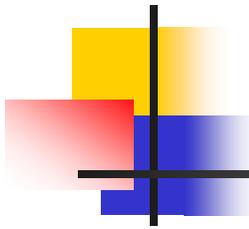


Pensions After Turner – What is the future for pension saving?

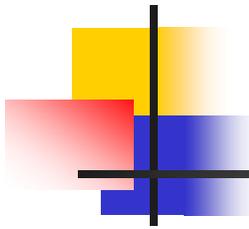
ACCA lecture
21st March 2006

Dr. Ros Altmann



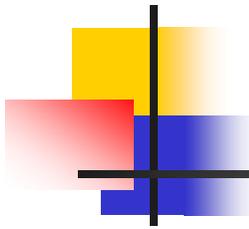
What is a pension?

- 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 20th Century
- Increasing private pensions supposed to offset state cuts
 - 21st Century employers won't provide social welfare
- State and private pensions both falling
- Turner tried to discover why and what to do about it
- Perhaps only state payments should be called 'pension'



Demography and pension history

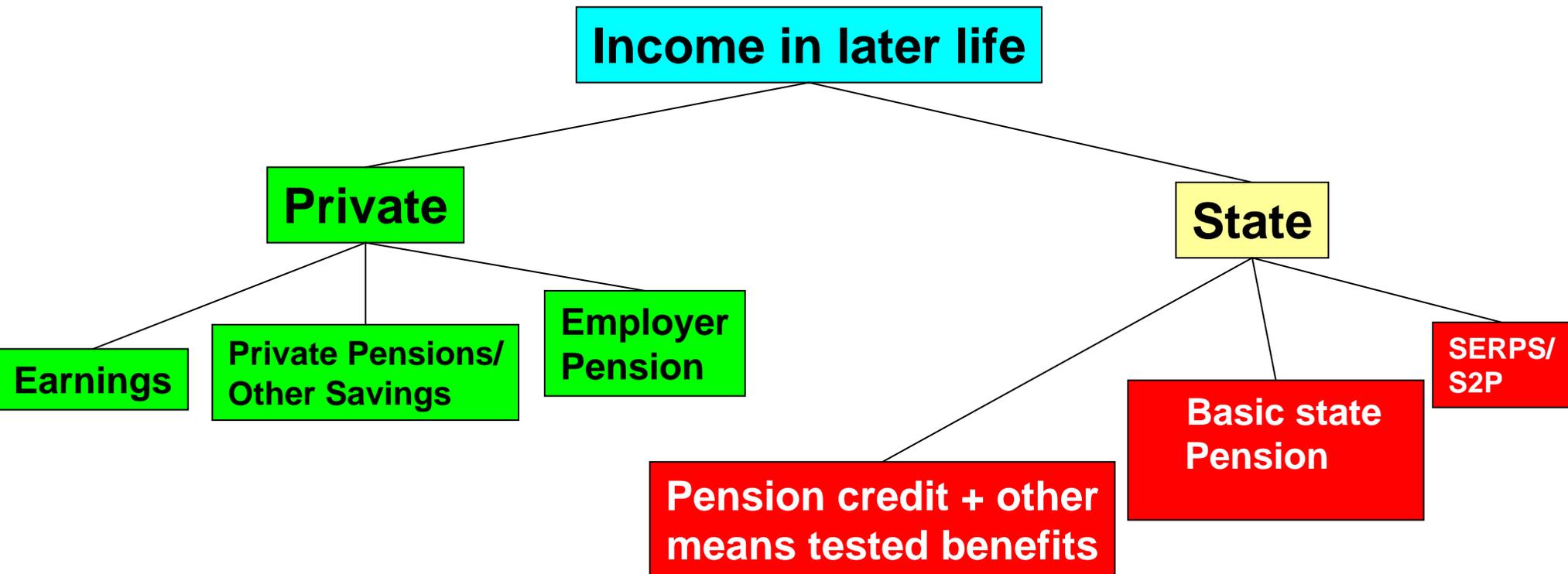
- Pensions helped baby boomer employment 1970's/1980's
- Early retirement, generous pensions, industrial restructuring led to unrealistic expectations
- Baby boomers now reaching pension age after 2010
- Not enough young people to fund future pensioners
 - Labour shortages, long-term economic decline – this is a crisis!
- Must rethink both pensions and retirement for new era
- Turner focused on pensions and savings, not retirement



