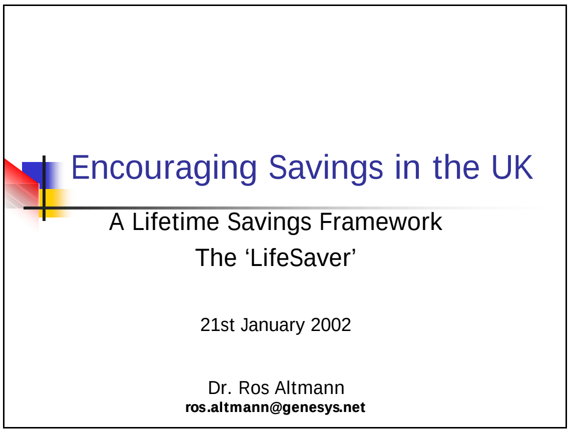
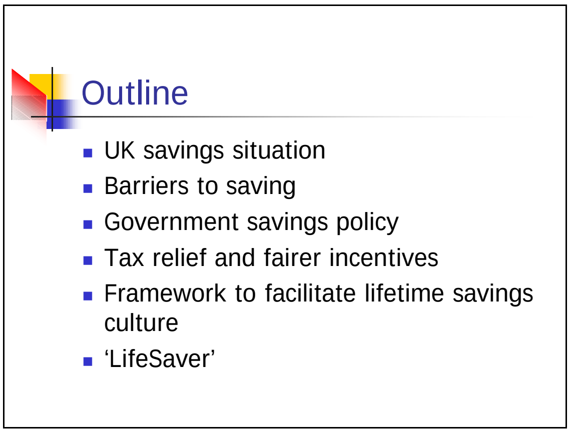
TRANSCRIPT OF SPEECH GIVEN BY DR. ROS ALTMANN ON 21ST JAN 2002 AT INSTITUTE OF ACTUARIES CONFERENCE 'THE AGEING POPULATION'





Good morning everyone and thanks for coming to listen. I'll be sharing with you today some thoughts on the savings situation in the UK, and how we might encourage more people to save. Not enough people are providing for their own futures and I will outline some of the disincentives and barriers to saving. After this, I'll take a brief look at Government policies which are trying to encourage more people to save and build up assets and consider the current system of tax relief.

I'd like to propose a new fairer system of savings incentives. I'll then put these into a Lifetime Savings framework, in which I've tried to incorporate the current financial products structure of the UK and develop it to help encourage more savings in the future. I've called this the LifeSaver.

Current UK Savings Situation

- High per capita savings relative to Europe
- Good retirement savings culture
  - BUT mostly from occupational DB schemes
- UK State pension very low
- Switch to DC and policy moves to individualism
- =>increasingly inadequate pensions, rising cost of State support, more poverty

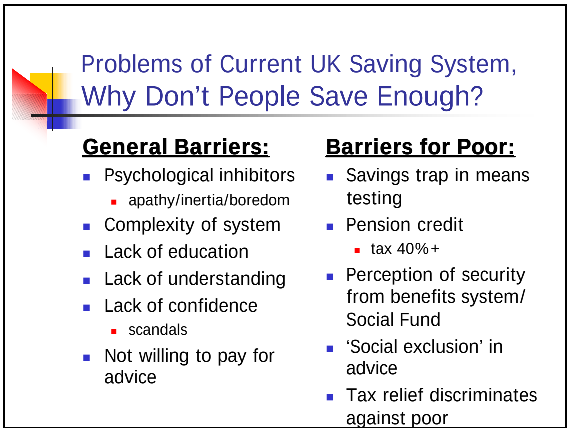
So what is the savings situation in the UK today? We have a higher level of savings per individual than the most of the rest of Europe (though lower than in the US), but much more of our savings are in the form of pensions and other life products. This may be because of the low level of the UK state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

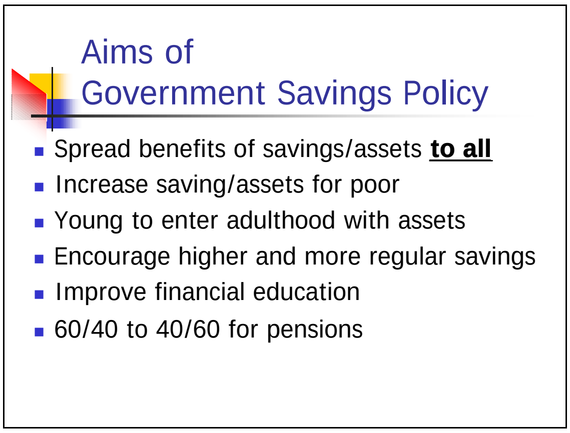
Current Problems

- 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.

