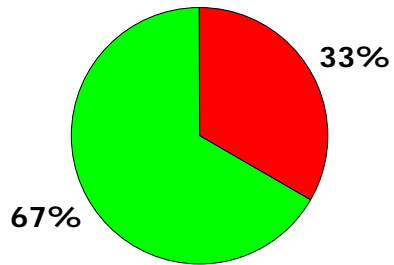
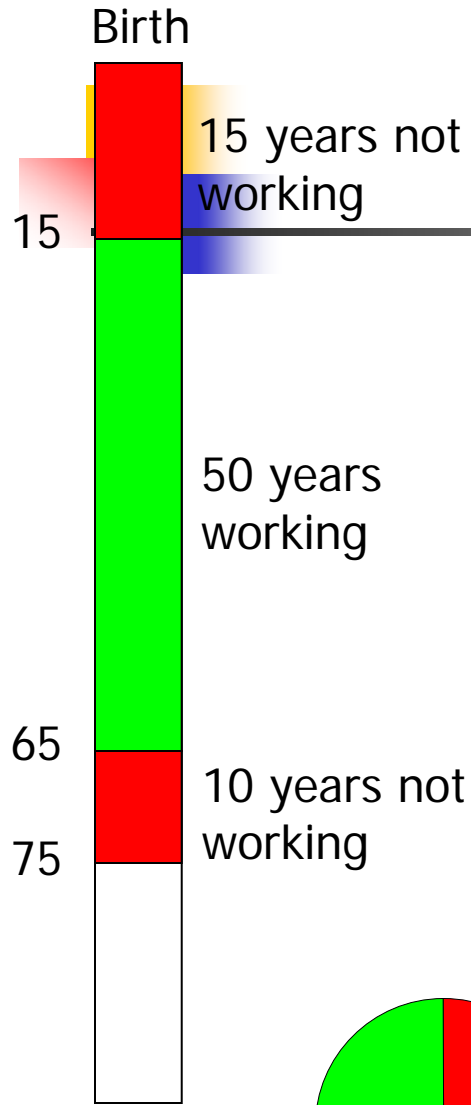
- Potential mis-selling scandal if pension credit stays
- A stealth tax – some forced to over-save
- Government blamed if investments go wrong
- Could damage wages, profits, employment, investment
- With citizen's pension, don't need compulsion
- Soft compulsion better?
 - Auto enrolment
 - Put some of annual pay rises into pension



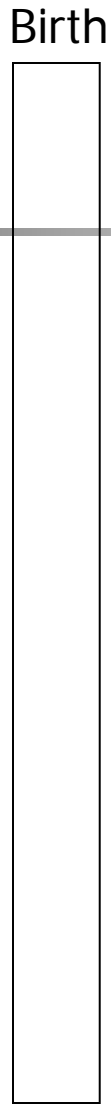
New pension thinking

- There is still more to consider
- Pensions alone cannot solve pensions crisis!
- Pensions never meant to last 30 or 40 years
- Pension and retirement policy lagged behind changes in demography, health and work practices