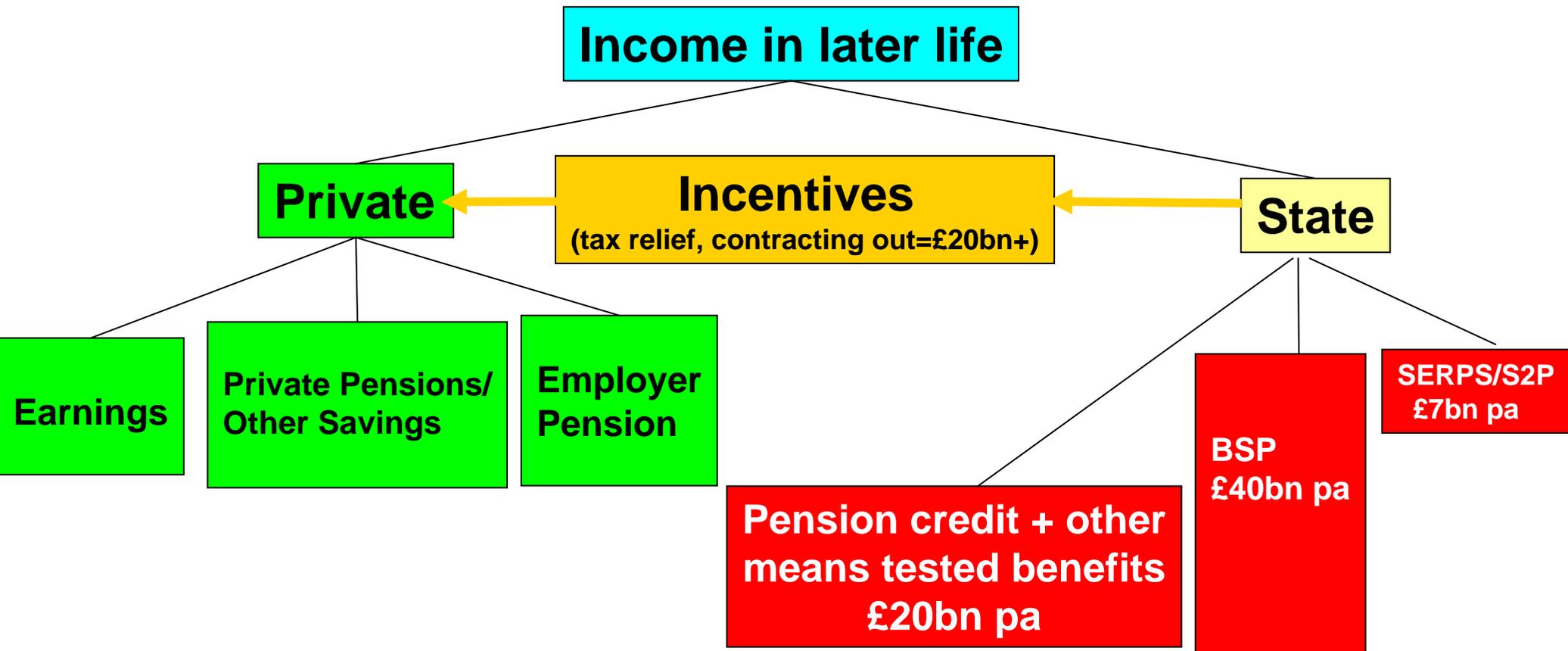
What's going on?

- Working years falling – trends to earlier retirement
- Saving years falling – debts, start saving later
- Retirement years rising – living longer
- Less time to save and expect savings to last longer!
- Doesn't add up – not enough younger people
 - Pensions were meant to last 5 or 10 years, not 30
- What will all older citizens live on?