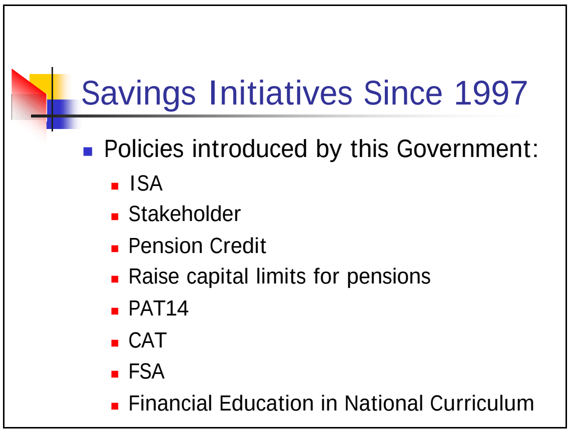


There are many reasons why people don't save. For the general population, factors such as finding savings boring and difficult, not being able to understand financial matters, not trusting financial institutions and not wanting to pay for advice, all prevent some people from saving. For the lower income 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.

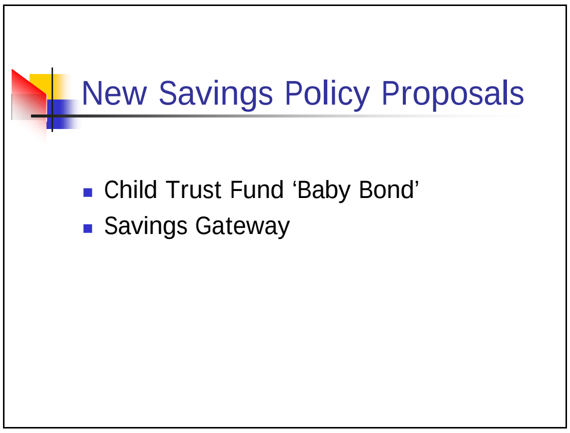


But the Government really wants and needs to help more people to save, especially those who aren't currently doing so. The Government wants to encourage saving and asset building by **all** members of society, not just the older ones and especially the poor. It recognises that people will benefit if 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.

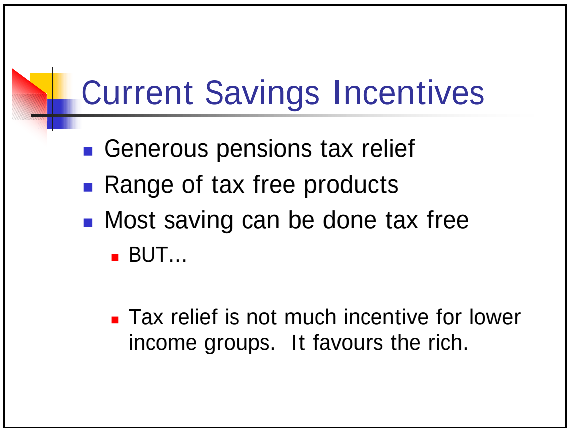
Unfortunately, the current savings incentive and tax/benefits regime is highly unlikely to achieve this, despite numerous policy initiatives being introduced since 1997.



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.

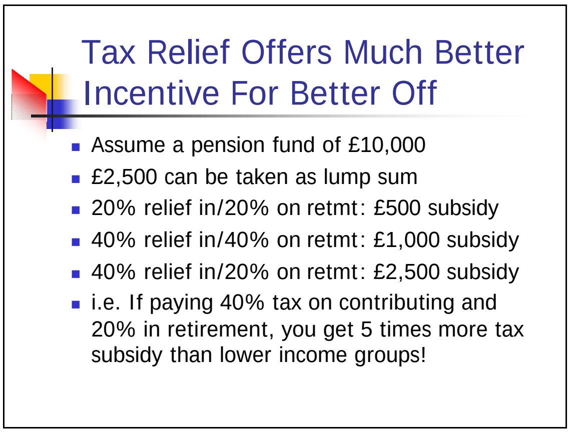


But there are two new proposals which have the potential, if structured correctly, to really make a meaningful difference to the savings environment in future generations. In particular, the Child Trust Fund (or Baby bond as it's sometimes called) could be a brilliant way to kick start the savings habit 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.

