



# Government Pension Reforms State and Private Pensions

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# Overview

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- What are pensions for?
- Pensions crisis
- Reforms so far
- Reforms still required
- Will Government rise to the challenges?
- Summary



# How to Think About Pensions

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- What are pensions for?
- Pensions have two functions
  - 1. Social insurance for the elderly – prevent poverty
  - 2. Savings vehicle – better living standards later
- Social insurance – state role
- Savings – private sector role – employers/individuals
- These two functions have become confused



# Confusion of state and private

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- State pension policy has relied on cutting state pension
- Hoped funded pensions, invested in equities, could provide social welfare AND savings
- Contracting-out unique, but flawed
- No proper protection for social security rights
- Employers can't afford social welfare and may not stay strong – no safety valves
- Risks of inflation, duration, longevity falling too much on private employers and individuals



# UK Pension Model

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- Government provides national insurance pension
- Constant cuts in state pensions
- Very low state pension supposed to be supplemented by private income
- Shift burden onto companies and individuals
  - Contracting-out costing £11 billion a year
- Means-testing for those without private income
- Aim for 40% state income/60% private income



# Government denies pensions crisis

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- Government forecasts state pension spending stable
- UK has more in private pensions than rest of Europe
- Other European pensions far too generous, need cuts
- Funded pensions were seen as blueprint for others
- All employers have to provide access to stakeholder
- Pension credit targets help on those most in need



# BUT – UK model not really OK

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- Only about half the population has private pensions
- NI pension too low, too fragmented, old-fashioned
- State system discriminates against many groups
- Contracting-out rebates been too low
- UK pension system most complex in the world
- Costs and risks of private pensions extremely high



# Pensions Crisis

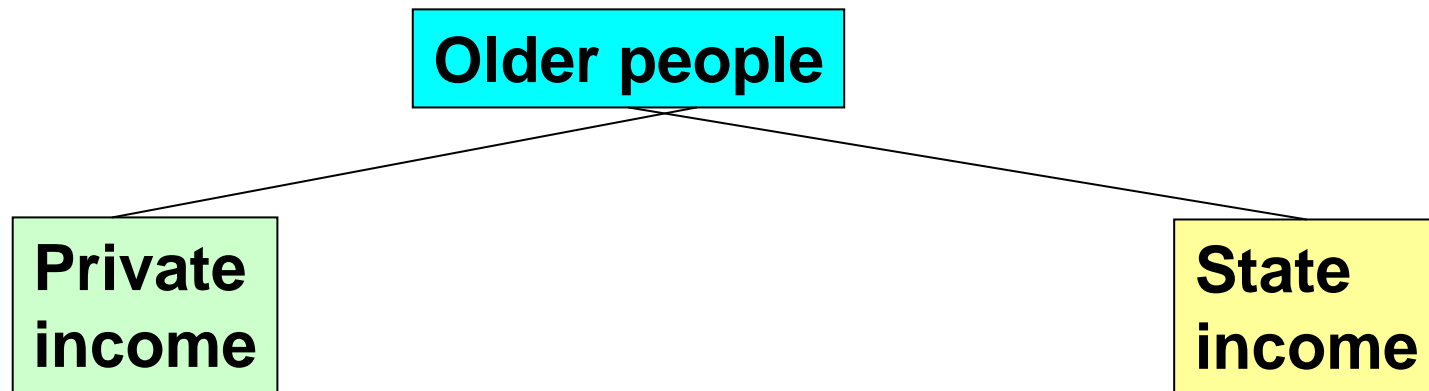
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- Public has lost confidence in pensions
- Companies pulling out
- Stakeholder schemes empty
- Personal pensions not improving for mass market
  - Millions have no private pension
- Half of pensioners need means tested benefits
- Long-term economic decline

