

# **Is Pension Reform Working?**

## **Raising pension coverage and adequacy**

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# Great news...but now crisis

- Longer, healthier lives-people not old in their 60s
- BUT – pensions crisis
- Less than half workforce has pensions
- Most traditional DB schemes now closed
- Pension incomes for new retirees falling

# Pensions policy isn't working

- Retirement income can come from
  - State
  - Employers
  - Individuals
- State forced burdens on employers, cut state pension
  - Leavers, spouse, inflation – too costly, employers cut back
- State pension too low
  - Mass means-testing undermines private pensions
- Individual responsibility, but they're not prepared

# What are 'pensions'?

- Pensions are two different things with same name
  - Social welfare
  - Long-term savings
- Traditional employer DB schemes covered both
- DB -> DC shift means social welfare falls on state now
- But state pension means-testing undermines saving
- DC investment, inflation, longevity risk fall on individual
- What is Government doing?

# State pension reform

- Increase state pension age (and end DRA)
- Single-tier, simpler state pension - £144pw
- Clear message – state will provide basic minimum
- Rest is up to you
- End mass means-testing
- Necessary condition for improving private pensions

# Private pension reform

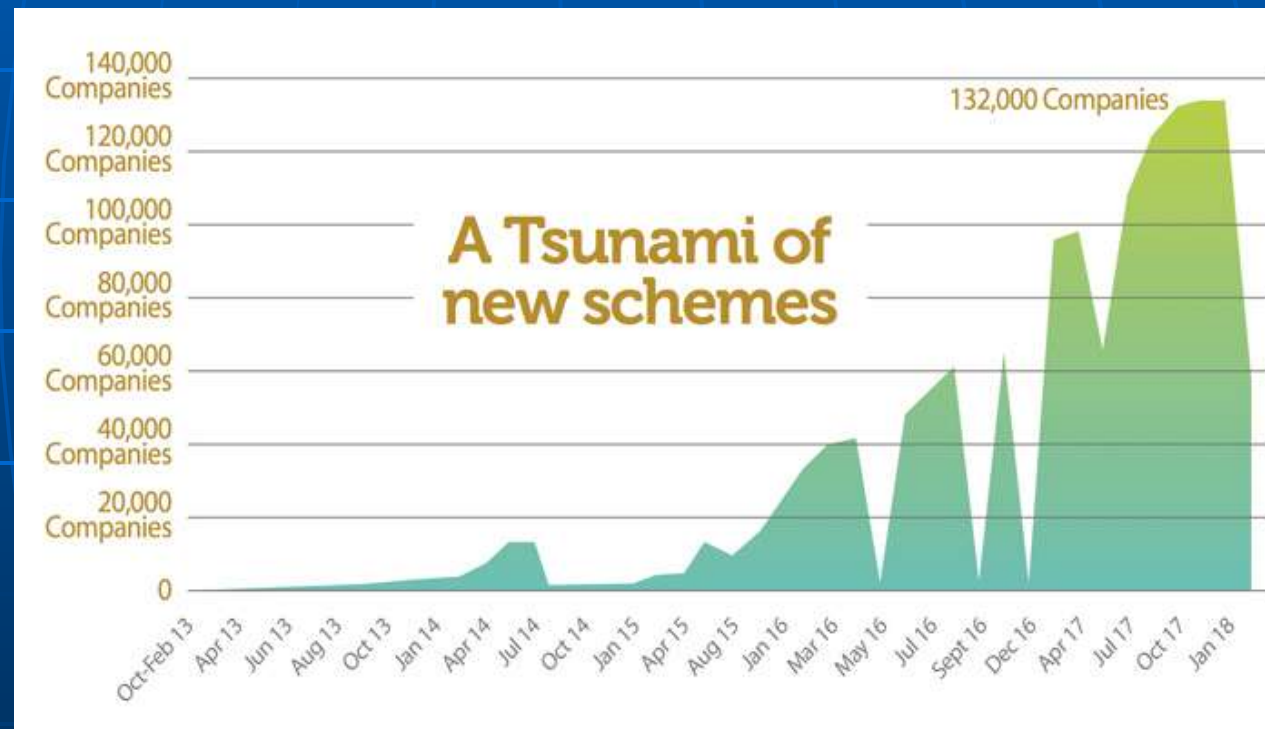
- Auto-enrolment
- All workers to be put into a workplace scheme
- All employers must contribute
- Controls on charges
- Will increase coverage, at least initially
- Will it improve retirement income?

# Effect of auto-enrolment

- Won't ensure adequacy
- Contributions too low to ensure good at retirement income
- Levelling down of contributions
- Will hit small firms hard – lower wages, fewer jobs?
- Costs of administration and complexity
- Employers need advice – capacity?

# Watch for auto-enrolment bottlenecks

- Will there be more delays for small firms?

