



A Pensions Solution?

CSFI Roundtable Discussion

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Rationale for Pensions?

- Social:
 - Support those 'too old' to work – prevent poverty
- Economic:
 - 'Reward' long working life
 - Provide long term investment capital
- Personal:
 - Lock savings away while working – deferred pay
- Political:
 - 'grey vote', pensioner numbers to rise from 11m to >15m



The UK Pension Scene

- Until recently, Government thought pensions under control
- UK has more private pension savings than rest of Europe put together
- Successive Governments relied on shifting pension burden to private sector
- But market collapse, falling rates, rising longevity causing major problems
- Now pensions crisis



Government Attitude

- Official Government attitude is 'no pensions crisis'
- Just a problem of confidence
- Spending will remain around 5-6% of GDP
- Despite 40% rise in numbers over State pension age!
- Every 1% of GDP to be shared between 3 million pensioners in future, compared with 2 million today



State Pension Expenditure Forecasts (% GDP)

<u>Country</u>	<u>2000</u>	<u>2020</u>	<u>2040</u>
■ France	12.4	15.0	15.8
■ Germany	11.8	12.6	16.6
■ Italy	13.8	14.8	15.7
■ Spain	9.4	9.9	16.0
■ Sweden	9.0	10.7	11.4
■ UK	5.5	4.9	5.0
■ EU Average	10.4	11.5	13.6

Source: Economic Policy Committee, EU working group on ageing populations, 2001



What is Government Pension Strategy?

- Encourage more private provision (60%/40% --> 40%/60%)
- Stakeholder pensions for middle income groups
- Means test (Pension Credit) for poorer pensioners
- Simplicity, security and choice



This Won't Work!

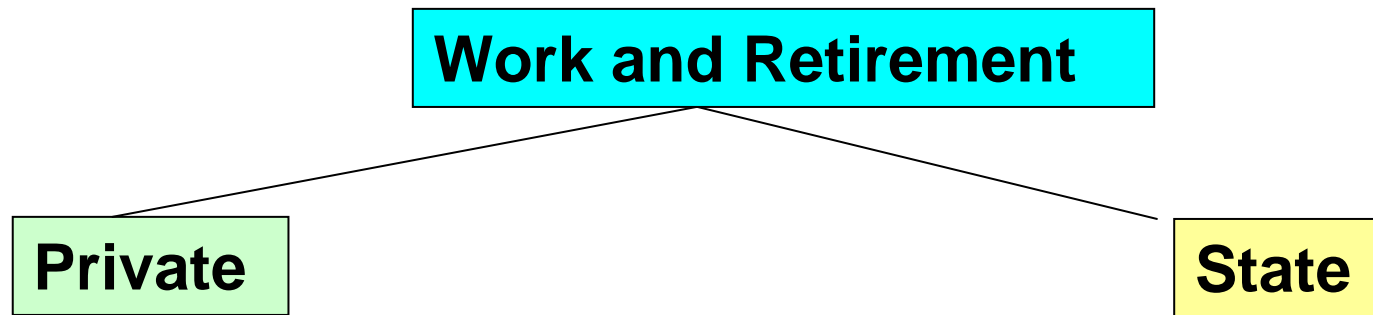
- Private sector cannot support this burden
- Long term economic decline
- Poverty
- Social unrest



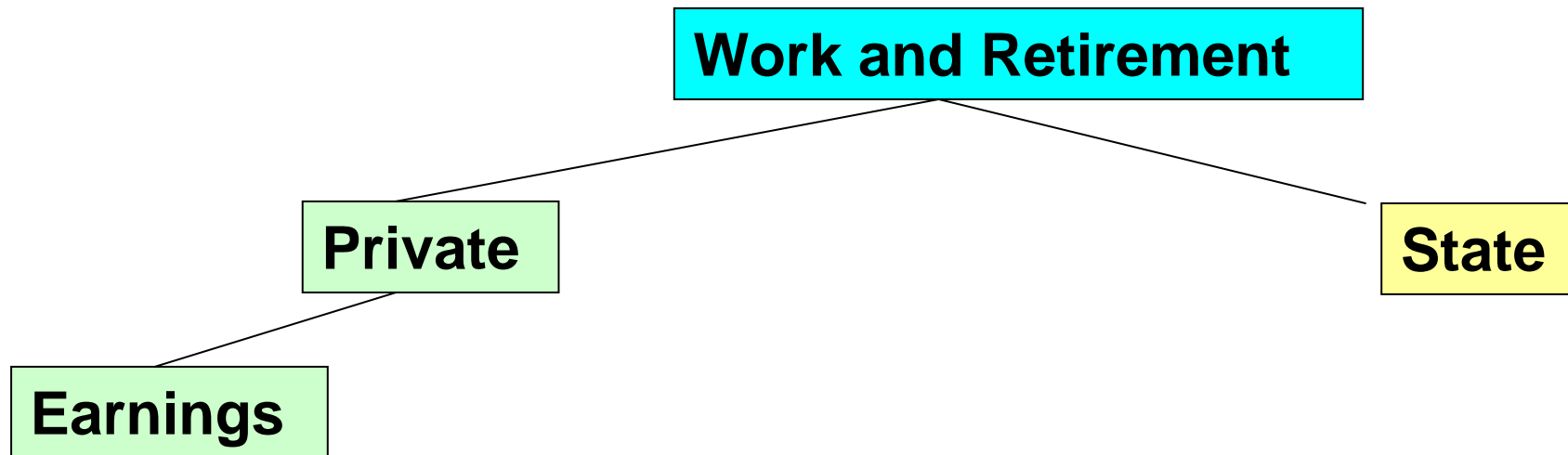
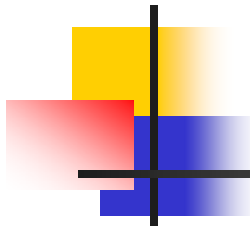
Pensions in Reality

- Private provision falling – both employer and personal
- Employers closing final salary schemes, cutting contributions to money purchase
- Employers cannot afford the costs of pensions today
- Stakeholder concept flawed (>80% of schemes empty)
- Government has not admitted this yet
- What is really happening?...