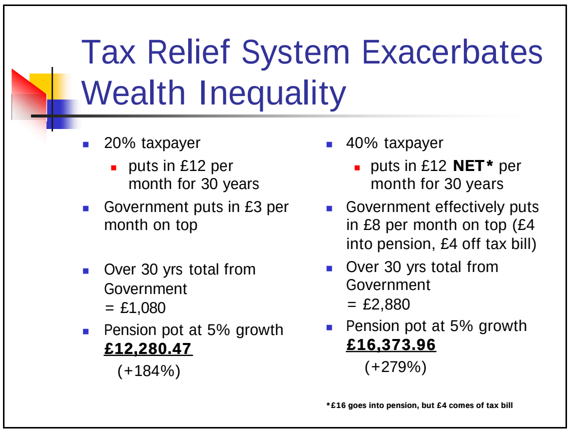


At the moment, the system of incentives to save revolves around tax relief. There is very generous tax relief for pensions (perhaps too generous) and there is a large range of tax free or tax favoured products. In fact, most people could do all their savings tax free – but many don't seem to realise 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.

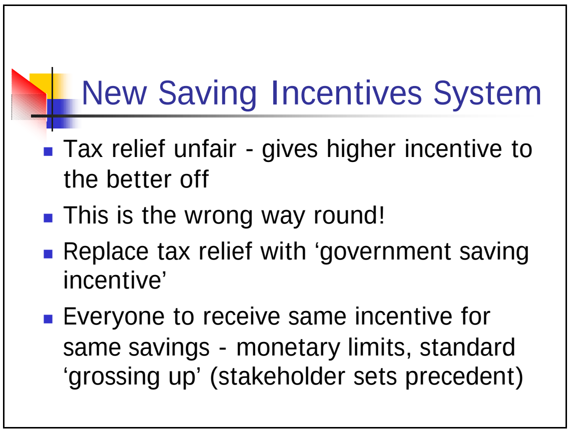


The tax free lump sum in the pension is a very valuable benefit to a higher rate tax payer. For someone on 40% tax both when contributing and in retirement, the value of the effective subsidy offered by the lump sum is twice as large as the subsidy for someone who is a lower rate tax payer when contributing 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 effective 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?



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!

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

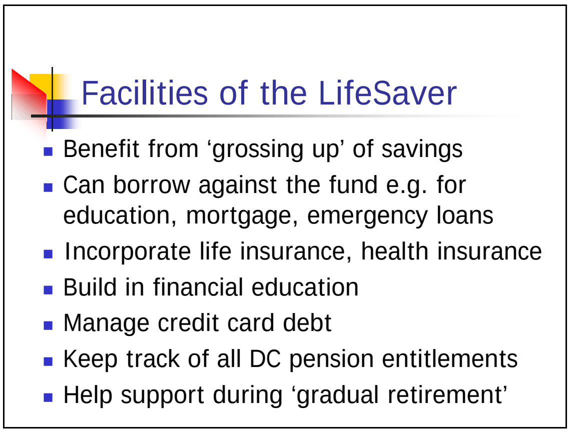
In order to get more people saving, for more years, we need to change social attitudes and establish a lifetime savings culture. We need to make savings easier to understand, with fairer incentives and a more integrated coherent system. We also need to improve financial education, so that people can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

The Lifetime Savings Framework can address all these issues.

So, What is the Lifetime Savings Framework?

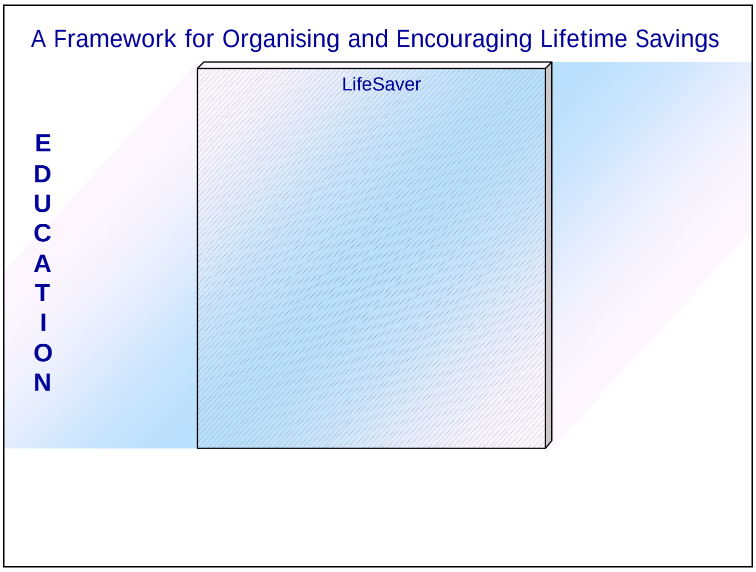
- Framework includes government incentives to encourage savings through lifetime
- Coherent framework for all tax favoured vehicles/other investments/borrowing
- 'One stop shop' for lifetime financial needs
- Bank account, progressing to ISA to new Fixed term ISA to 'locked' pension section
- Fully transferable/hold any products