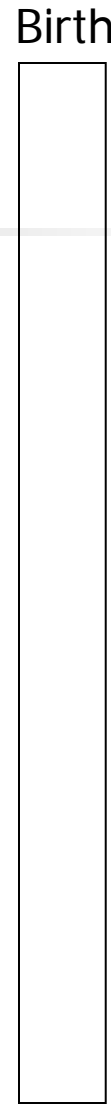
1950's



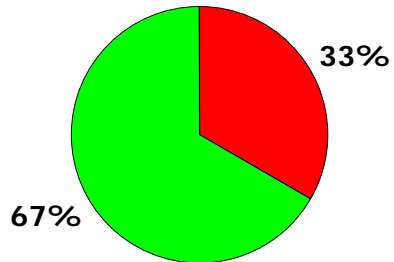
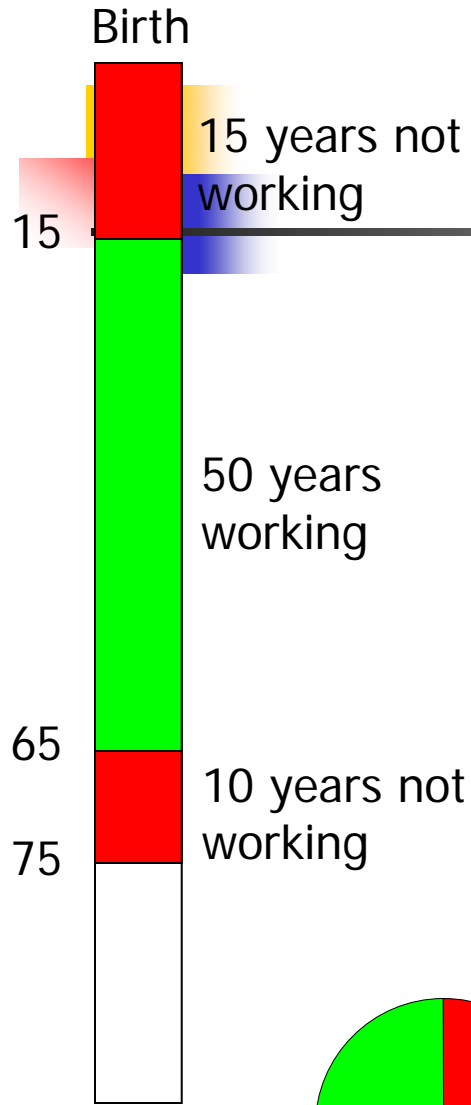
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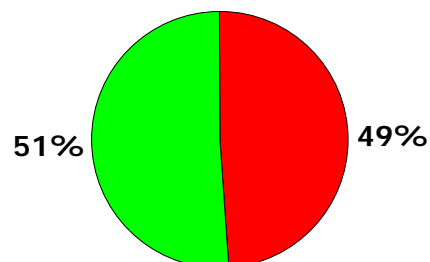
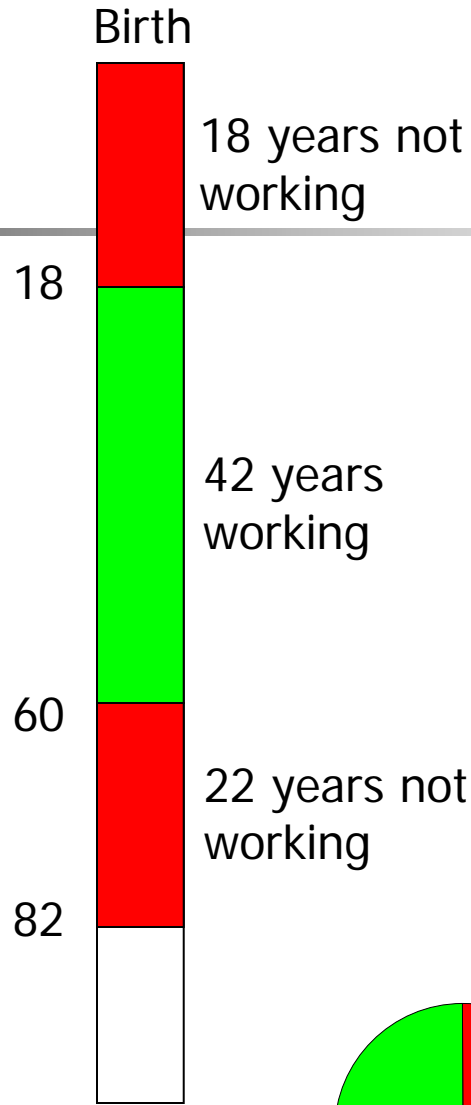
Future?