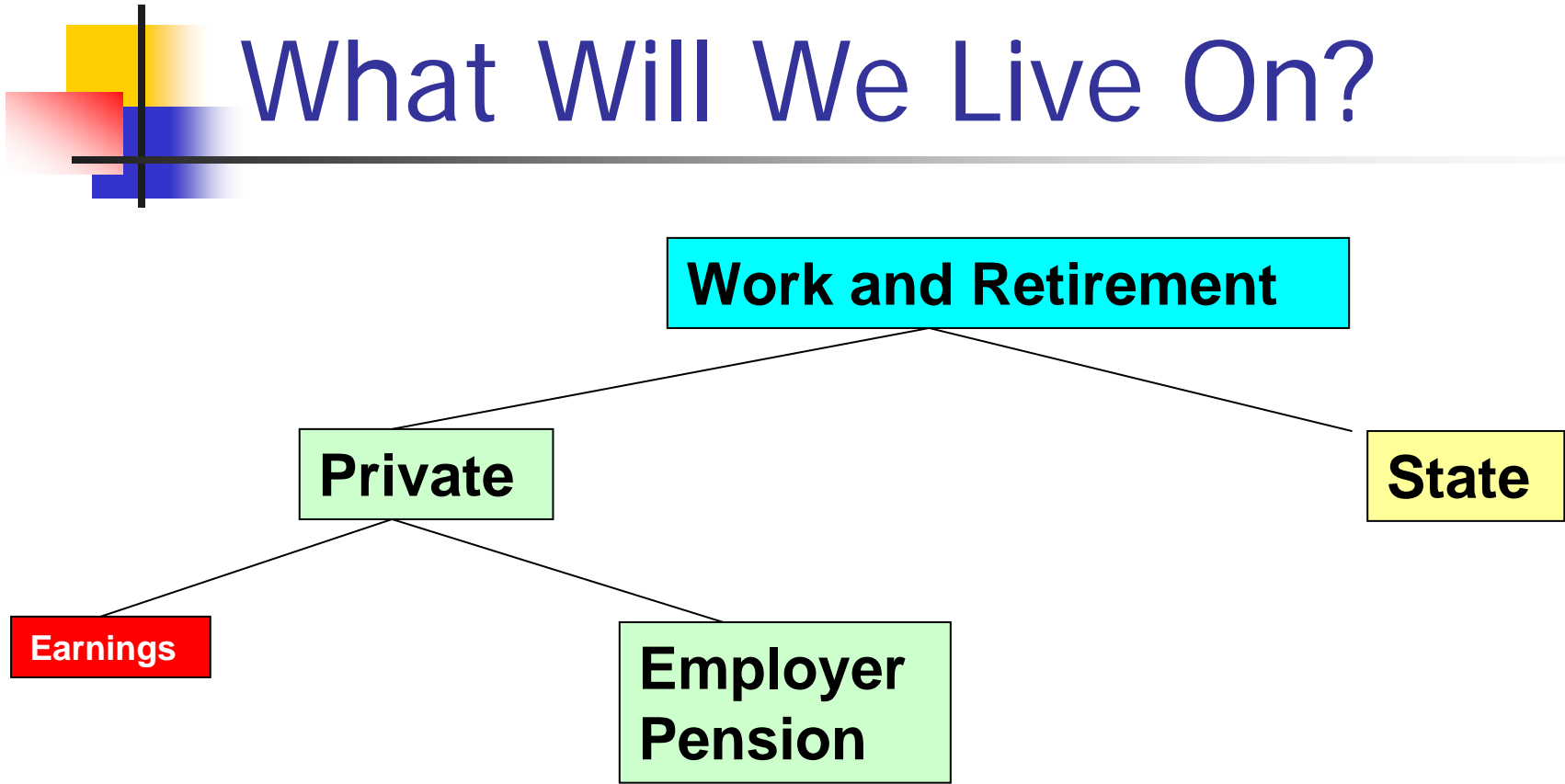
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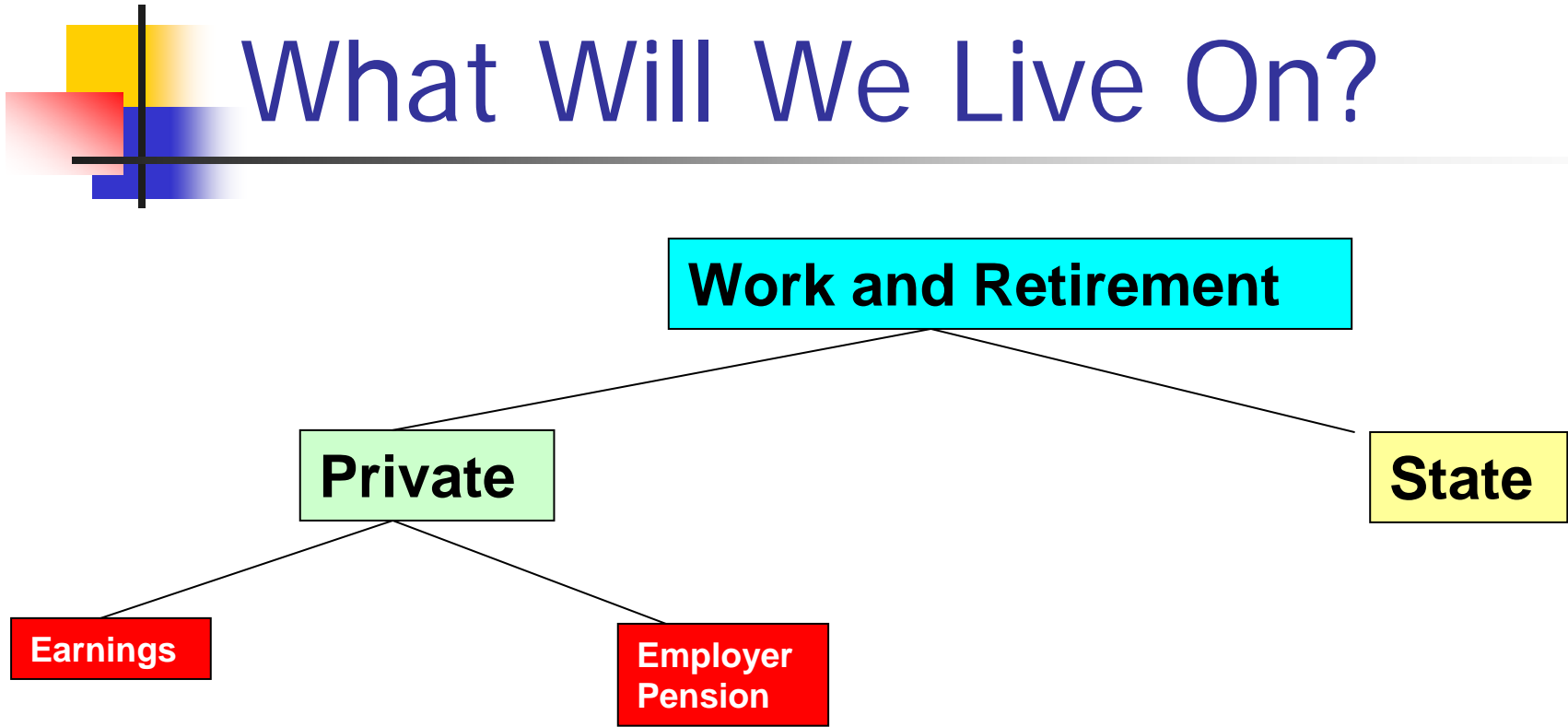
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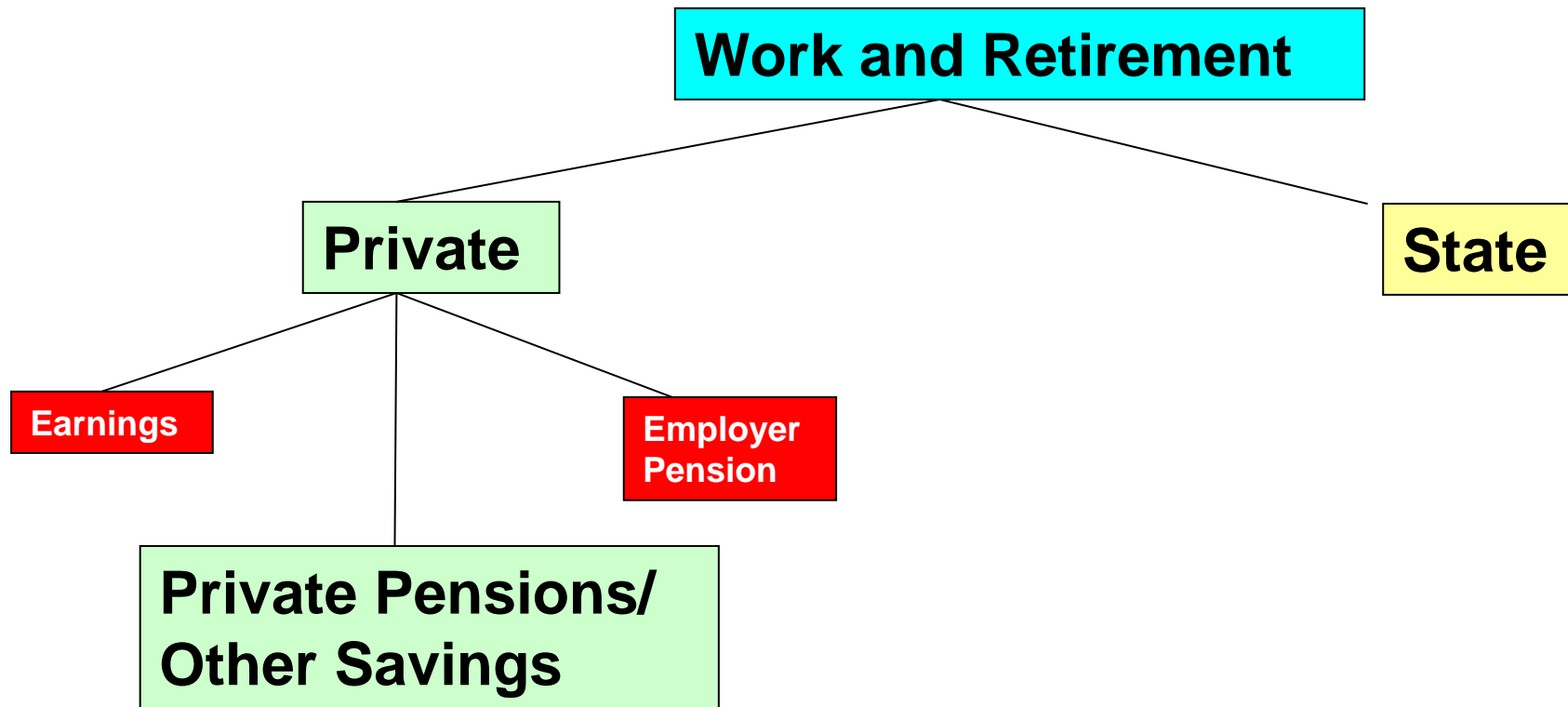
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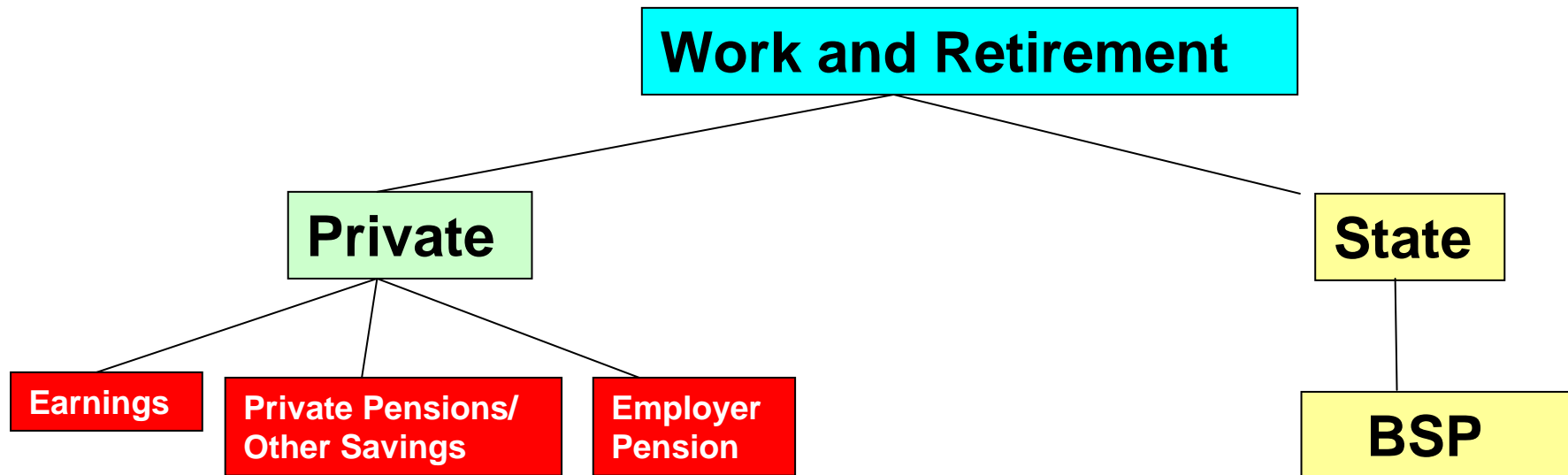
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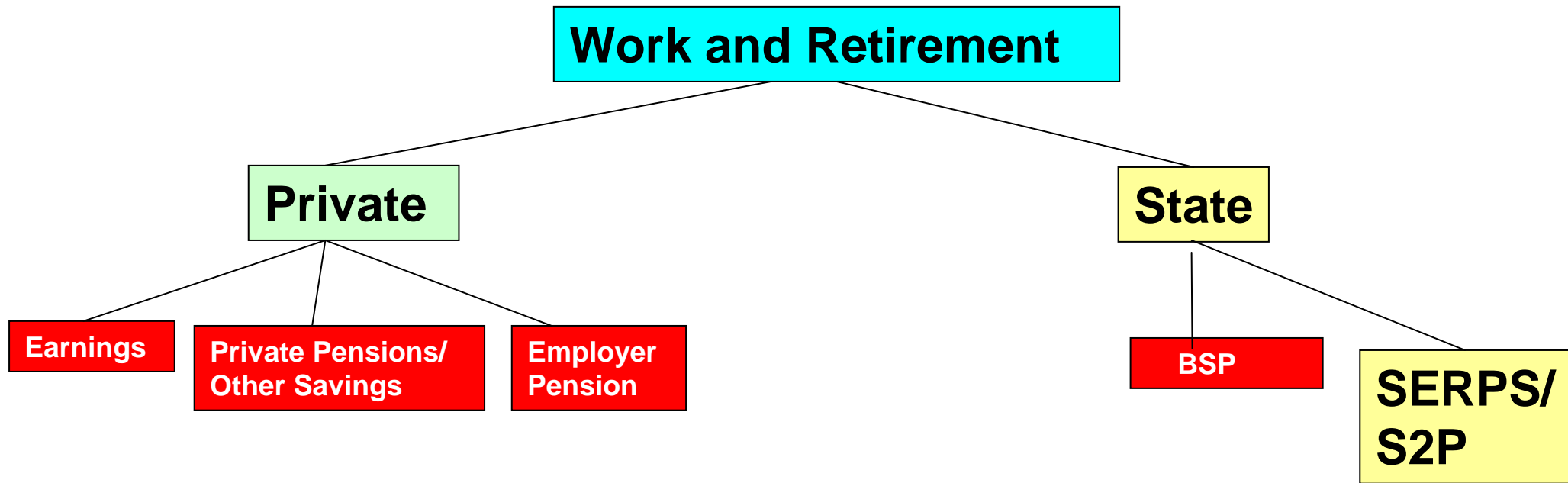