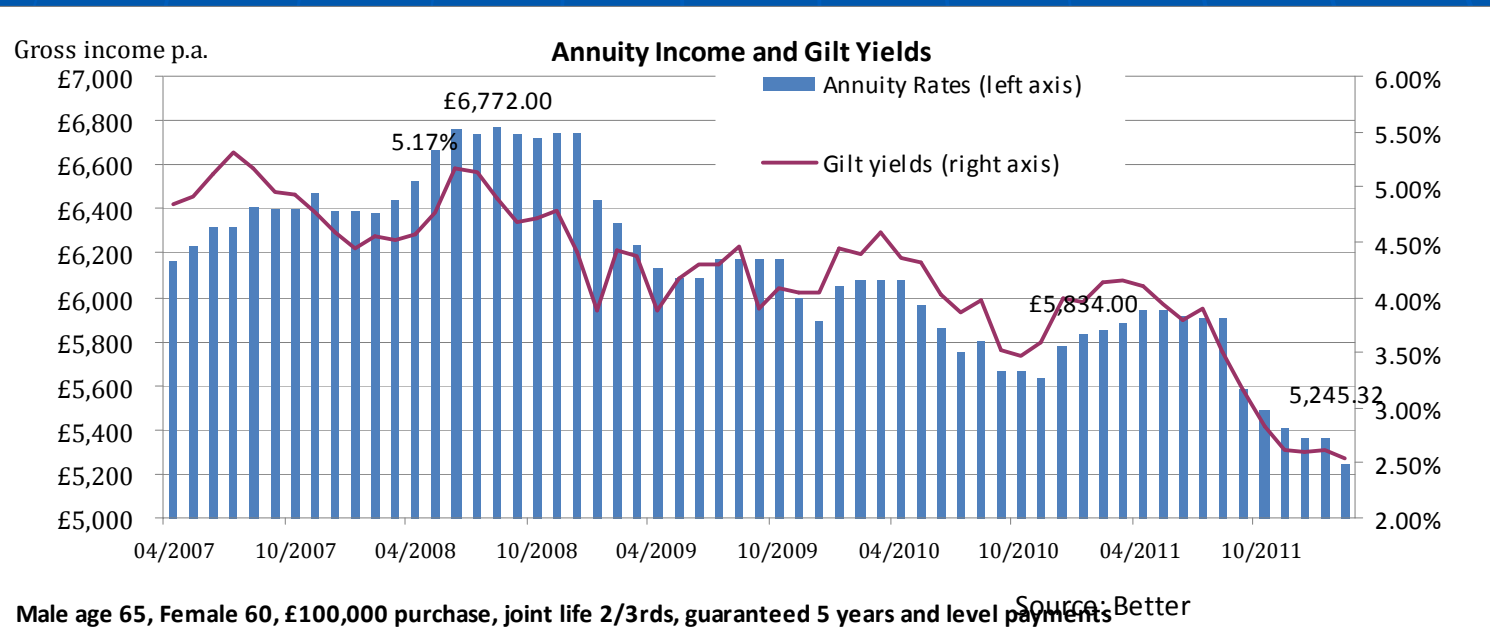




# Pensions hit by economic crisis

- QE disaster for both DB and DC pensions
- £375bn gilt buying increases DB deficits
- DC income hit as annuity rates/drawdown income fall
- Economic policy damaging pensions in aging population
- Bank of England in denial about dangers

# QE has damaged annuity rates



# Pensions don't grow on magic trees

- Just putting some money in doesn't mean good income
- Lack of understanding about pension costs and risk
- Unrealistic expectations
- Keep planning flexible – ongoing review
- Other policy ideas being considered
  - Consultancy charge and caps, pot-follows-member, Defined Ambition, behavioural economics?

# Consultancy charging

- What a mess
- Of course employers need advice
- But CC should never have been approved in first place
- Workers don't pay for accountancy or legal bills
- A/e so complex that admin cost more than contributions
- Must warn employers of time and costs – more delay?

# Pot follows member – “Big Fat Pot”

- Build up one large pot, but no aggregator
- Will ban short-service refunds from 2014
- DWP doesn't like 'active member discounts'
- Job-changers move pension <£10,000 to new employer
- Not clear how it will work
  - Maybe central IT records, or member gives the info
- Will have to remove NEST restrictions

# Defined Ambition

- Government wants more employer involvement again
- DWP trying to reduce risk for individuals
- DC plus, rather than DB minus?
- Cash balance - target a lump sum rather than income?
- Employers already grappling with auto-enrolment duties
- Hard to see much headway

# Behavioural economics

- My favourite!
- Number 10 very keen – behavioural insights team!
- Auto-enrolment takes advantage of inertia
- Should consider SMaRT – Save More Tomorrow
- Part of pay rise goes into pension
- Could be better than auto-enrolment

# Further reforms required?

- Do pensions need an image makeover – new name?
  - Inflexible, locked box not so attractive
- Later life income needs more than pensions
- Care costs not catered for at all
- Redesign Lifetime Savings
- Is auto-enrolment for long-term saving or selling pensions?
- Leave employer money/tax relief locked, access to rest



# Annuities no longer good choice

- Risks in retirement that annuity won't help with
  - Dying early
  - Becoming ill
  - Inflation
  - Rates rise
  - Markets rise
  - Paying for care
- At current rates, main risk met by standard annuity is
  - Living longer than expected

# Decumulation complex - needs advice

- Not just about OMO or shopping direct, need advice
  - OMO gets better rate for wrong product and charges for it
- Phased annuities: become ill, partner, markets, rates
- Don't annuitise too young
- Annuitising not right for many 60-65 year-olds
- Annuity rate 5%: don't get money back if die before 84
  - 5 year guarantee – insurer keeps 75% of fund
- Could leave small pots to pass tax free if die before 75

# Pensions won't solve the crisis

- Advice required to make proper later life income plans
- Consider human capital as well as financial capital
- Must also rethink retirement
- Social revolution with a whole new phase of life
- Cut down gradually, work part-time, more money
  - 'Bonus Years'

# Conclusions

- More to be done to ensure adequacy of retirement income
- Save for pensions – also for care?
- Rethink retirement – bonus years
- Policy reforms increase pension coverage but not adequacy
- Flexibility, more savings, reassess regularly with adviser
- Great new opportunities