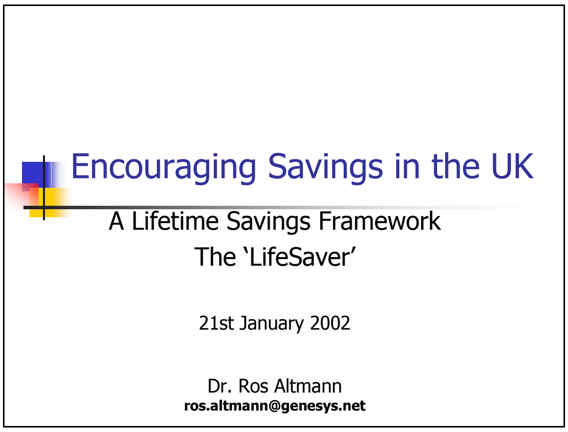
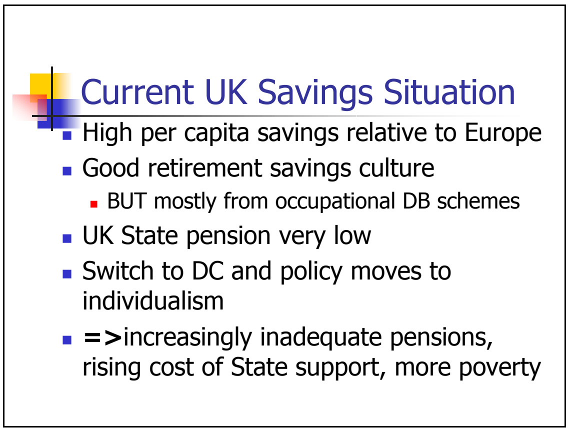
**TRANSCRIPT OF SPEECH GIVEN BY DR. ROS ALTMANN ON 21ST JAN 2002 AT INSTITUTE OF ACTUARIES CONFERENCE 'THE AGEING POPULATION'**




So what is the savings situation in the UK today? We have a higher level of savings per individual than the most of the rest of Europe (though lower than in the US), but much more of our savings are in the form of pensions and other life products. This may be because of the low level of the UK state pension.

We have a strong culture of providing for our retirement. In 1999, of the £4.6 trillion under management, around five-sixths was by people <u>in</u> or for their retirement. Much of these pension savings are in DB occupational pension schemes, but the switch to DC, lower contributions and policy moves away from collectivism towards individualism imply a big risk that savings will fall in the future. There are already many people who don't save much, if at all and, if savings levels fall further, this will mean much higher costs of State support, much lower pensions and the risk of more poverty, unless something is done. We are at a possible crisis point in the UK and we need to ensure that there is an increase in savings. We cannot rely on the comfortable position built up in DB schemes in the past. DB is unlikely to last and people need to be encouraged to save more.

## Current Problems

- Risks/difficulties of saving are greater than the risks/difficulties of NOT saving
- Very low savings among low income groups
- Poverty does not explain low saving levels
  - lack of access
  - complexity of products
  - lack of sufficient incentive
  - lack of information/education

Given the many benefits – both to the individual and to society as a whole that savings can bring – there must be powerful reasons why people don't save enough. People feel that the risks and difficulties of saving outweigh the risks and difficulties of not saving – this is the wrong way round. People don't seem to understand how or why they should save and this is particularly the case for the poor. Nearly half of low income groups and 70% of lone parents have NO savings at all. Studies show that poverty itself does not explain these low saving levels, it's more to do with the difficulties of the current system, inadequacies of government incentives and lack of financial education in society as a whole.