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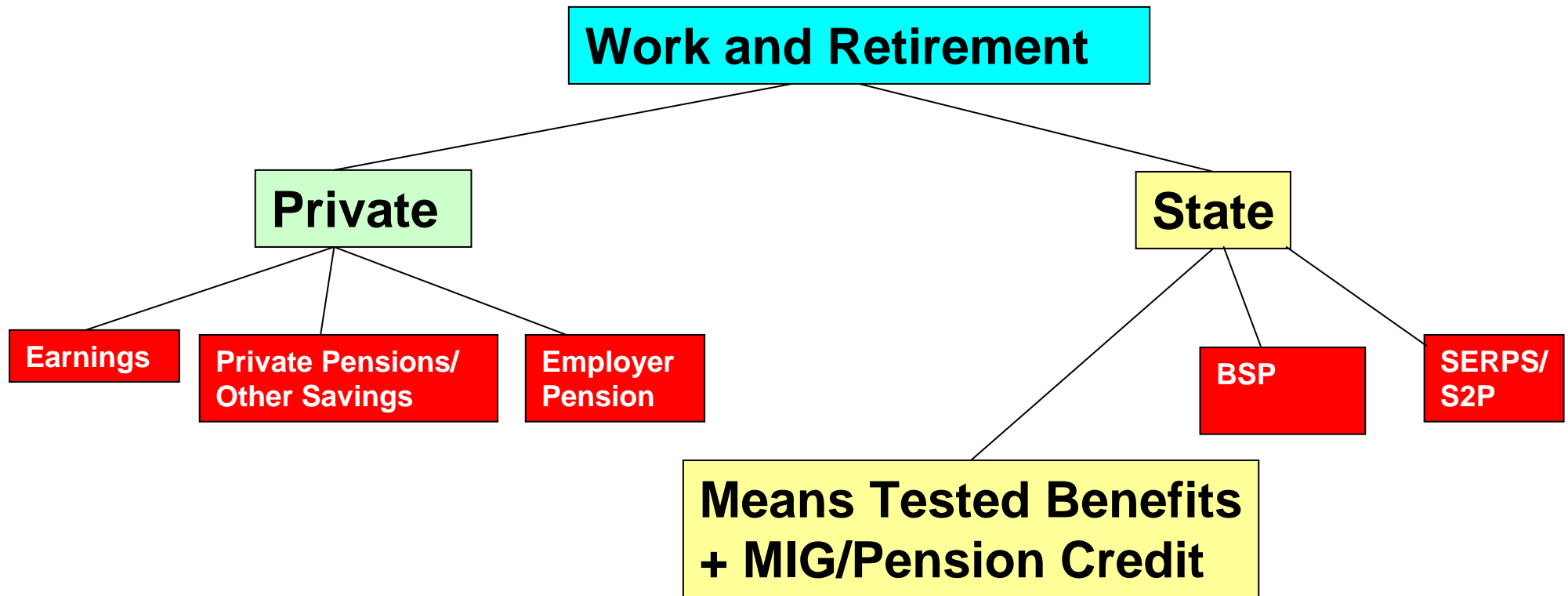
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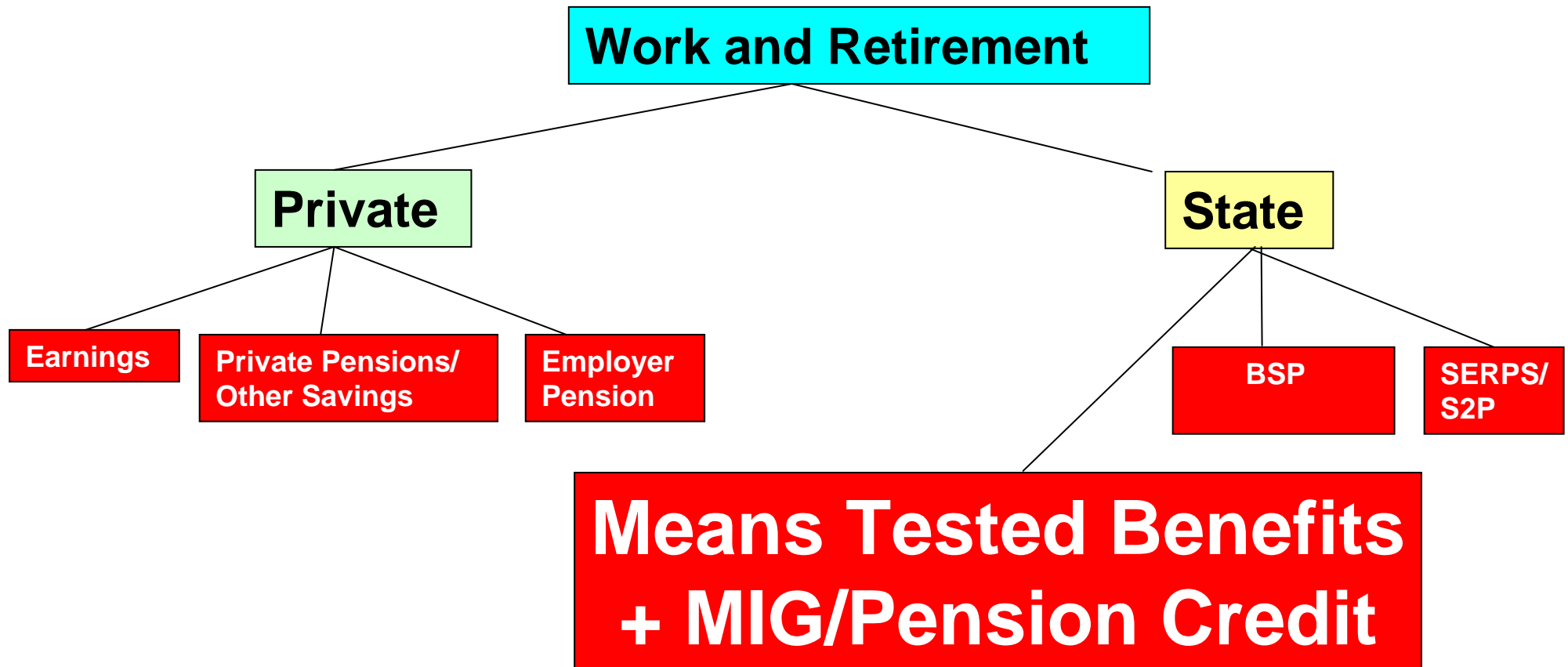
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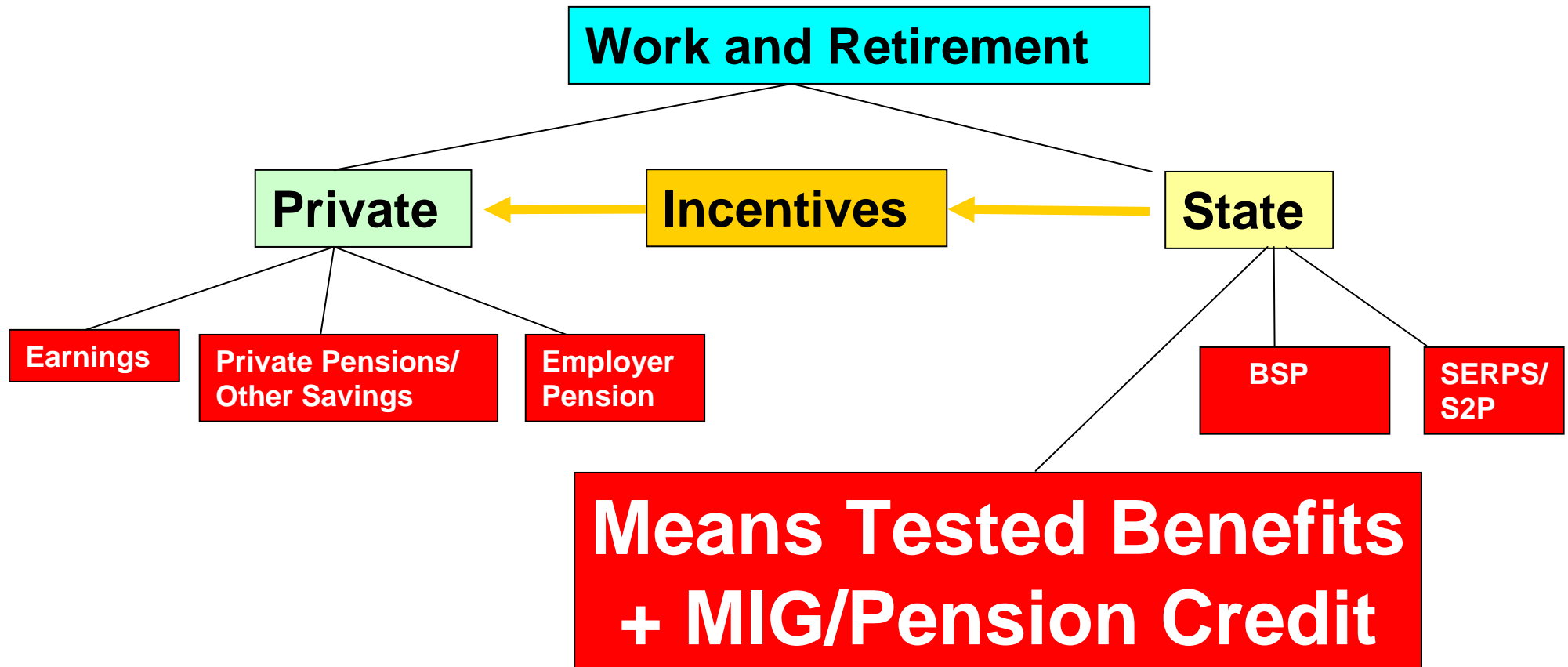
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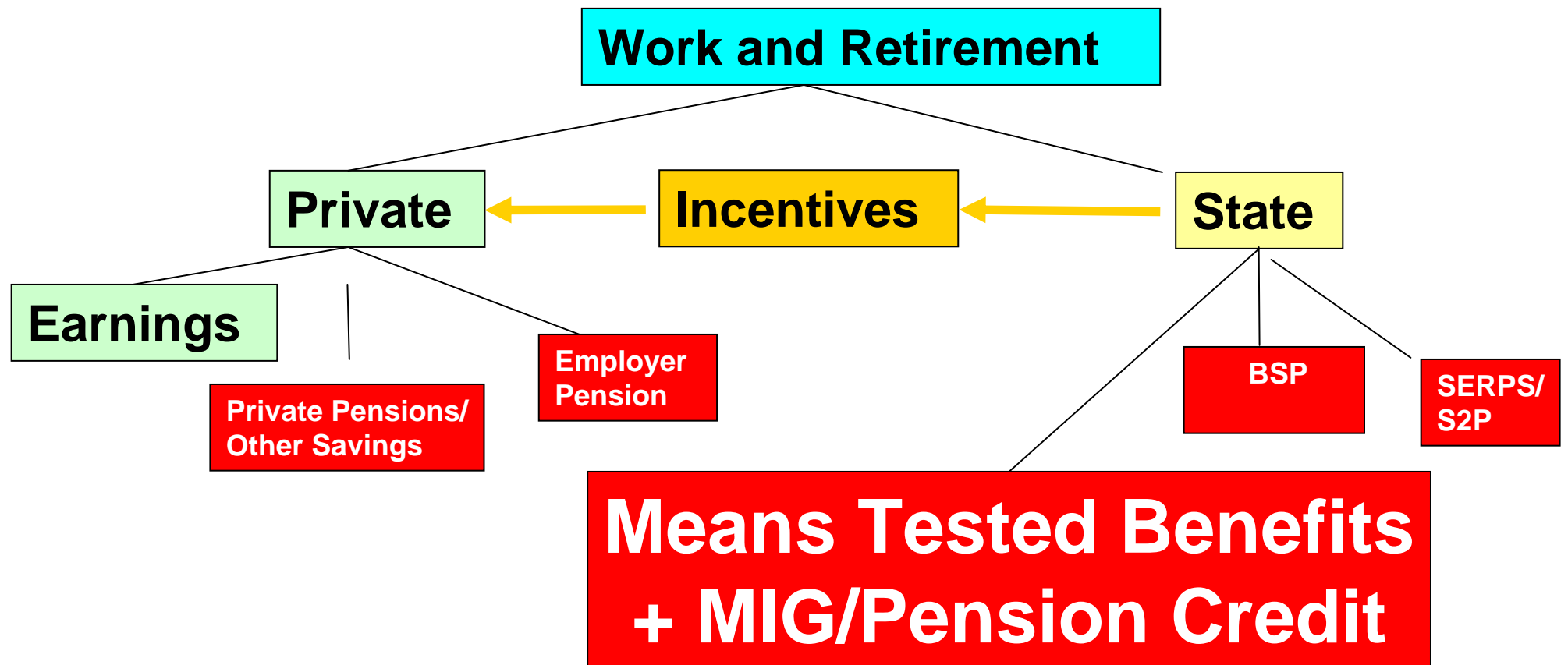