What we need is not just new products, or just better incentives, but a new structure, which can help to integrate all the current savings and investment products – both tax favoured and other – into a coherent framework. It could provide a 'one stop shop' to cater for all a person's financial needs, throughout their lifetime. Progressing from birth to death and from short term cash accounts to 'locked' pension investments. People could only hold one of these accounts (as it would encompass all the government's financial savings incentives), but they could transfer their account from one provider to another. The account would be able to hold products from many providers and would probably be subject to CAT standards for charges. I've suggested calling it the LifeSaver.

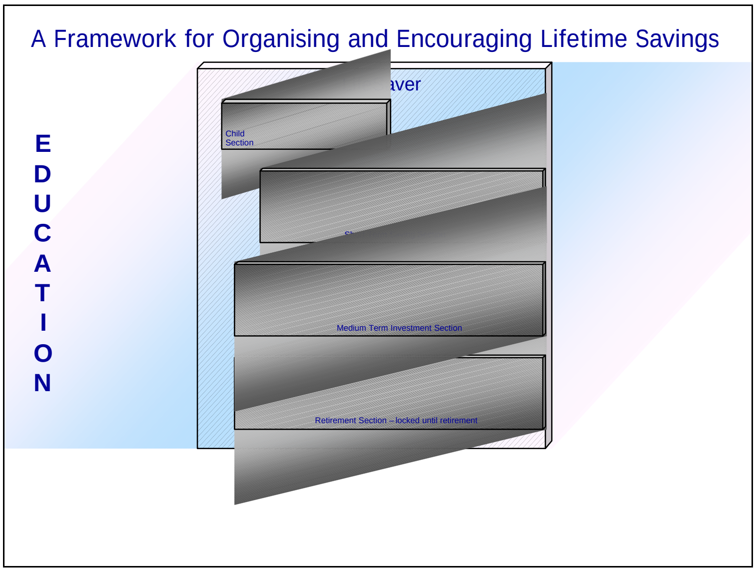


The LifeSaver would be used to keep all a persons financial needs in one wrapper, including the government savings incentives, loans could be taken out against the fund for education, housing and for emergencies. Insurance can be offered with the account (life cover, health and other types) and credit card debt could be managed from it. All DC pension entitlements could be kept in one place and the fund would be useful to help support people if we move to a system of more gradual retirement. One of the easiest ways to solve the problems of supporting an ageing society is to encourage people to work and keep earning for longer. Retirement and pension policy is light years behind the changes in demography and health status. Retirement should be thought of as a process, rather than an event and there should be opportunities to gradually cut down, rather than suddenly stop working. Then people could take a partial pension and keep earning to better support themselves in later life.

So what might this 'LifeSaver' look like?



I've tried to imagine starting with a blank sheet of paper and thinking how might we organise savings through a persons life?



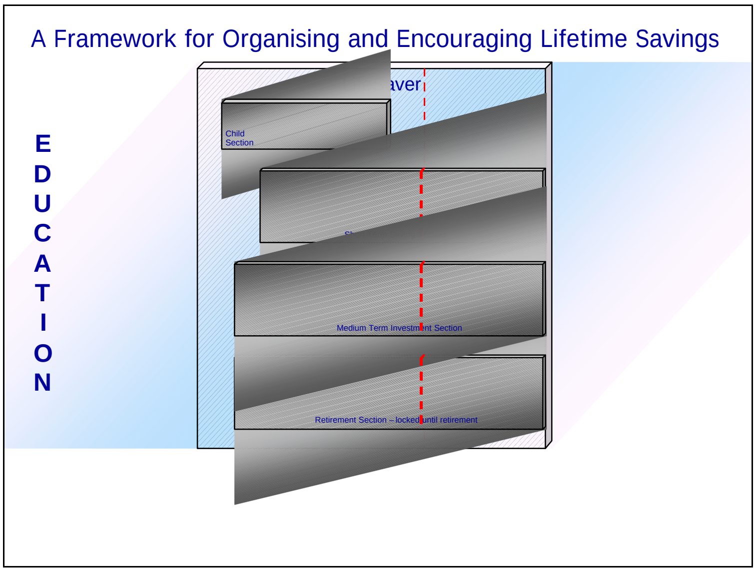
I thought it would be great if we could just start from scratch and design a system where we have a section for Children, who then graduate on to the adult part. This would need a short term cash account section, medium term investments and a 'locked' retirement section, with incentives to move on from one part to the next.