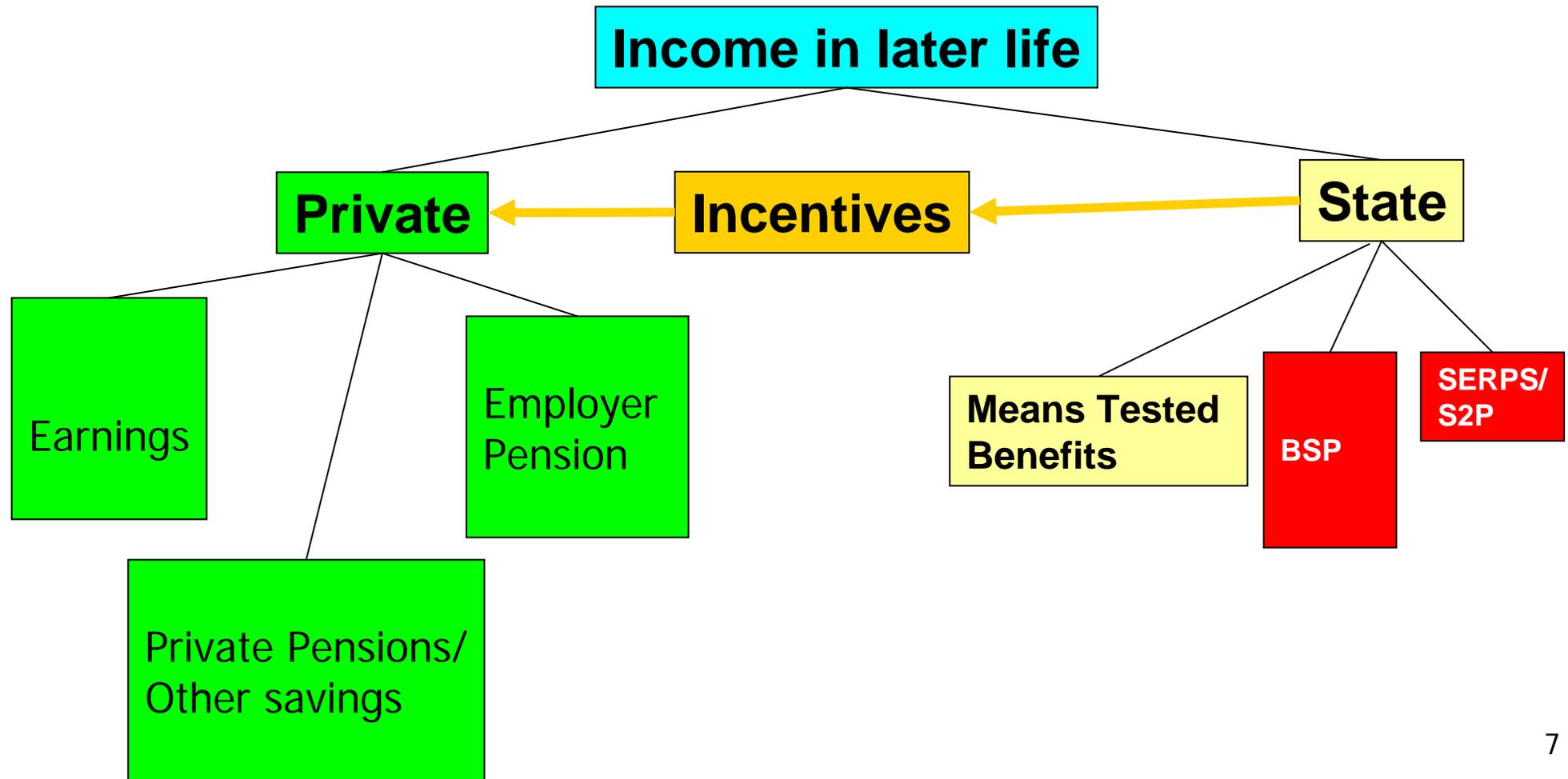
Old age income from 2 sources: State or private