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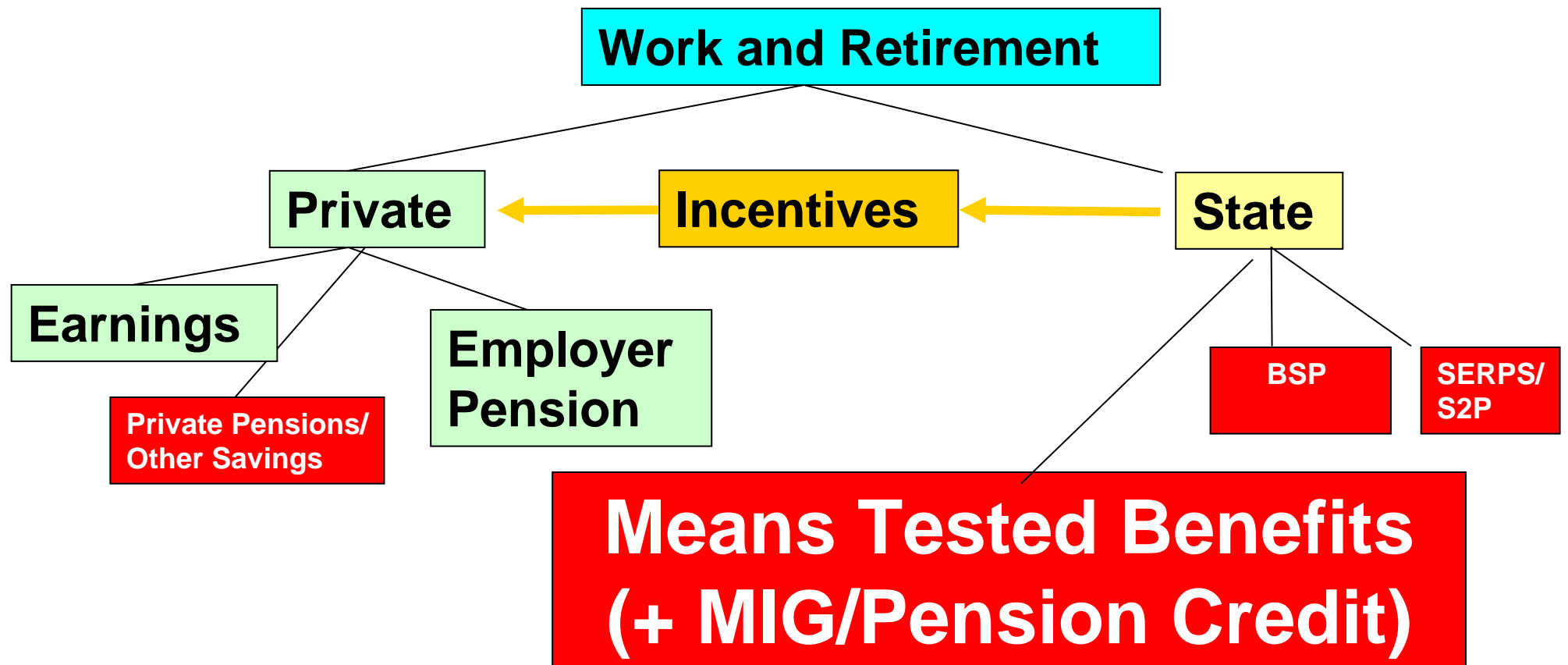
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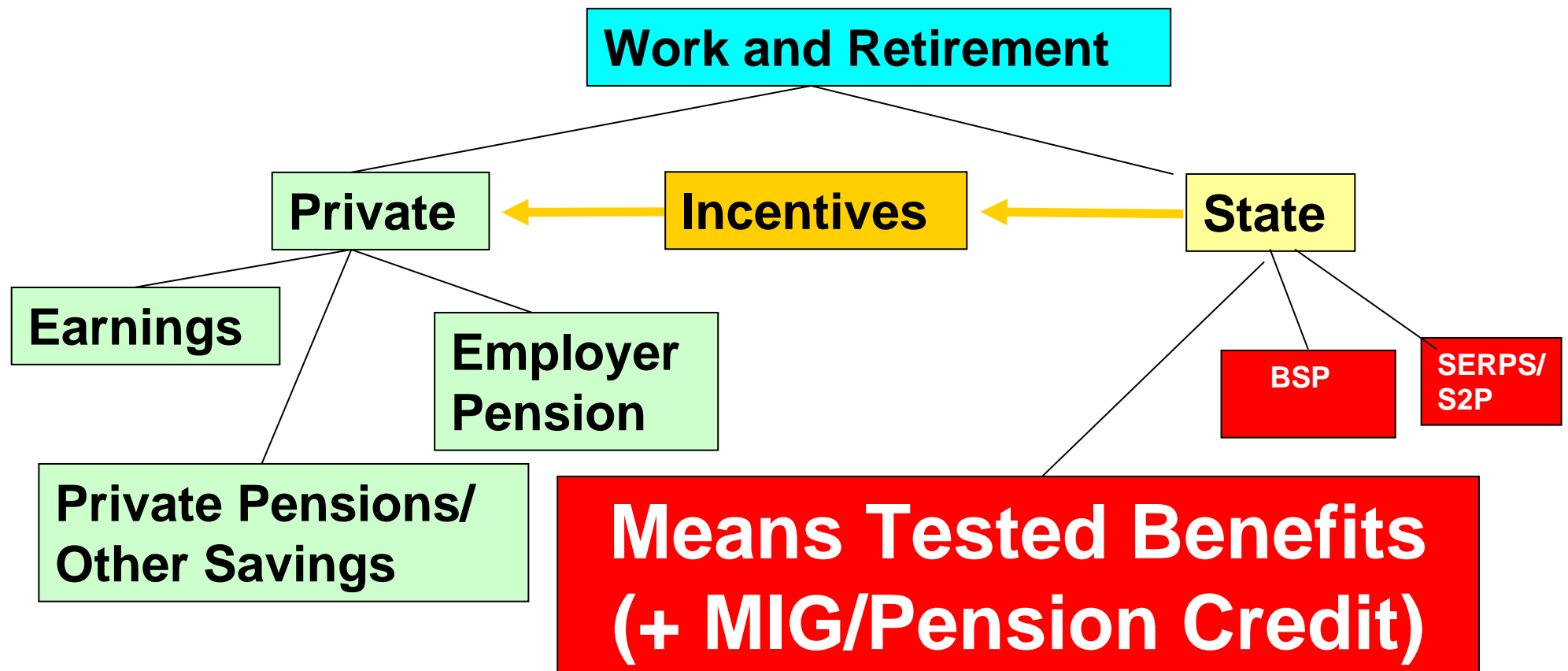
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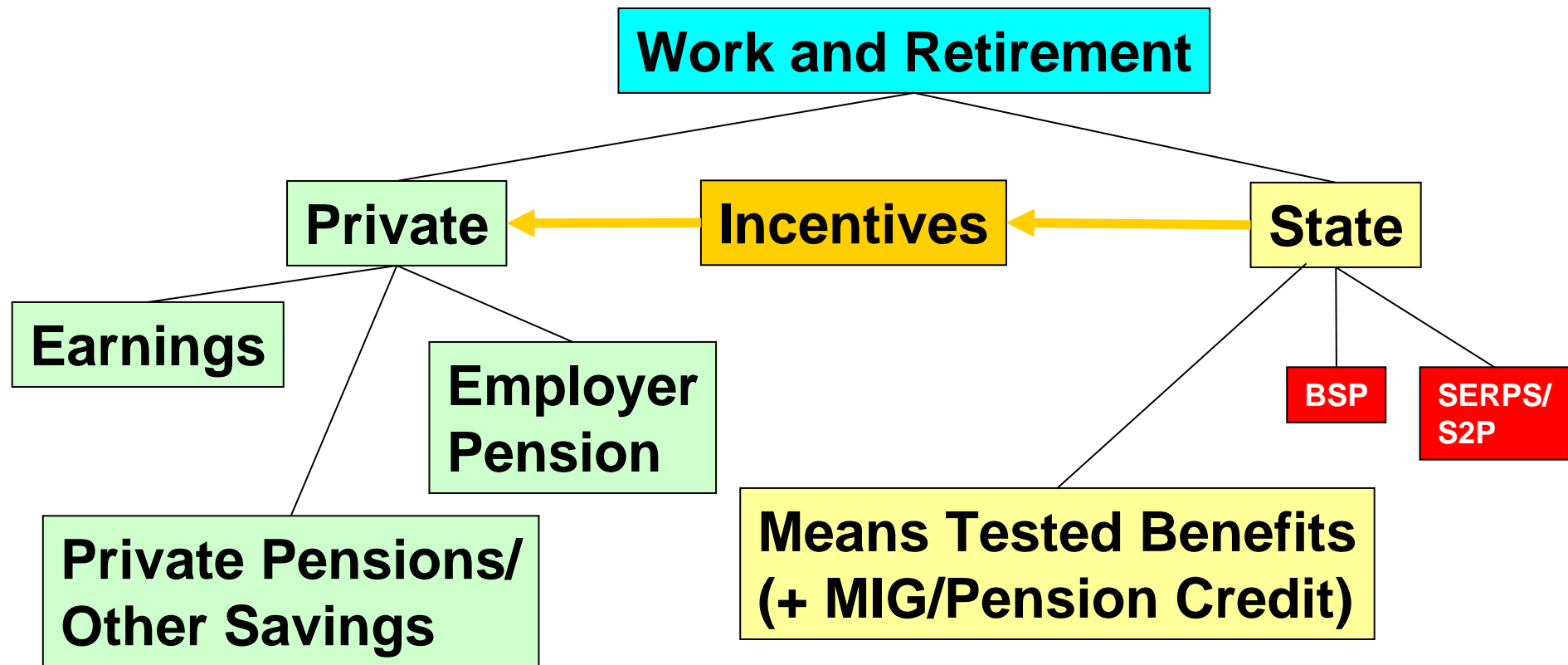
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Government Policy Undermining Pensions

