



Private pension policy, pension reform and compulsion

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Overview

- What are pensions for?
- Role of the state
- Role of the employer
- Role of the private individual
- Compulsion?
- Summary



What are pensions for?

- Pensions have two functions
 - 1. Social insurance for the elderly – prevent poverty - State
 - 2. Savings vehicle – better living standards later - Private
- These two functions have become confused
- UK pension model unique



UK pension model

- State pension policy has relied on cutting state pension
- Government tried to pass social welfare to private employers and individuals
- Hoped funded pensions, invested in equities, could provide social welfare AND savings vehicle
- Contracting-out flawed
- No proper protection for social security rights
- Risks of inflation, duration, longevity falling too much on private employers and individuals



UK model failing

- 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
- Only about half the population has private pensions

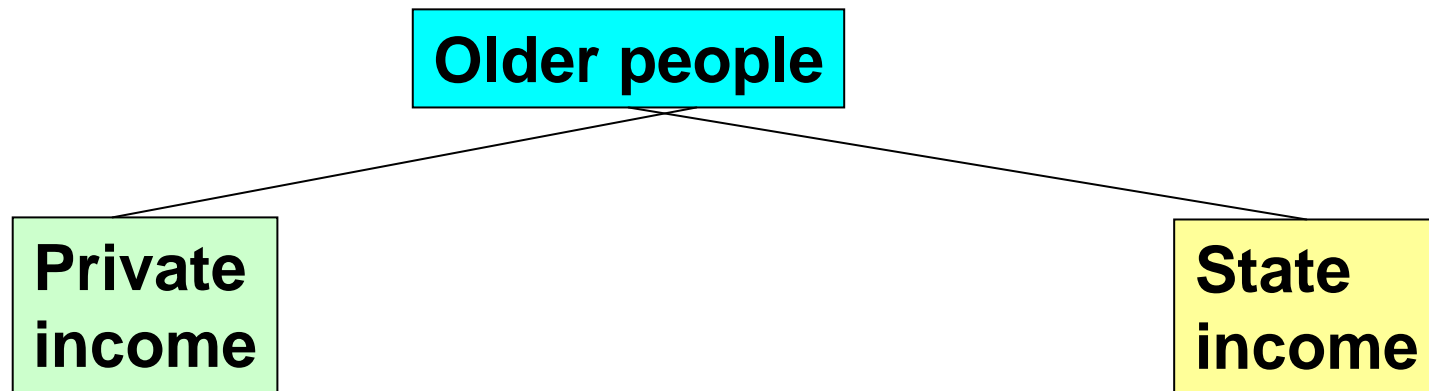


Role of the state

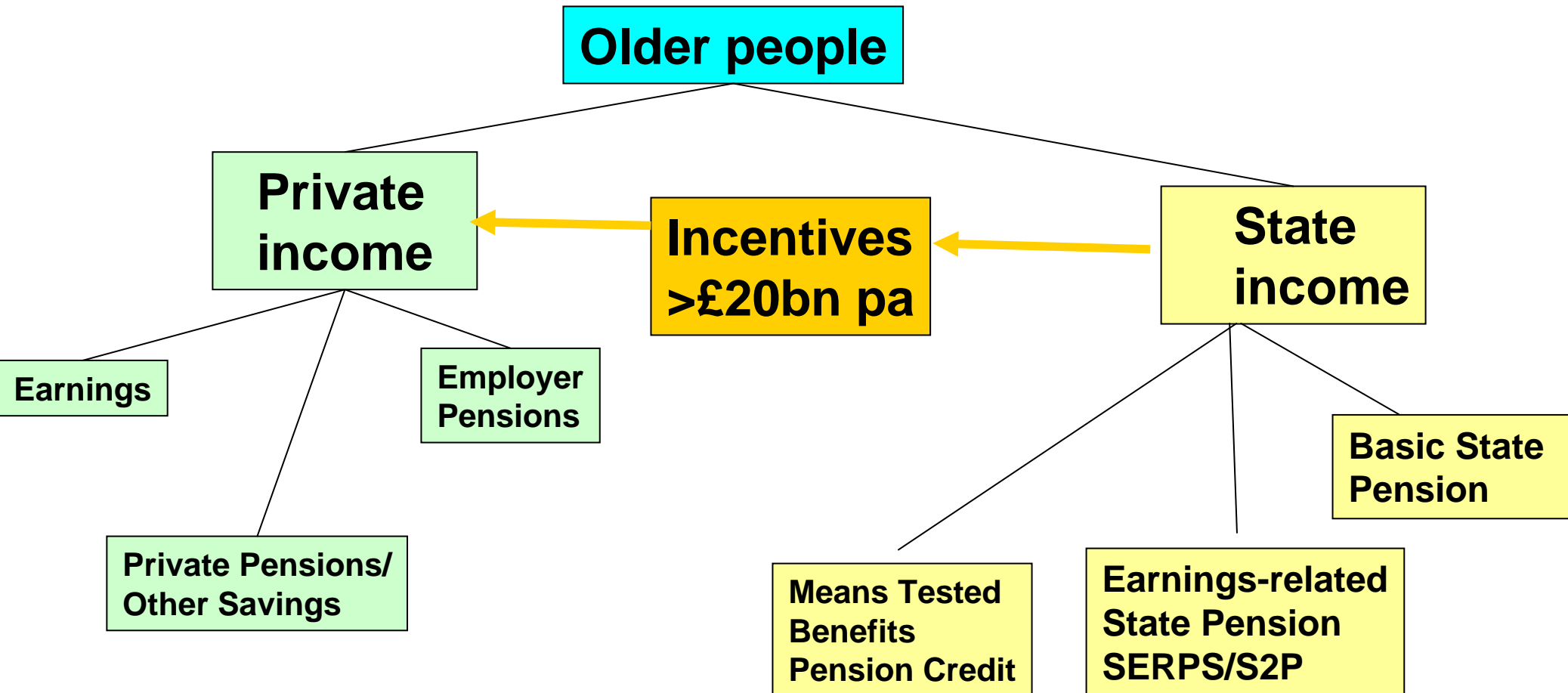
- Provide social welfare underpin – regardless of waged work
- Help people understand what they get from State
- Leave private sector to add savings element on top
- Create safe framework for private investments
- Remove disincentives
- Provide good incentives for those who need most help



Income in later life



State tries to offload costs





Problems with state system

- 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
- Contracting-out not working – rebates too low
- Pension credit undermining private pensions
 - Mass means-testing makes pensions unsuitable



Role of the employer

- Traditional role is paternalistic defined benefit provision for loyal, lifelong workforce