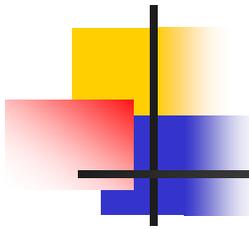


To control state pension costs ... Government gives incentives



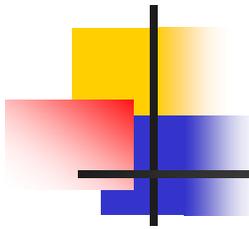
Theory: reduce state costs, increase private income





Not working in practice

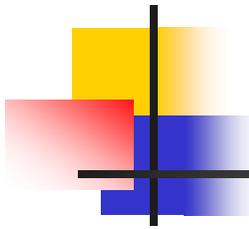
- State pension too low, complex, over reliance on mass means testing
- Undermines private sources of income
- Turner questions role of state pension
- Aims to improve state and private pension provision
- Wants to address complexity, unfairness



State pension reform – radical or evolutionary?

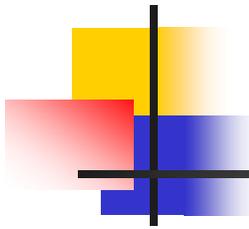
Pensions Commission considered:

- Should State provide just social insurance or more than this?
 - Recommended more than just social welfare
- Questions considered on state pension:
 - 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? – earnings
 - Contracting out? – keep some, get rid of some



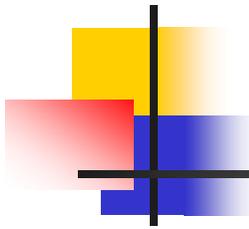
Pensions Commission state pension reform proposals

- Modify but keep 2 state pensions –
 - BSP universal, flat rate, linked to earnings not prices
 - S2P contributory, flat rate, different pension age from BSP?
- Pension credit to remain, but coverage fall to 1/3 not 2/3
- Abolish contracting out for DC not DB
- Raise state pension age to control long term costs



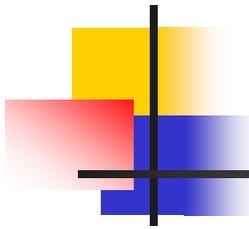
Problems of Turner State reforms

- Half way house compromise
- Still complex and confusing
- Contracting out still a problem
 - Could release £8billion or more by abandoning it
- Still too much means testing – poverty, disincentives
- Raising state pension age not a long term solution
- Not radical enough – my view: need citizens pension, clear separation of state and private roles



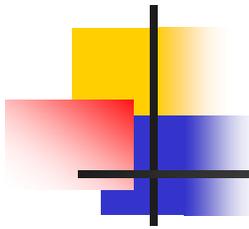
Traditional employer pensions

- Final salary schemes in terminal decline
- Employers see pensions as company 'cost' not 'benefit'
 - Average job tenure 5 years – not lifelong employment
- Traditional pension costs up 5%pa (inflation, mortality)
 - Recognise true costs – wake up to reality!
- Pensions Commission no solution, just slow death
- Schemes raided by employers and Government
 - Allowed employers to make promises, told members all safe and protected by law



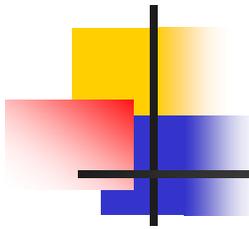
Government guilty on final salary

- Parliamentary Ombudsman report highlights Government responsibility for biggest social injustice of our time
- 85,000 people's lives destroyed
- Government denies any wrongdoing – unbelievable
 - Parliamentary democracy must prevail
- FAS totally inadequate and unfair
 - Compensation requires £150million a year
- Who will trust pensions in future if those who believed their pensions were safe and guaranteed are left without
- Compensation essential if Turner reforms considered