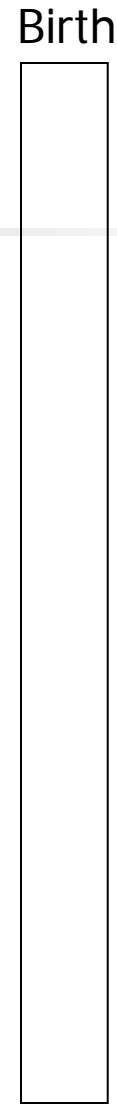
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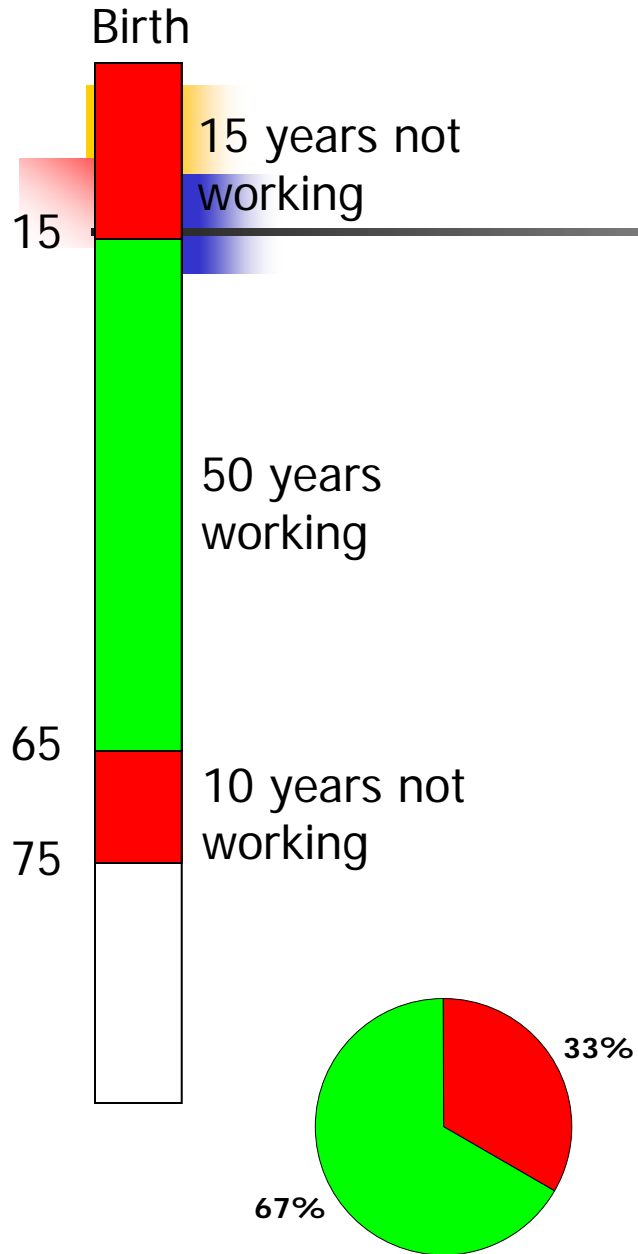
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