## Problems of Current UK Saving System, Why Don't People Save Enough?

**General Barriers:**

- Psychological inhibitors
  - apathy/inertia/boredom
- Complexity of system
- Lack of education
- Lack of understanding
- Lack of confidence
  - scandals
- Not willing to pay for advice

**Barriers for Poor:**

- Savings trap in means testing
- Pension credit
  - tax 40%+
- Perception of security from benefits system/ Social Fund
- 'Social exclusion' in advice
- Tax relief discriminates against poor

There are many reasons why people don't save. For the general population, factors such as finding savings boring and difficult, not being able to understand financial matters, not trusting financial institutions and not wanting to pay for advice, all prevent some people from saving. For the lower income groups there are even more problems. The social security benefits system mitigates against saving – means tested benefits penalise savings and tax relief gives more incentives to the rich, who would be most likely to save anyway.

## Aims of Government Savings Policy

- Spread benefits of savings/assets **<u>to all</u>**
- Increase saving/assets for poor
- Young to enter adulthood with assets
- Encourage higher and more regular savings
- Improve financial education
- 60/40 to 40/60 for pensions

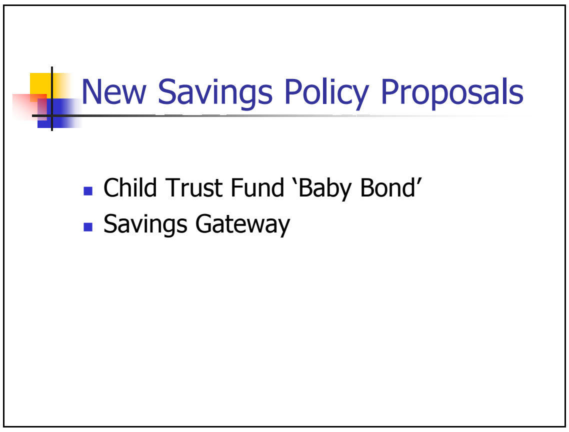
But the Government really wants and needs to help more people to save, especially those who aren't currently doing so. The Government wants to encourage saving and asset building by **<u>all</u>** members of society, not just the older ones and especially the poor. It recognises that people will benefit if they enter adulthood with some financial assets and have developed a savings habit. The act of saving and accumulating assets has behavioural benefits for the individual (such as self reliance, ability to plan, financing their education etc) and also improves their lifetime chances. In addition, society as a whole benefits from increased savings. Of course, in order to achieve the behavioural benefits, people have to actually save, just giving them cash handouts or loans won't achieve the aim. The Government is also committed to improving financial education. In terms of pensions, it has stated that it wants to move from a position where 60% of retirement income comes from the State to one where the State provides only 40%, with 60% from private savings.

Unfortunately, the current savings incentive and tax/benefits regime is highly unlikely to achieve this, despite numerous policy initiatives being introduced since 1997.

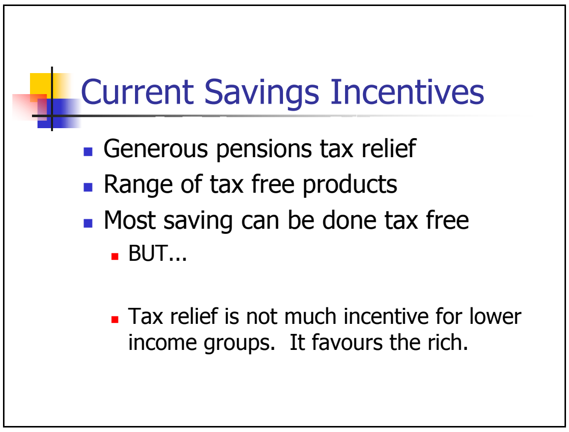
## Savings Initiatives Since 1997

- Policies introduced by this Government:
  - ISA
  - Stakeholder
  - Pension Credit
  - Raise capital limits for pensions
  - PAT14
  - CAT
  - FSA
  - Financial Education in National Curriculum

The Government has introduced several new policies since 1997 to increase private savings, especially by low income groups. .All of the policies shown here have been designed to try to encourage and facilitate more savings, but I'm afraid they may actually have the opposite effect. For example, the Pension Credit is likely to prevent stakeholder pensions being taken up by their target market! The interaction between the benefits system and savings incentives is a big problem here.