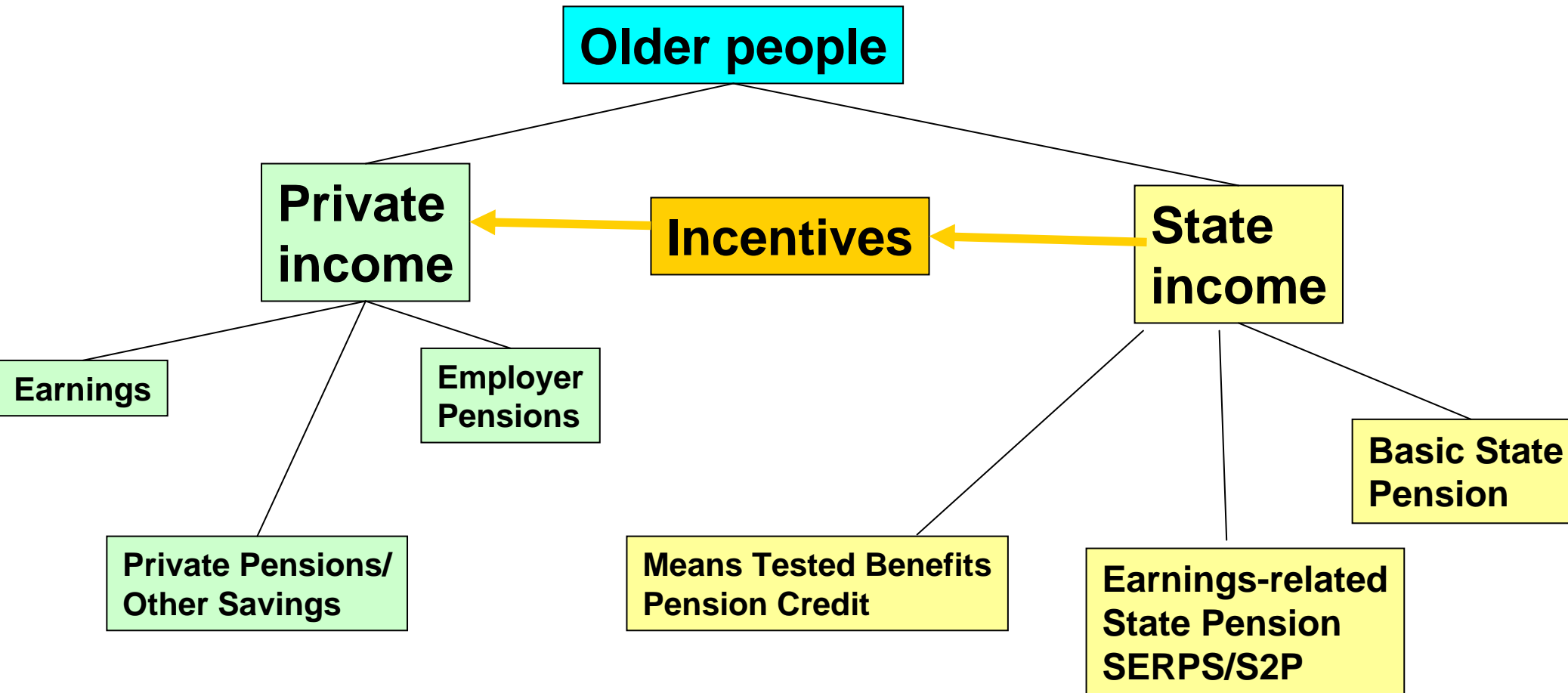


# Income in later life

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# Pensioner Incomes





# Problems with state system

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- NI pensions too low to provide decent social insurance
- Women, carers, disabled, low earners, part-time workers don't get proper state rights
- State system too complex
  - No-one knows what they will get
- Pension credit undermining private pensions
  - Mass means-testing makes pensions unsuitable
- Contracting-out not working – rebates too low



# Problems with private pensions

- Employers pulling out of pensions
- Final salary schemes unsustainable (> 25% salary)
- Money purchase schemes not delivered good value
- Average job tenure 5 years, not lifelong employment
- FD sees pensions company 'cost' not company 'benefit'
- Loss of confidence, scandals



# Government's reforms so far

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- New Regulator and PPF protection for occupational
- Stakeholder pensions
- Simplicity, security and choice
- A-day tax simplification
- Encourage later retirement
- Age discrimination legislation



# A-day simplification reforms

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- Simplify all rules – abandon eight different regimes
- New rules for contributions
- New rules for investment – beware reliance on property
- All pension schemes in the UK will be affected
- Big changes for employers, individuals and providers
- Need for advice!



# Fantastic for top earners

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- Tremendous new opportunities – SIPP's etc.
- IFAs need to explain implications
- Over 50s exciting environment – unsecured pensions
- Investment freedom needs careful handling
- Protection and contributions
- Best opportunities for those who don't actually need a pension, but want efficient investment vehicles



# Examples of benefits for top earners, over age 50

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- 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...

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- 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



# So what's the problem?

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- Nothing much for 90% of taxpayers
- Top earners are not the group the Government was supposed to be encouraging
- No new incentives for pension contributions by employers or individuals
- Policy only been addressing the supply side
  - Cheaper, simpler products, decision trees, leaflets
  - Informed choice
- What about demand?
  - We need more pension coverage for non-savers



# A-day for basic rate taxpayers

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



# What about occupational schemes?

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- Defined benefit schemes closing
- Employers struggling with deficits
- PPF to help provide some protection for members
- Top directors and top earners may pull out
  - £25,000 cap
- Are they funded – will young members actually get the pensions they expect?
- Pray-as-you-go



# Defined contribution?...

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- Employers more likely to move to DC
- Contributions falling
- Trust-based or contract-based?
- Are pensions suitable for low earners?
- Providers and advisers pulling out of small firms
- Flexible benefits are a risk as pension confidence falls



# Reforms still required

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- Radical reform of state pension – end mass means test
  - state take on welfare role, leave private sector for savings
- Merge BSP and S2P - end contracting-out?
- Citizen's pension fairer for all
  - private pensions rely on waged work, why social welfare too
- Encourage workplace provision
  - auto-enrolment, economies of scale, access
- New incentives for individuals and employers
  - matching payments, employer rewards



# Will Government rise to challenges?

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- Pension Commission
- National debate to build consensus
- Compulsion?
  - Auto-enrolment
- Contracting-out rebates – raise or erase?
  - New pension savings vehicles?
- Treasury wants to wait a few years
- Gradual retirement – longer working lives



# Summary

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- Radical reform of state pensions urgent
  - Make fairer and clearer
- Clear separation of state and private pensions
  - Abandon pension credit. End contracting-out, save £11bn
  - Social welfare from state + private savings on top
- Use £11bn for higher state pension AND
- Fairer and better incentives
- Make it safe for financial advisers to offer pensions to everyone