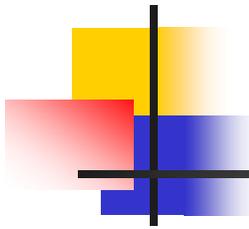
Compulsion could be dangerous

- Already have compulsion in NI
- Turner proposes employer compulsion plus auto enrolment in low cost quasi-Government scheme (NPSS)
- But only proposing 8% default – not enough
- What if things go wrong? suitability, mis-selling?
- Turner has not made the intellectual case for employer compulsion
- Need better and fairer incentives for voluntary system



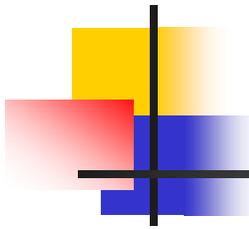
Incentives

- Currently only incentive is tax relief – costs £21bn 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
- Believes costs are major disincentive (I don't agree)



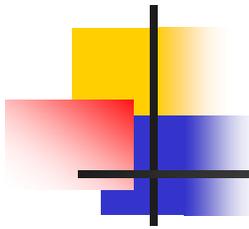
Proposed NPSS

- 4% employee, 3% employer compulsion, 1% tax relief
- Admits current tax relief not an effective incentive
- £ for £ matching incentive much more powerful!
- Pensions Commission proposes employer pay 75p in £, state pay 25p
 - Auto-enrolment optional for employee
 - Low charges
 - State organised admin
 - Approved investment vehicles?



Concerns about NPSS

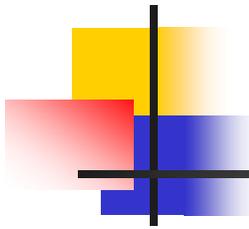
- This is effectively a tax on small employers!
 - Small employers struggle – pension is part of pay, should employers then fund mortgage too?
- Big risk contributions will actually fall overall
 - Nearly half DC contributions now >8% (DB > 20%)
- Employer contributions cut- minimum becomes maximum
- 8% not enough. People may think it is
- No advice, suitability check, financial planning help?
- Safety and diversification?



Government criteria for reform

<u>Hutton's 5 tests</u>	<u>Pensions Commission Proposals</u>	<u>Citizens Pension Proposals</u>
Personal responsibility	✓ auto-enrolment good	? clear message
Fairness	X still favour top earners	✓ universal
Affordability	✓ better than now	✓ if redeploy spending
Simplicity	X still complex	✓ same for all
Sustainability	? need more change	✓ changes obvious