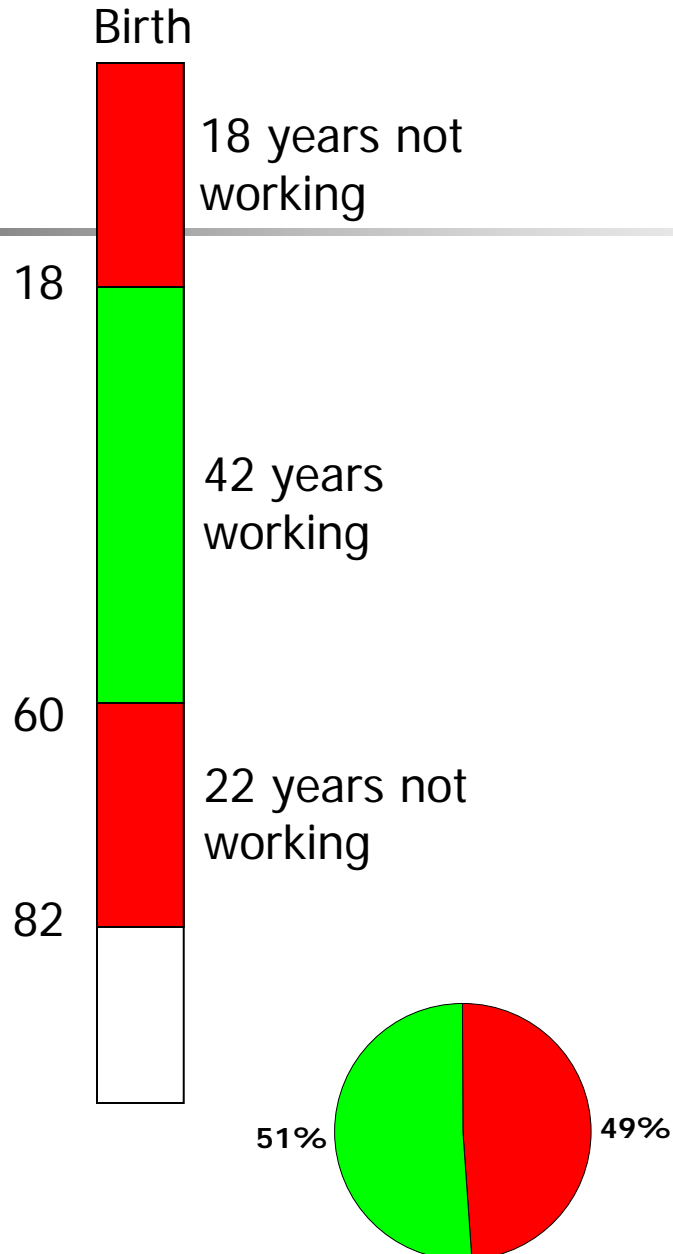
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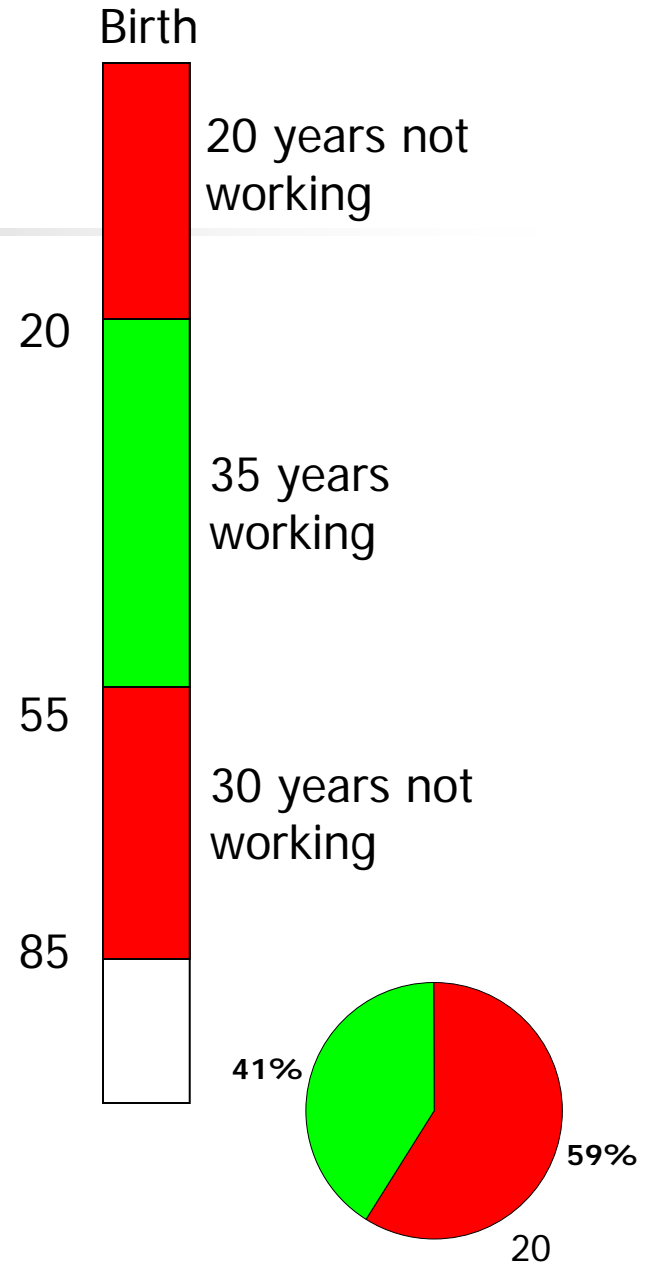
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Now