- This no longer so relevant – most employers don't feel obliged to provide social welfare
 - Average job tenure 5 years – what is the responsibility?
- Pensions are deferred wages – individuals choose
- Employer can provide access to pensions and advice
- Can no longer assume employers must contribute



Employers pulling out of pensions

- Final salary schemes unsustainable (> 25% salary)
- FD sees pensions company 'cost' not company 'benefit'
- Money purchase schemes not delivered good value
- Employers cut contributions to new schemes
- Loss of confidence, scandals



What about occupational schemes?

- 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?...

- 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



Role of private individual

- Lifestyle choices
- Saving now? How much to save?
- Choose between saving now or working longer
- Can't get big pensions from small contributions
- If want more than state minimum, must either save or work more
- Women particularly penalised – both state and private pensions depend on waged work



State pension reforms urgent

- Radical reform of state pension is necessary condition for sorting out private pensions
 - State take on welfare role, leave private sector for savings
- Abolish pension credit
- Merge BSP and S2P
- End contracting-out?
- Citizen's pension fairer for all – especially women
 - private pensions rely on waged work, why social welfare too



Private pension reforms

- Reform demand side, not just supply side
- New incentives for pension contributions
- Tax relief unfair, inefficient – gives highest incentive to those who need least
 - matching payments, employer rewards
- Encourage workplace provision
- Employer incentives
 - economies of scale, access, advice



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



Summary

- 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