Education would be a fundamental part of this account It could incorporate financial education, helplines, on-line tutorials and so on, to try to ensure that everyone knows what they should be doing with their finances through their lifetime.

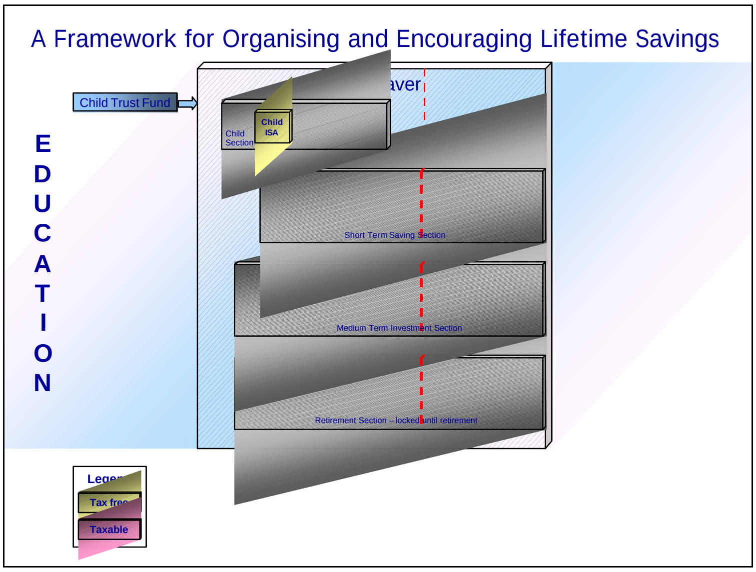
Of course, people would need to receive some incentives from the government to encourage them to save. Some people would only be able to afford to save up to the government limits and others would probably have much more than this.

I had started with this blank sheet of paper, but then I wanted to try and fit our present system into this scheme and see how what we have today could be used. I started to think about all the products we have now and realised that we do already have the Childrens section, and short term, medium term and long term products sections. It's just that people don't tend to have portrayed it in this way. In addition, we have many products which can be used to save tax free, but people are just not aware of them all, or how they fit together. I'm suggesting putting all these products into a new framework which, firstly tries to draw together what is available today and, secondly, tries to incorporate new government financial incentives to save, into a system which encourages and helps people to save throughout their lifetime.

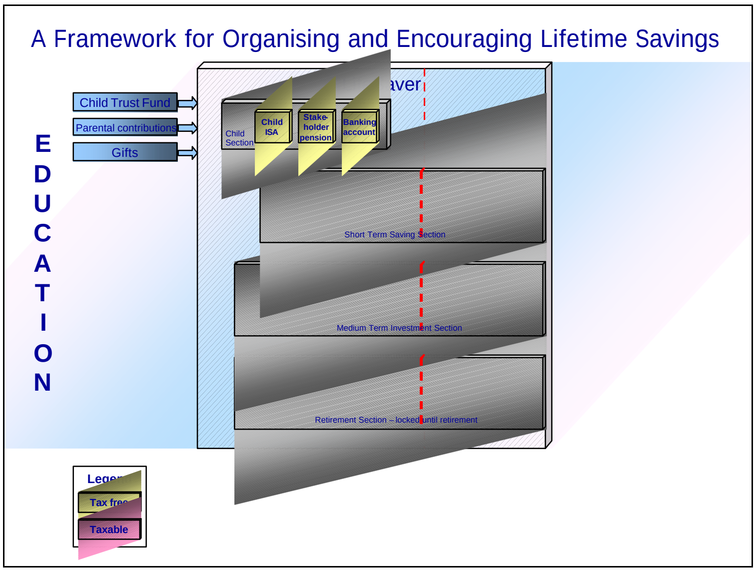
It recognises that there will be times when people need to borrow, rather than save, but this can be incorporated into the framework too. Let me show you what I've come up with.