- Incentives are not working
 - Employers and individuals not contributing enough
- Pension Credit is a barrier to future pensions
 - 75% of future pensioners will be eligible for means testing
 - Pension Credit 'taxes' pension at least 40% - disincentive
- Government policy will not reduce number of pensioners in poverty – still 1 million in 2040
- Policy is relying on supply side reforms
- Need to improve *demand* for pensions, not just supply
 - Better incentives, lottery?



But are we Thinking Correctly?

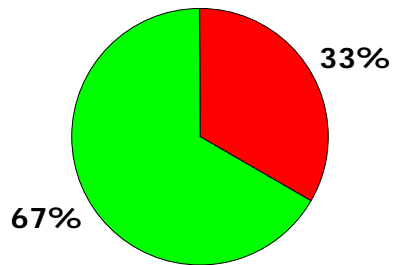
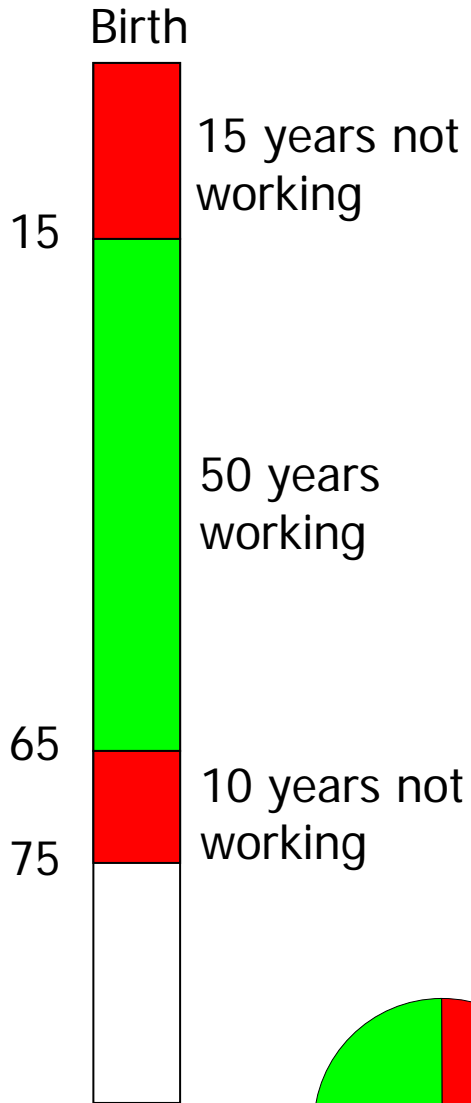
- This is not really a 'pensions' problem
- It is a 'retirement' problem
- Can't sort out pensions without rethinking retirement
- Pensions are now too expensive because they have to last too long