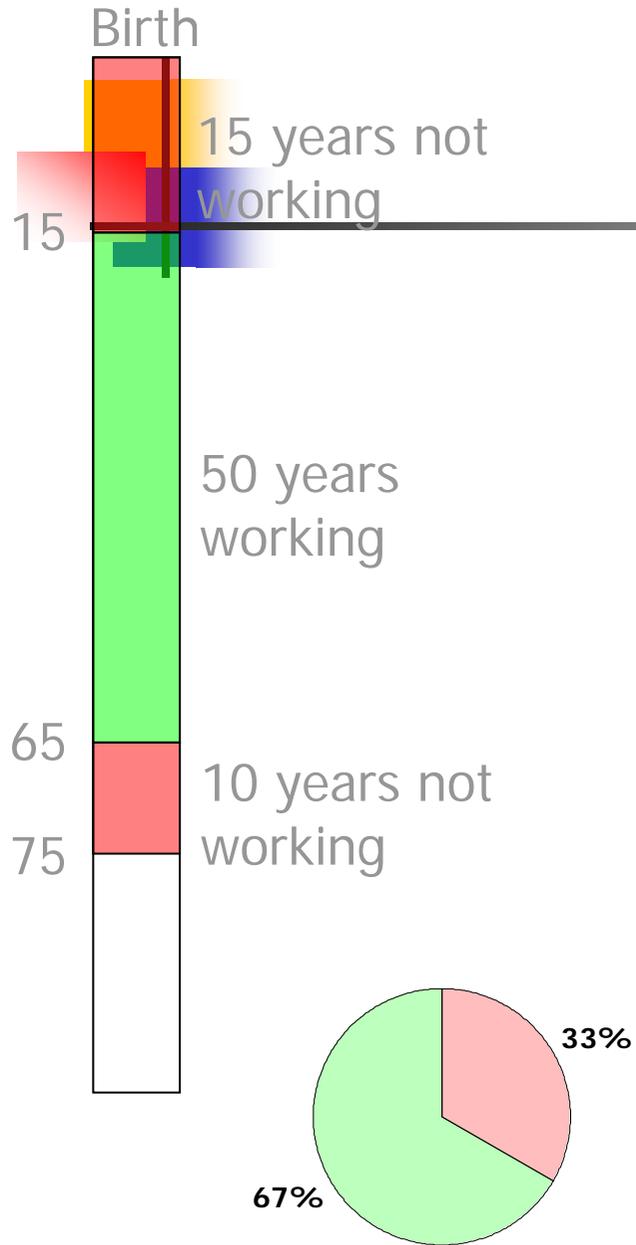
BUT ... pensions not the whole problem



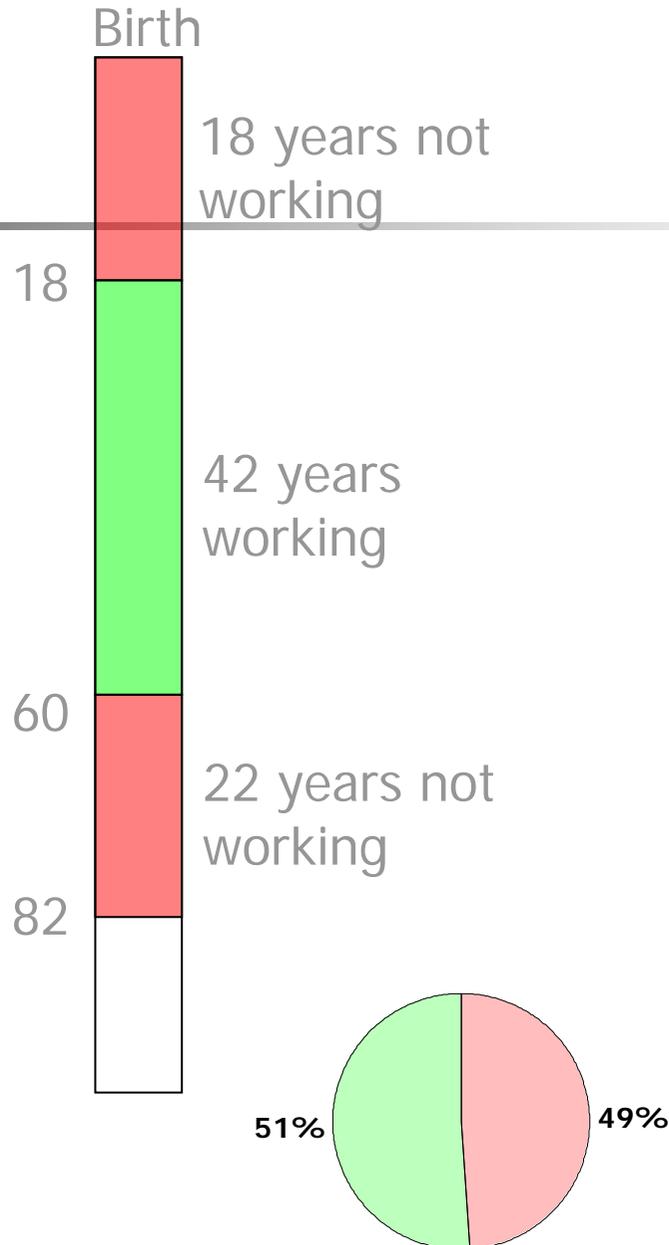
Pensions alone cannot solve the pensions crisis

- Must rethink retirement – not just raising SPA
- Retirement lasting too long
- Waste of resources- paying people not to work
- Retirement a 'journey' not a 'destination'
- New phase of life – part time work, flexibility
- This is the employer's role in 21st century labour market