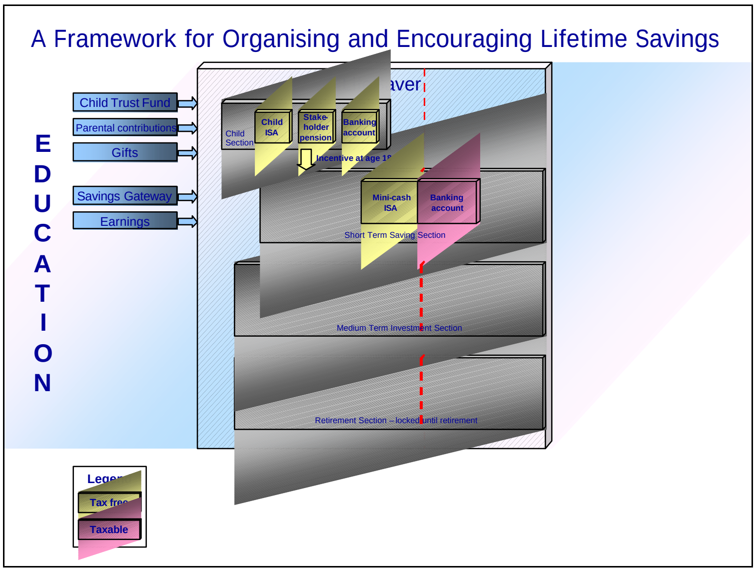
Everything that enables people to save tax free at the moment can be fitted in to the left of this red dotted line and the products will be shown in yellow. As you will see, there are many products which can fit into this section, and I hope that by putting them all together in this coherent framework, people will be better able to realise the tax free opportunities that are available to them and how to make the most of them.



Obviously, the younger you start saving the better. That's why the idea of the Baby bond could be so powerful here. Starting at birth, the Child Trust Fund could be paid into a Childrens Section of the Life Saver. I suggest this should be called a Child ISA, in order to integrate this better with existing policies. We could build all the products for incentivising savings around the ISA name. Why introduce yet another three letter acronym and product name, people are confused enough as it is. This Child ISA would be paid to every baby in the country and could therefore be used to seed a 'LifeSaver' for every child.



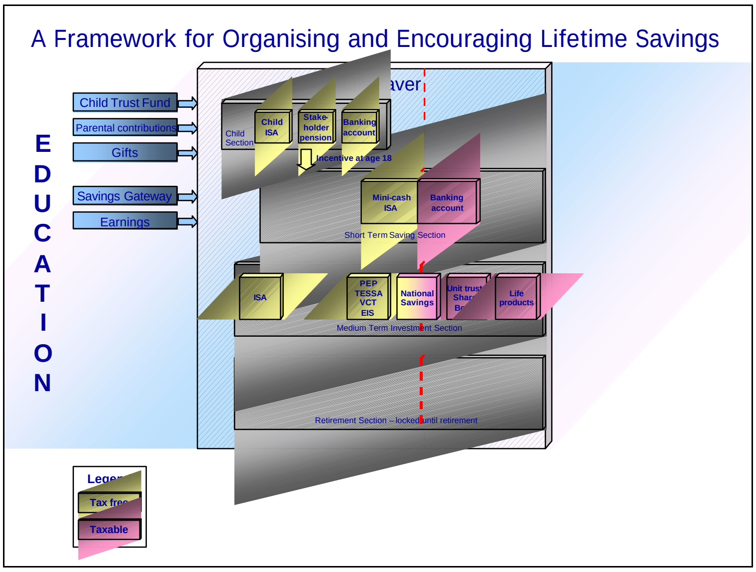
Apart from this Child ISA, parents can contribute more or other relatives can provide gifts to bring the Baby bond Fund up to its maximum limit and, even now, children can own stakeholder pensions. If they earn money or get birthday presents these can be paid into the Child Section of the LifeSaver and will normally grow tax free. 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!



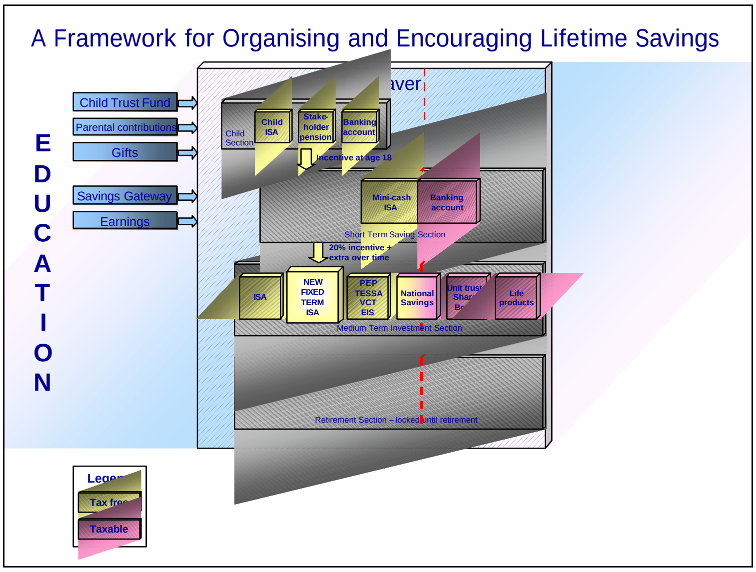
It is vital that extra government incentives are given (or even an extra small payment) to keep the LifeSaver open, with the child 'graduating' on to the adult part. It's very important that everyone should always have a vehicle in which they can save.