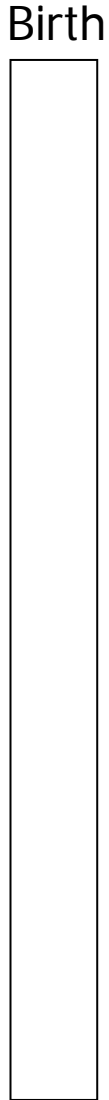
We Expect Too Much of Pensions

- Pensions never meant to last 30 or 40 years
 - Originally designed to last 10 years or so
- Annuity market unlikely to cope in future
- Pension and retirement policy lagged behind demographic and health changes
- Pension/retirement expectations influenced by industrial restructuring in 1980's and 1990's
- Must move into 21st Century

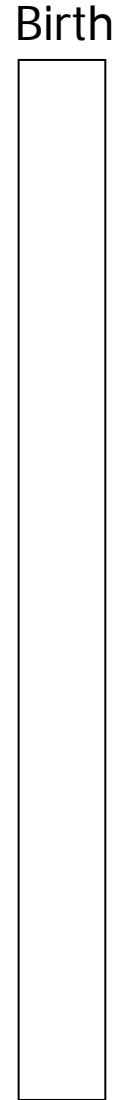
1950's



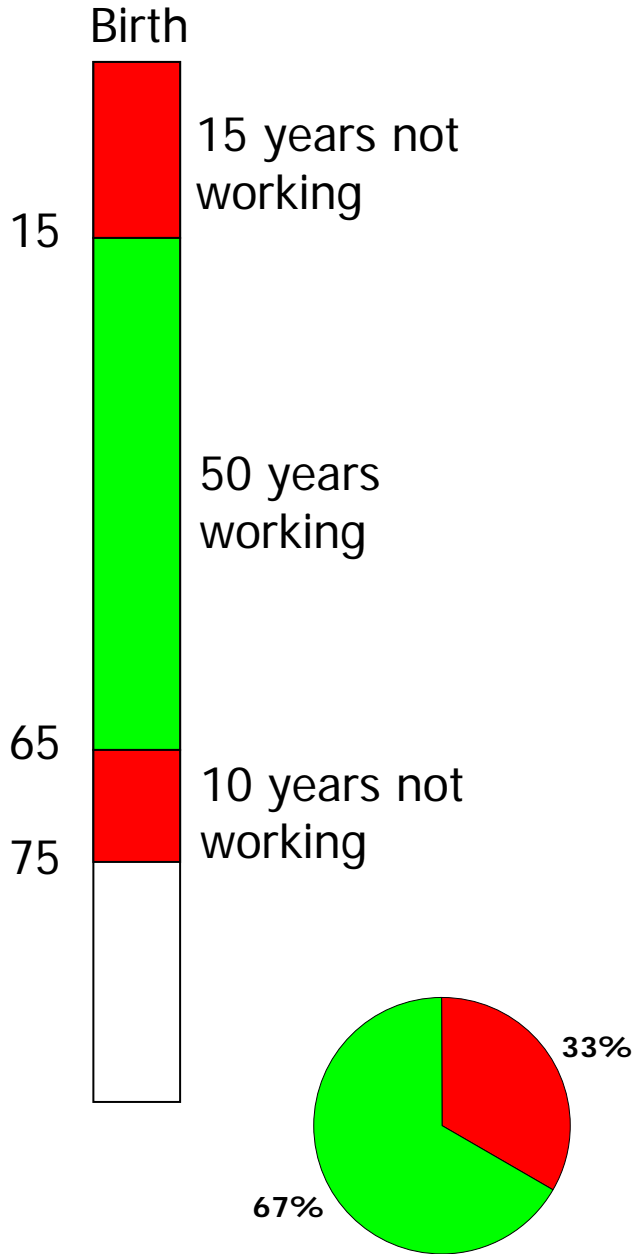
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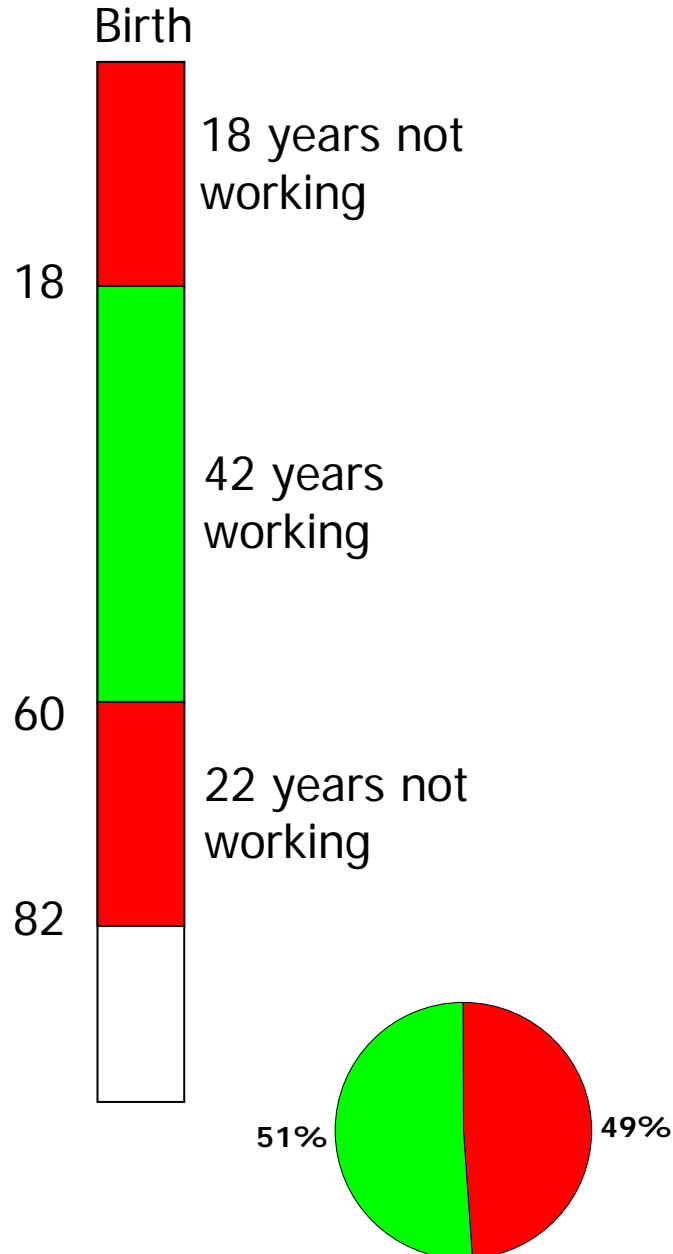
Future?