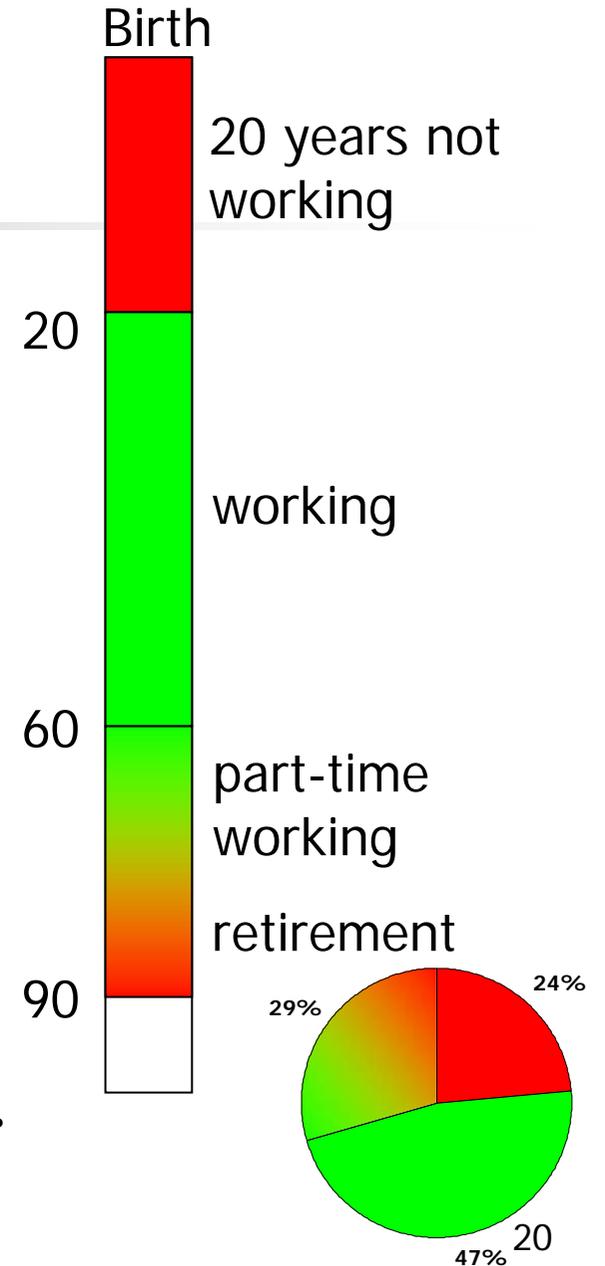
1950's

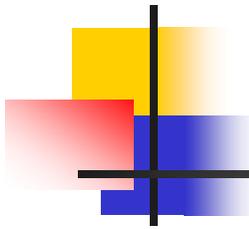


Now



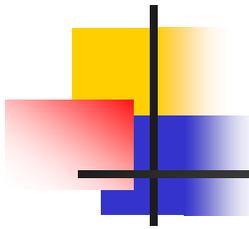
Flexible Working





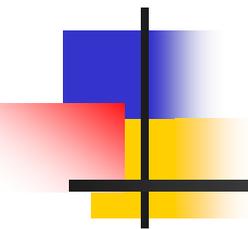
Rethinking retirement

- Turner proposals will not work – raising pension age prolongs old fashioned thinking
- New phase of life we never had before
- Cut down gradually- part time working, job sharing
- 2 3days working, 4 5 days off
- More leisure and more money to enjoy the leisure
- Better for individuals, employers and the economy



Summary

- Can't reform private pensions without radical state reform, better incentives and changed retirement attitude
 - State provide basic social welfare – citizens pension
 - Individuals responsible for extra either savings/part-time work
- Need bolder approach – doesn't look like we'll get it
- Dangers of NPSS and compulsion with mass means tests
- Could even make things worse – must face reality
- Turner not radical enough – not sustainable in long term
- Need to re- think pensions and retirement



Pension reform beyond Turner

These are just my views, let's discuss...

Dr. Ros Altmann

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