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.

The new Savings Gateway proposal for the poorest members of society could easily be incorporated into the cash section of a LifeSaver.

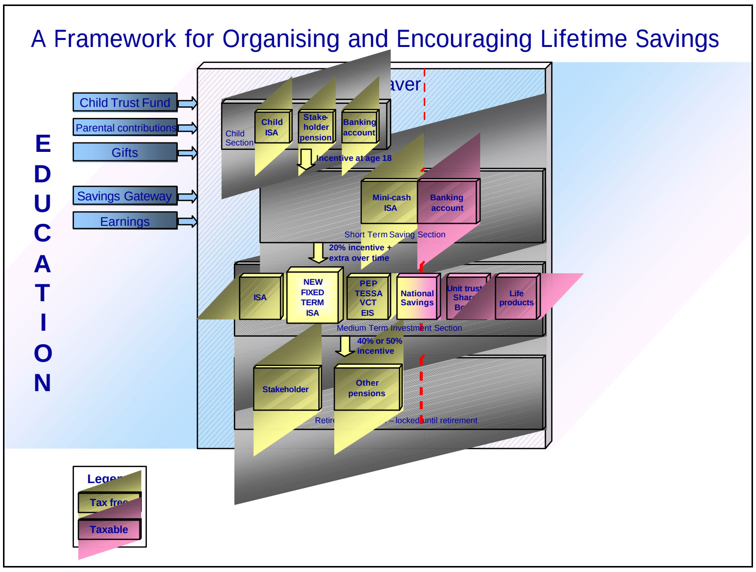


Of course, the largest number of financial products we have today would fall into the medium term investments category. On the tax free or tax favoured side, we have ISA products, which are completely withdrawable and then PEP's, VCT's and also <u>some</u> of the National Savings bonds. Then there are other products with little or no tax advantages – shown in the pink.



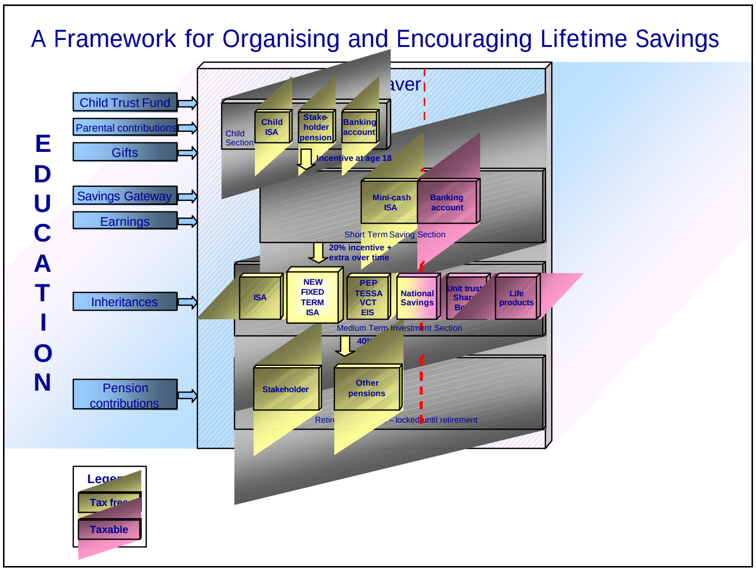
The one vehicle we don't really have is a medium term investment ISA-style offering, which can hold equities and bonds. ISA's are currently withdrawable immediately, but I'd suggest the Government should consider introducing a fixed term ISA, which could form part of the medium term section of the Life Saver. It could have a standard, say, 20% level of financial incentive – or grossing up – which would apply to everyone, regardless of their tax code. The amount that could be put into this each year would be limited by the Government and I'd suggest it would also be helpful to offer extra incentives for people to keep their money in the product for longer, on maturity. For example an extra 5% grossing up every 10 years. This would be designed to help people realise they can manage without the funds in this medium term ISA and can keep saving, rather than spending it. I'd also suggest that it is taxed on withdrawal, to further discourage people from spending the money, unless they really need to.

The idea would be to encourage people to move from the medium term section to the retirement section, which would be locked until later life, but would benefit from higher levels of government financial incentive in exchange for the lock in.

