Pensions 2017 – Changes underway

Baroness Ros Altmann

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blog: pensionsandsavings.com
twitter: @rosaltmann

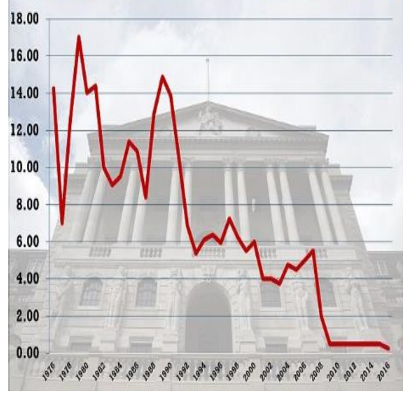
Important issues in a changing world

- Investment issues
- Managing DB
- Modernising DC
- Retirement is changing
- Future of pensions policy

- Turning first to the investment issues

- MONETARY POLICY AND QE HAVE DAMAGED PENSIONS

QE hits pensions



Short-rates near zero BoE created new money to cut long rates too

- Increased cost of providing pensions
- Rising DB liabilities, deficits and annuity costs
- DB schemes now cost >50% of salary – 85% closed
- Companies battling with deficits and buyout costs
  - PENSIONS AND INVESTMENT RISK

Pensions and investment risk

- As deficits worsen trustees told to ‘de-risk’ with gilts/bonds

- Equity allocations fallen from 60% 2007 to 30% 2017
- Bond allocations increased from 28% to 51%

- But QE distorts investment risk models – what is low risk?

- Negative yields ‘Risk-free returns’ or ‘return-free risks’

- TRUSTEE INVESTMENT CHALLENGES

Trustee investment challenges

- Bonds don't actually match liabilities

- And need to <u>outperform</u> liabilities to fix deficit

- Is selling potentially higher return assets 'de-risking'
- Or just locking in deficits? Sponsor covenant important

- Manage risk, not minimise risk
- Diversification gives more types of investment risk premia
  - FUTURE OF DB – OPEN AND CLOSED SCHEMES HAVE DIFFERENT ISSUES

DB legacy – open vs. closed

- DB transfers are rising – good news or bad news?

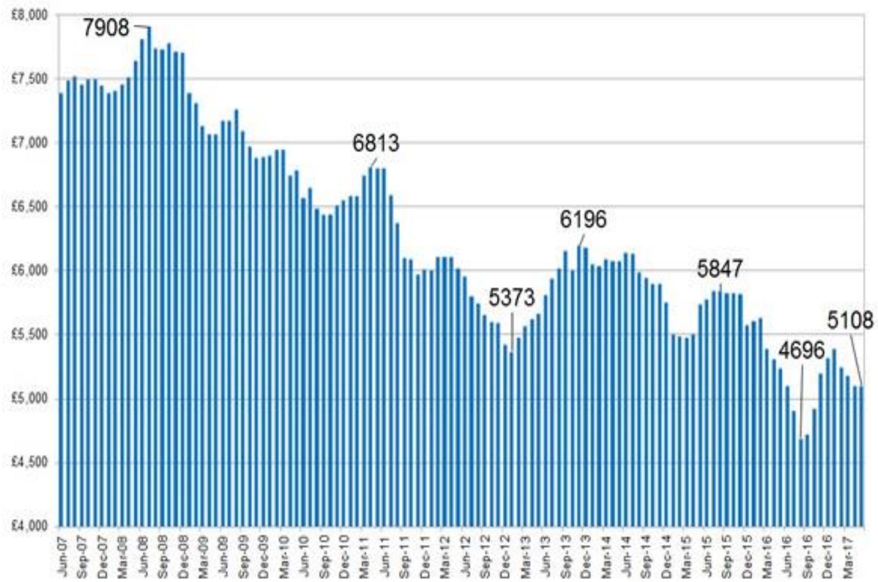
- Investment allocation and cash flow implications – MAY LIMIT Access to illiquid infrastructure, social housing, alternatives

- Vital to differentiate between open and closed schemes
- For closed schemes - consolidation, economies of scale, better governance

- Buyout prohibitive, self-sufficiency wind-down regime?
  - SHARP INCREASE IN ANNUITY COSTS SHOWN IN THE NEXT CHART

Sharp increase in annuity costs post-QE

- 2008: £10,000 level annuity at 65 cost £125,000
- 2017: £10,000 level annuity at 65 cost £200,000 +60% increase – i-linking
- 2015 reforms ended quasi-mandatory annuitisation for DC



Annuity rates chart for £100,000 fund, aged 65, level and single life

- HAS LED TO MODERNISING DC

Modernising DC

- Freedom and Choice paves way for new DC approach

- New investment options – lifestyle, target date outdated - New approaches for accumulation and decumulation

- Can we maybe learn from DB – there's more than equities & bonds

- Diversification, downside protection
- Non-linear income streams?
- Financial education incorporated into employer schemes?
    - MAKING DC MORE USER FRIENDLY

DC more user-friendly

- Benefit from behavioural economics
- A/e sees millions automatically start contributing - tax-free accumulation, locked in for later life
- **But please beware Net Pay for low earners!**
- Disincentives to withdraw too much too soon
- Sensible tax brakes and IHT-free no 55% death tax so it is now safe to keep money in pensions – could use for care?