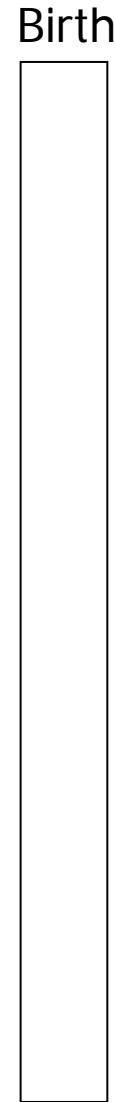
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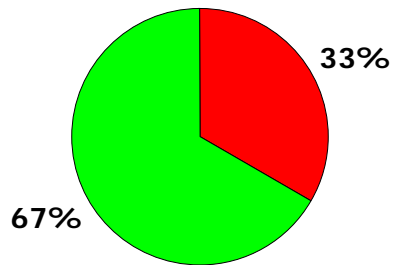
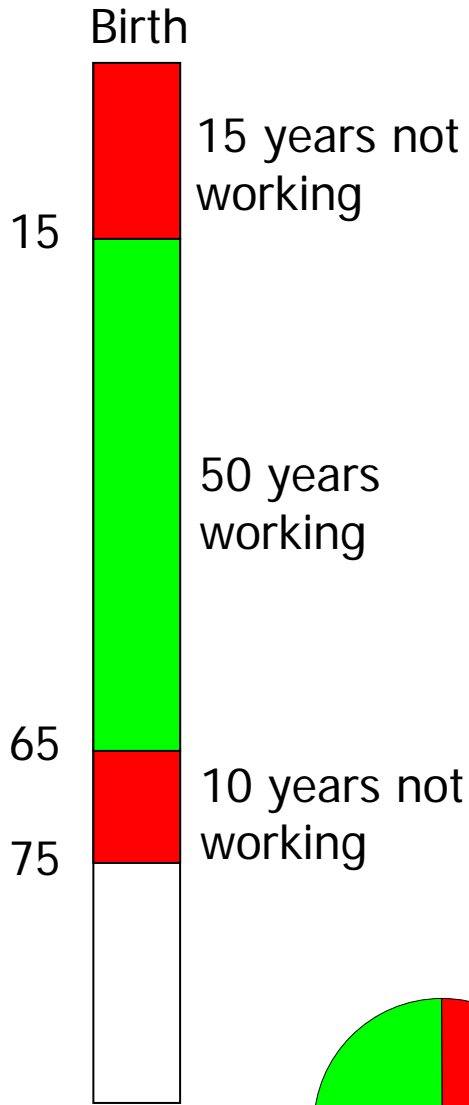
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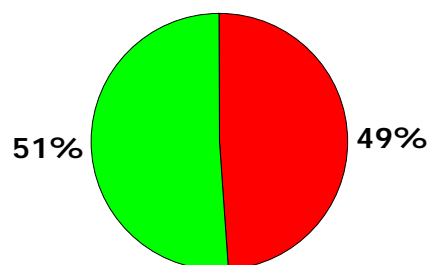
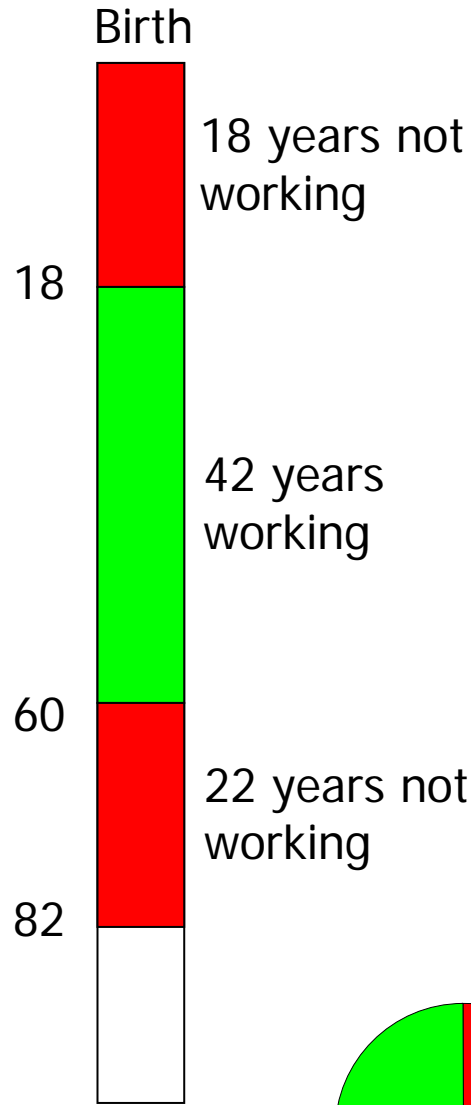
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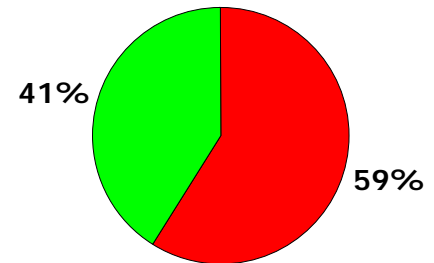
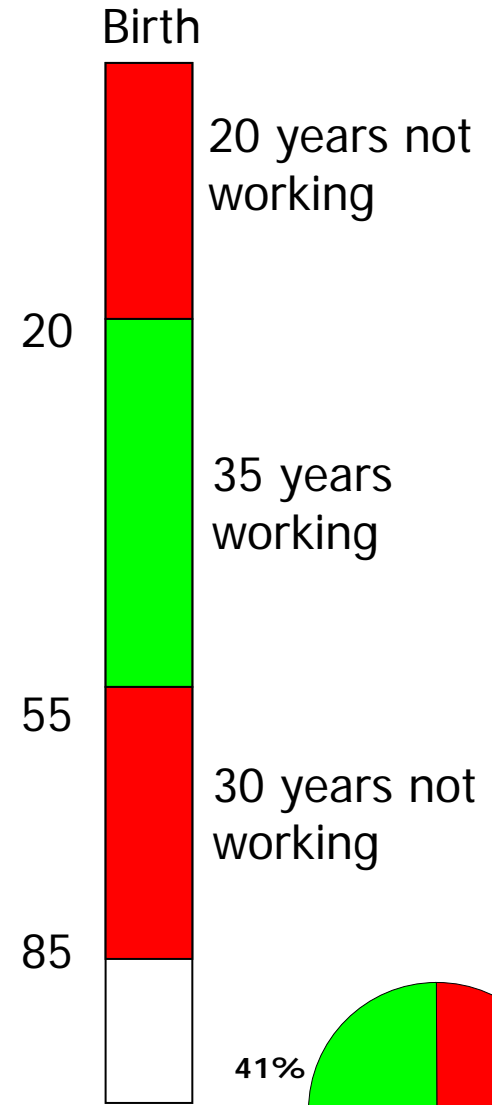
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Now



Future?