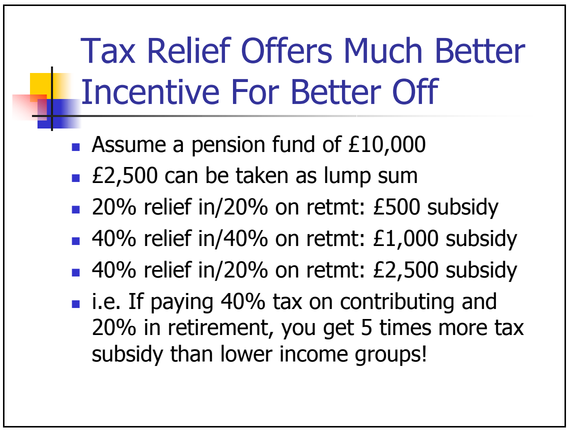



But there are two new proposals which have the potential, if structured correctly, to really make a meaningful difference to the savings environment in future generations. In particular, the Child Trust Fund (or Baby bond as it's sometimes called) could be a brilliant way to kick start the savings habit for children and it could be built on to encourage them to keep saving throughout their lifetime. It would need to incorporate good financial education and would need to be introduced with a different government savings incentive system than the one we have right now.

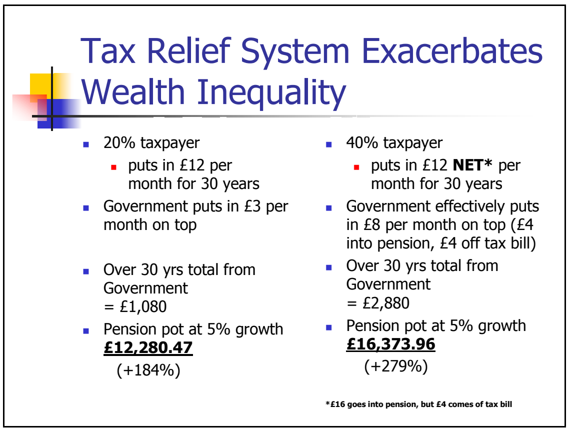



At the moment, the system of incentives to save revolves around tax relief. There is very generous tax relief for pensions (perhaps too generous) and there is a large range of tax free or tax favoured products. In fact, most people could do all their savings tax free – but many don't seem to realise this. And, tax relief is not actually much of an incentive, if any, for lower income groups. It very much favours the rich.

Let me just illustrate this with a couple of examples from the pensions arena.




The tax free lump sum in the pension is a very valuable benefit to a higher rate tax payer. For someone on 40% tax both when contributing and in retirement, the value of the effective subsidy offered by the lump sum is twice as large as the subsidy for someone who is a lower rate tax payer when contributing and in retirement. For example with a £10,000 pension pot, the subsidy for a lower rate tax payer amounts to around £500, compared with £1,000 for the higher rate payer. But, the biggest benefits go to the person who was a higher rate taxpayer when contributing and is a lower rate taxpayer in retirement. They receive 5 times the amount that the lower income group gets.




This also applies to the tax relief on pension contributions themselves. Over recent years, the inequality of wealth in the UK has increased. This slide shows that the effect of higher rate tax relief, versus standard rate tax will exacerbate wealth inequalities. The effect of compounding over time of the extra amounts put into the pension from government tax relief mean that, for the same <u>effective</u> cost, and same investment growth, the rich would end up with much bigger pension pots than the poor.

So what can we do about this?