Future?

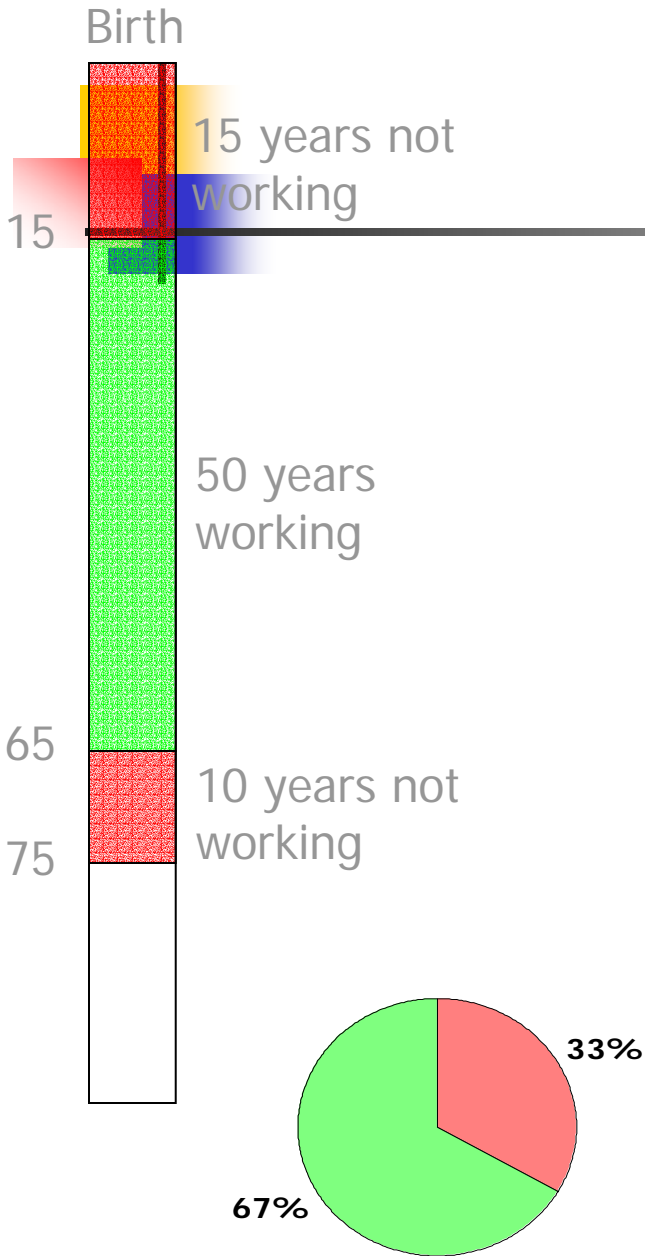




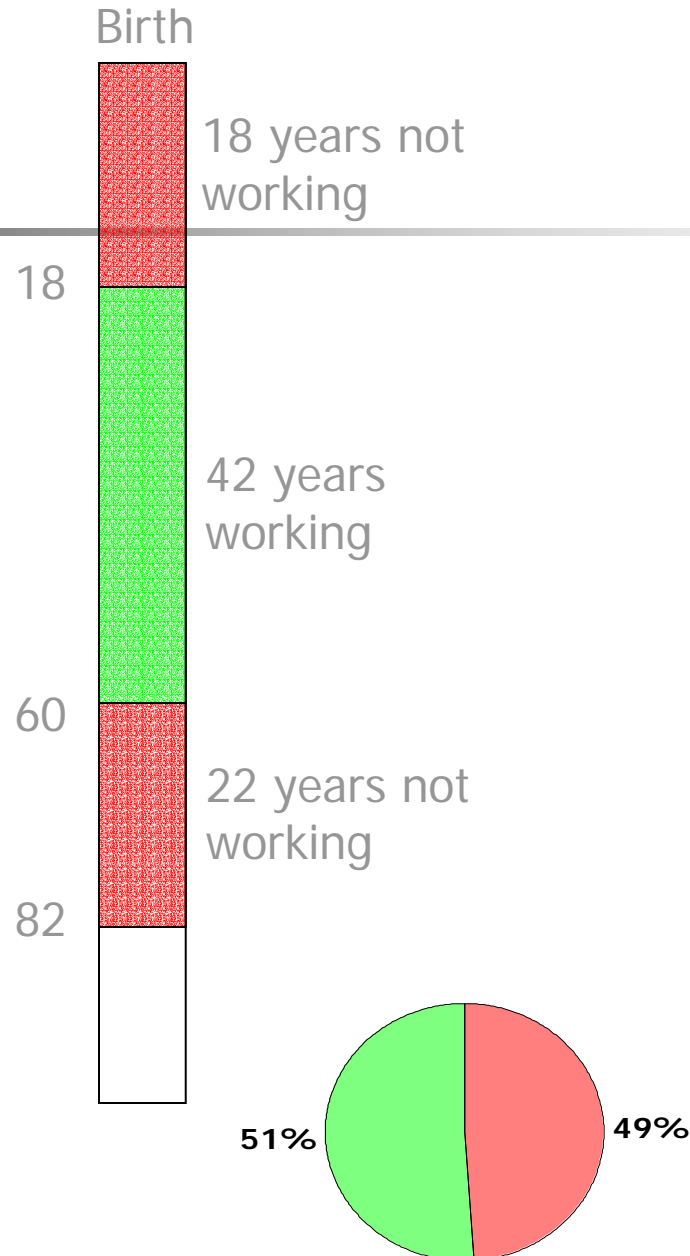
Rethinking retirement

- Pensions meant to last 5 or 10 years, trying to live on them for decades – what a waste!
- Just raising pension age to 70 is not the answer
 - Age 70 could soon be just as outdated as 65
- Retirement a 'process' not an 'event'
- New phase of life – part time working
 - Pensions supplement earnings, not replace
 - No fixed retirement age – flexibility
 - THIS IS GOOD NEWS!!

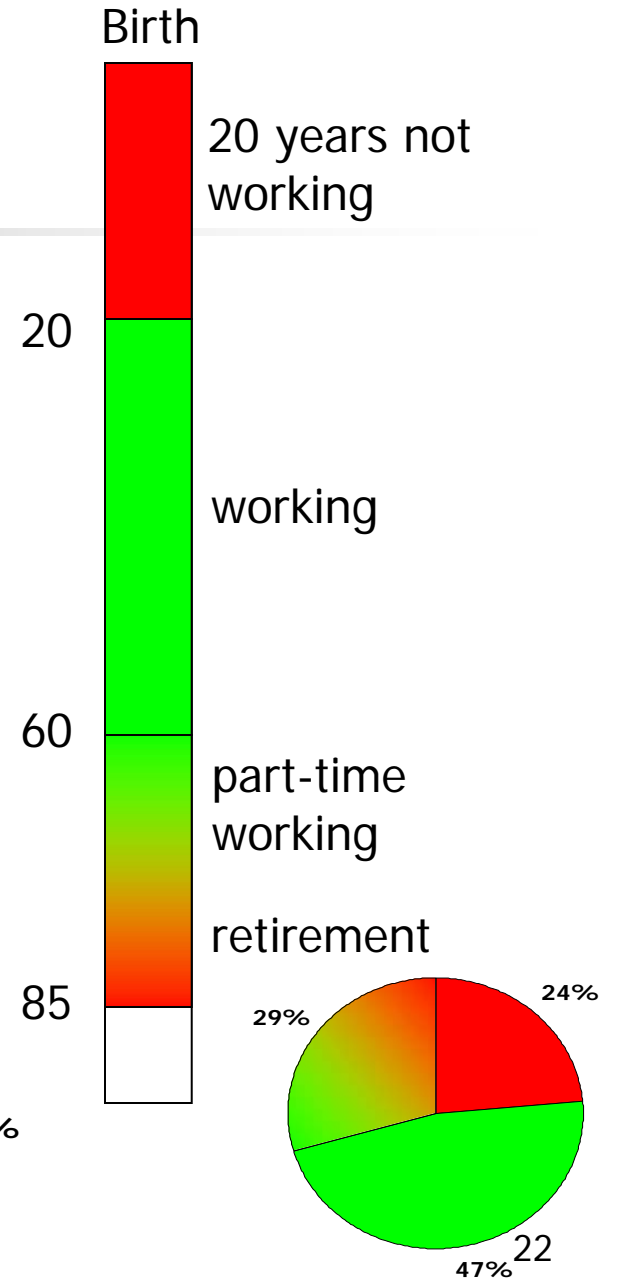
1950's



Now



Flexible Working





Role of accountants

- Help corporate and individual clients understand new pension realities
- Focus on costs of providing pensions as we know them
- Most people won't be able to afford big pensions
- Companies need to beware of open-ended cheques
- Re-think pensions and retirement
- Education and honesty



Conclusions

- Radical pension reform urgently required
- Clarify state role in social welfare
- Private pensions to provide investment vehicles
- Need fairer and meaningful incentives for all
- Rethink retirement
- Honesty and reality



Thank you for listening

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