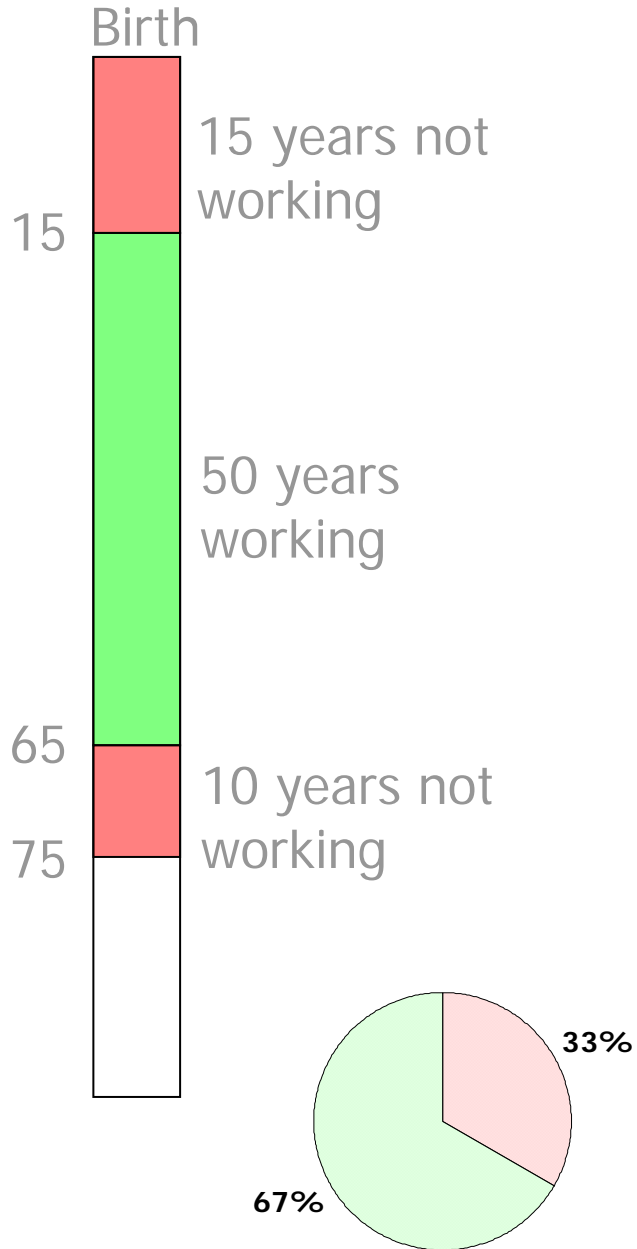




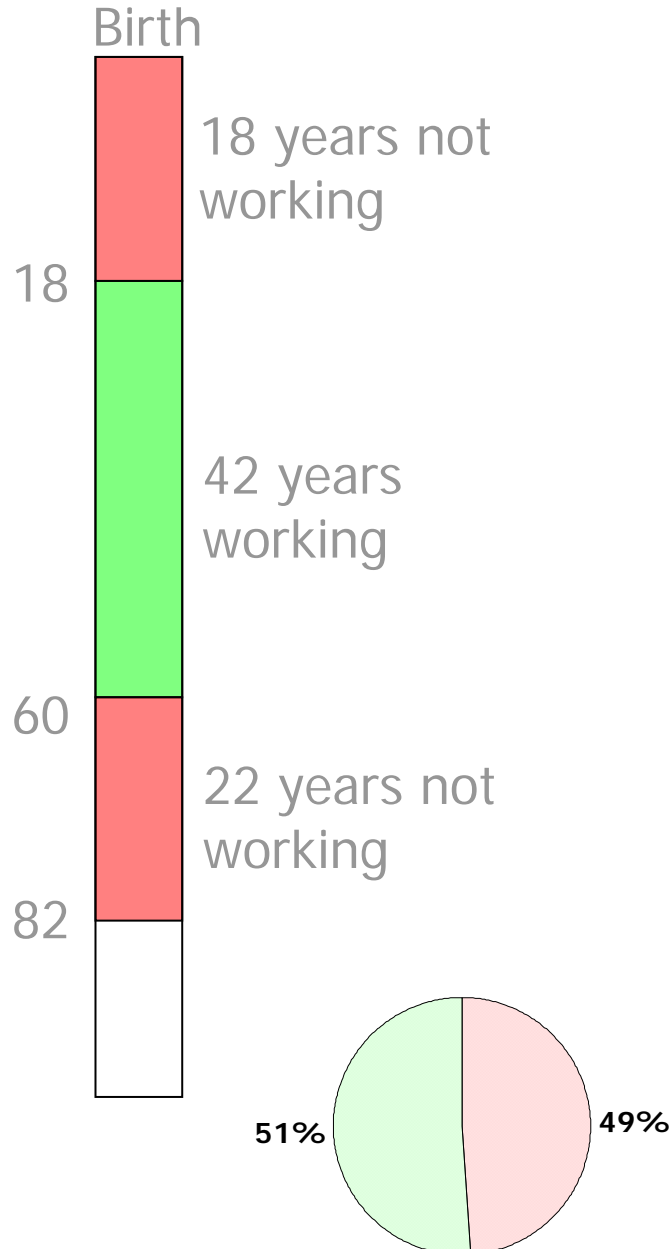
Towards a Solution

- Abandon the current concept of retirement
- Why should people expect to stop working altogether at any particular age?
- Society can't afford 30 year pensions - waste of resources
- Flexibility and choice in working life needed
- We've achieved this for working mothers, so why not for those in later life?

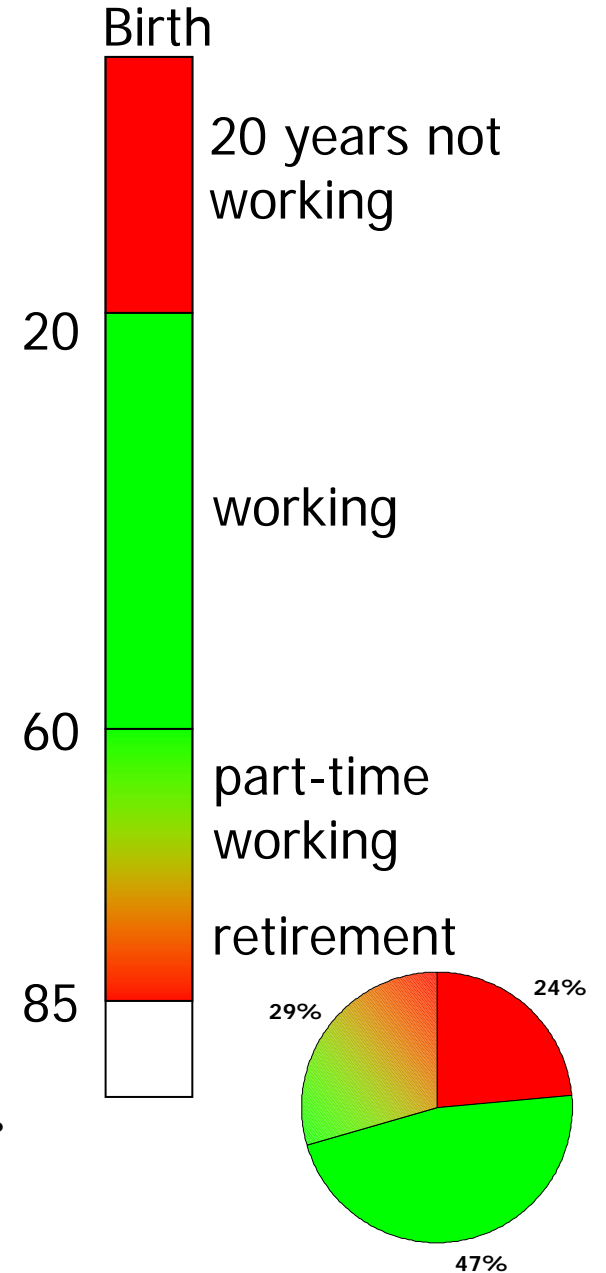
1950's



Now



Flexible Working





Retirement Reforms

- Change social attitudes for younger generations
- This is a positive message
- Retirement to be a 'journey' not a 'destination'
- Whole new phase of life we never had before
 - No fixed age to stop work completely, gradually cut down
 - Work sharing, mentoring, retraining, second careers
- Better for the individual, for society and for economy



Then Radical Pension Reforms

- Urgent need to reform State pensions
 - End contracting out
 - Remove disincentives of means testing
 - Clarify state benefits at above poverty line level from 75
- Clearer State system to allow individuals to build on top
- Individuals choose how to structure their lives and their incomes



Future Non-State Pensions

- Defined contribution most likely provision for future
- 3 crucial areas in DC - all 3 have problems:
 1. contributions falling
 - Need fairer and better incentives (demand side)
 2. investment returns (net of fees) disappointing
 - DC investment options must be designed better
 - 1% world won't work – need economies of scale, not one by one
 3. annuities misunderstood and unpopular
 - Advice? Money-back guarantees? Government to write annuities?
- Ultimately, public sector pensions could move to DC
 - Taxpayers cannot afford open-ended, unfunded, generous defined benefit pensions



Vital Pension Questions

- Why should state provide earnings-related pensions?
- If State ensures the elderly have above poverty line income, why worry about private pensions?
- Do we need to spend £14 billion a year on tax relief for pensions?
- Can private sector in UK rise to the challenge of providing attractive savings vehicles for mass-market?



New Products

- Better investment options for DC pensions
 - Structured, guaranteed, age related, other assets etc.
- Lifetime savings accounts, to manage savings through the life-cycle
- Government to write annuities
 - Could issue Government debt at gilts minus $\frac{1}{2}$ %?!
 - More natural place for longevity and inflation risk
- Inflation or longevity related bonds required



Summary

- A solution for pensions requires re-thinking retirement
 - Most people can't save enough during 30 years of work to support a decent lifestyle for 30+ years' retirement
- State pensions must be reformed
 - End contracting out
 - Move away from means testing - Pay state pension above poverty line (e.g. for all over 75's)
- Advice essential, must achieve cost effective delivery
- New pension planning and investment approaches
 - New pension product design (e.g. guaranteed products) and DC vehicles needed