## New Saving Incentives System

- Tax relief unfair - gives higher incentive to the better off
- This is the wrong way round!
- Replace tax relief with 'government saving incentive'
- Everyone to receive same incentive for same savings - monetary limits, standard 'grossing up' (stakeholder sets precedent)

The current system based on tax relief is unfair. It's regressive and gives the biggest encouragement to the rich, who would probably save anyway. We need to consider replacing tax relief with a new fairer system of 'government saving incentives' which will give the same financial incentive to everyone, for the same amount of savings. Non-taxpayers would also be able to get the same 'grossing up' as the rich. In fact, stakeholder pensions have already set a precedent for this, where non taxpayers still receive basic rate 'tax relief' or grossing up by 22%.

I suggest for pensions, for example, that everyone gets the same grossing up for the same amount of contributions. Perhaps something like the first £1500 per year could receive 50% extra (quite nice because you can tell people that for every £2 they put into their pension, the government will put in £1), then an extra 40% for the next, say. £1500 with a sliding scale downwards for higher amounts. This would need to be carefully costed of course! I think there should be the same incentives for everyone, regardless of their income or their age. At the moment, those who are better off and those who are closer to retirement are allowed to put more into their pension than those who are young or earning less. Is this fair?

This system would immediately offer a much more realistic incentive to lower rate taxpayers to start saving and perhaps to put money into a pension. They could be encouraged to put their money away for a few years and then incentivised further to keep it invested or move it to pensions over time. I'll go through this in more detail soon. This should help encourage more savings by those who don't currently feel it is worthwhile. So what should we do?

## What Do We Need To Do?

- Establish lifetime savings culture
- Encourage more people to WANT to save
- Make saving simpler
- Offer **fairer** and better incentives
- Integrate financial products into coherent system
- Improve financial education
- LifeSaver can address these

In order to get more people saving, for more years, we need to change social attitudes and establish a lifetime savings culture. We need to make savings easier to understand, with fairer incentives and a more integrated coherent system. We also need to improve financial education, so that people can better understand why and how they should save.

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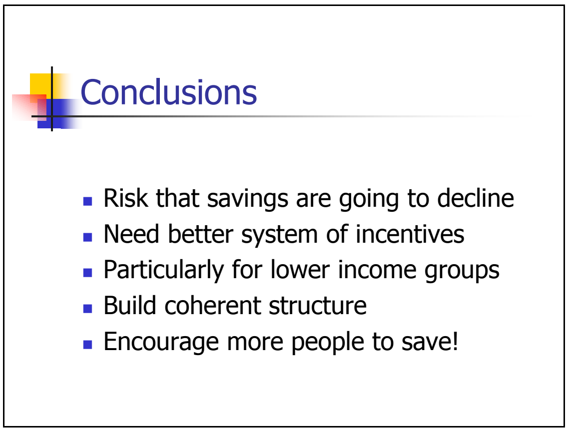
*(Note for Carey: Just a few extra bits of the talk, which I thought might be of interest for you).*
The current government proposal for the Baby bond is that, at age 18, the child will be free to spent the funds as they wish. I believe this would be a dreadful waste!

It is vital that extra government incentives are given (or even an extra small payment) to keep the account open, with the child 'graduating' on to the adult part. It's very important that everyone should always have a vehicle in which they can save.

Studies show that, even if people have money they want to save, they often can't be bothered to go and open an account, so they just spend it. But, if every young adult already has an account they are familiar with, which they have followed for many years, they will know what to do. For example, when they earn their first pay cheques, these can be paid into the cash section of the Life Saver and then some could be put into a longer term holding. If the account is just closed at age 18, some of the major benefits of the Baby bond policy for developing lifetime savings habits would be lost.




So, I've tried today to talk you through what I see as the current savings situation in the UK.

To highlight the serious risks that overall levels of pensions and savings will fall in coming years, if government policy isn't changed, and to outline a new fairer system of government incentives to encourage more saving.

I've tried to build this into a coherent framework for managing financial needs throughout a person's lifetime. I've had to cover a lot of ground in a very short time, but I do hope my talk will generate some good discussion of how we can give fairer savings incentives and encourage more people to save.

THANK YOU FOR LISTENING