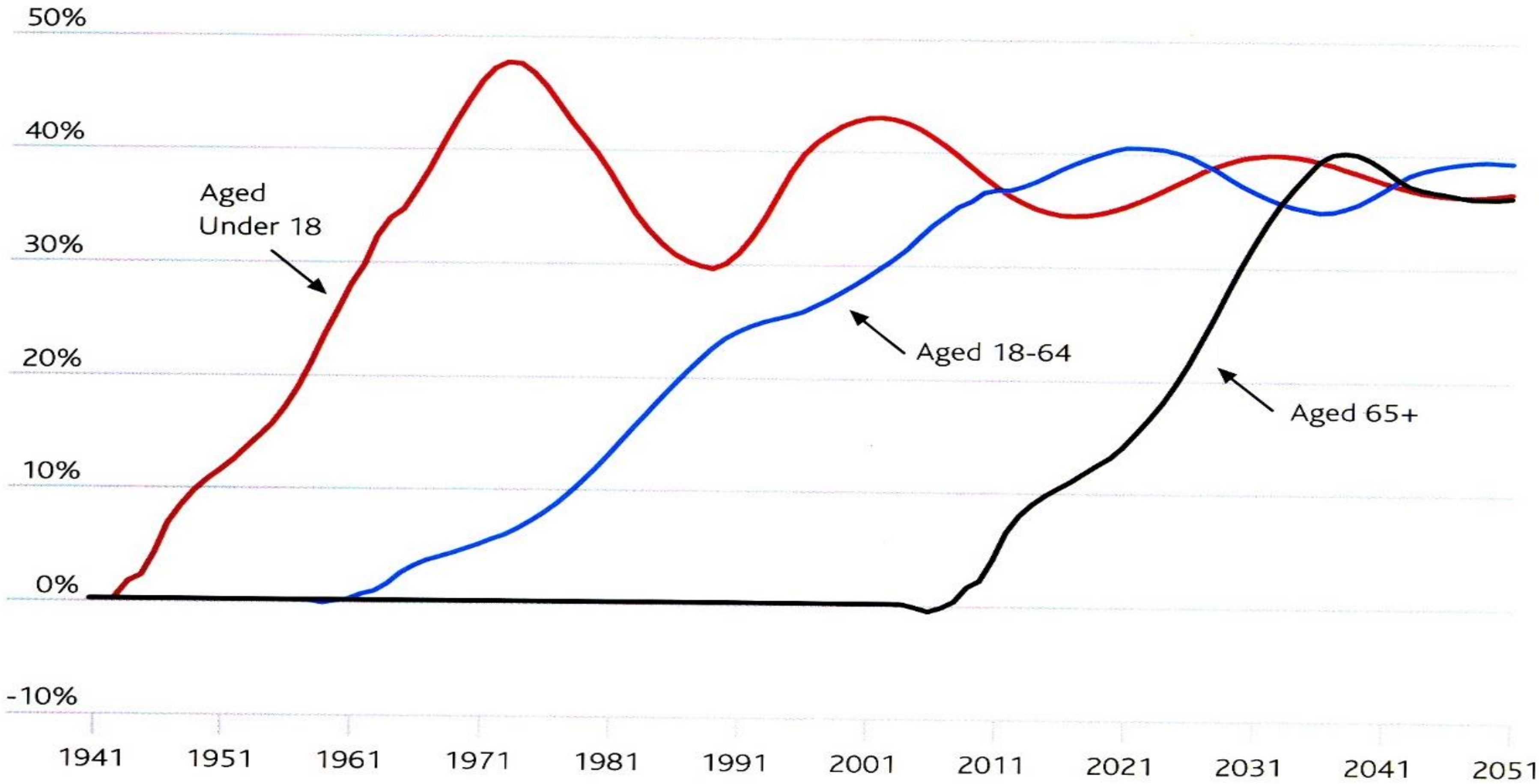
NEW PENSION THINKING

New pension thinking

- Lifetime Pension Accounts – with Growth phase, Income withdrawal phase
- User-friendly communications – not jargon
    - New language – who wants to ‘default’?!
- Investment options offering more choice such as Socially responsible investing to attract millennials?
- High on my wishlist is sending out wake up messages at age 50
    - DEMOGRAPHIC SHIFTS

Demographic shifts – baby boomers aging

CARE CRISIS



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

Care crisis

- Worse than pensions crisis
- No funds set aside to pay for care – public or private
- Current cohort tiny and already breaking NHS

- Welfare State National Insurance leaves out care – massive policy failure

- Too late for babyboomers – use pensions, ISAs, home?
- Insurance for younger generations and system reform

  - RETIREMENT WILL CHANGE AND PENSIONS NEED TO ADAPT

Retirement will change

- Rising longevity & early retirement with aging population was wrong!

- We actually need to extend working life, ongoing training, career re-skilling
- Employers should not overlook older worker talents
- 3 ‘R’s – Retain, Retrain, Recruit – don’t waste precious resources

- Age 50 is the start of second half of adult life
- Rethinking retirement essential – part-time glidepath

    - WHAT POLICY AGENDA WITH A NEW GOVERNMENT AND BREXIT

Policy agenda slimmed down as focus on Brexit

- Auto-enrolment review – no new burdens on business
- DB Green Paper – pooling, regulatory powers
- Cridland response – no change to state pension age?
- Improve financial guidance as new Pensions UnderSecretary takes responsibility for financial education

- Will we get a comprehensive Pensions Dashboard – who will fund it?

- Reform of pensions tax relief – on hold?

- THE FUTURE

The future

- Auto-enrolment bring millions to DC – maybe compulsion?
- Then auto-escalation or incentives to do more

- This is a truly tremendous industry opportunity
- Engage DC investors, education, technology, gamification

- New investment approach for growth and income phases
- IT'S TIME TO EXPLAIN THE BENEFITS OF PENSIONS PROPERLY
- **<u>Promote pensions - engage, enthuse, educate</u>**
- **<u>EXCITING OPPORTUNITIES AHEAD</u>**

Any questions?...

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