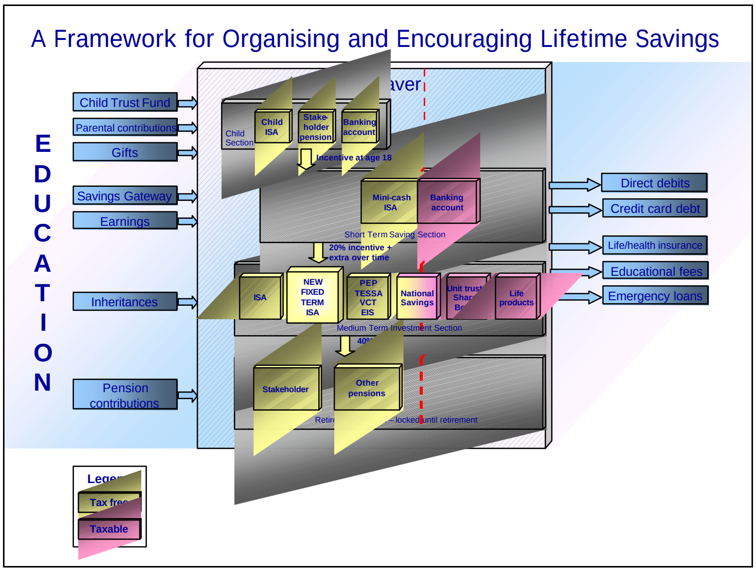


The pension section would perhaps be grossed up by 50% for the first part, then 40%, 30% and so one for extra pension contributions. Products in this retirement section would have the highest government financial incentives to save, but there would be the same incentives for everyone, regardless of their 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?

SLIDE Inheritances and Pension contributions



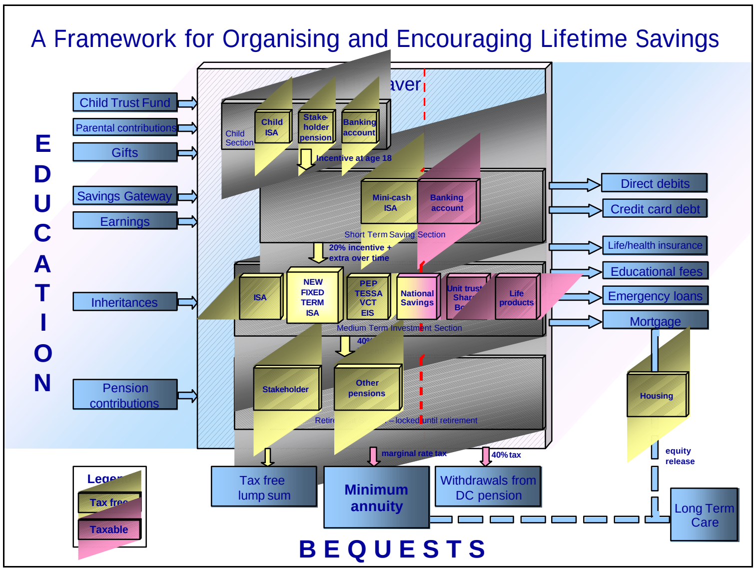
All people's DC pensions would be held in one place, with DC pension entitlements from previous jobs and any stakeholder pensions being put into the retirement section of the LifeSaver. People could then see more easily what pension funds they have, find out what pension this could product and then decide if they need to put in more to achieve their desired standard of living. having all DC entitlements in one place should also be useful for annuitising at the point of full or partial retirement.



The LifeSaver can also be used for direct debits, as a normal bank account and to help people better manage credit card debt – making it easier to pay off balances and help keep interest costs minimised. Life, health and other insurances could be built in and, of course, there would be borrowing facilities, using any assets in the LifeSaver and earnings records as security for loans, for education – even mid career retraining – and emergency loans if needed.

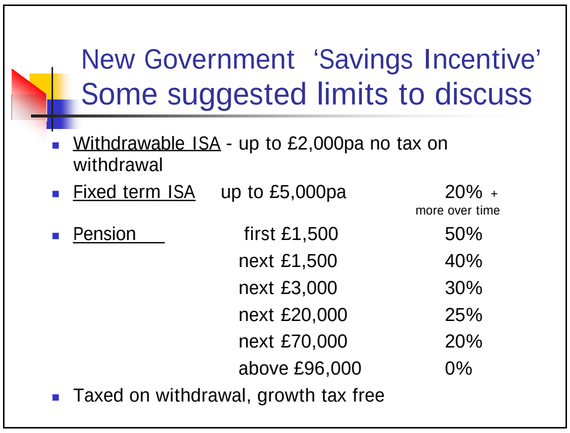
The LifeSaver could also be used for mortgage lending, to finance the other major asset, apart from a pension fund, which people accumulate over their lifetime – that is their house. This is also shown in yellow as it is tax free if owner occupied.

And now to complete the picture for the rest of the life cycle.

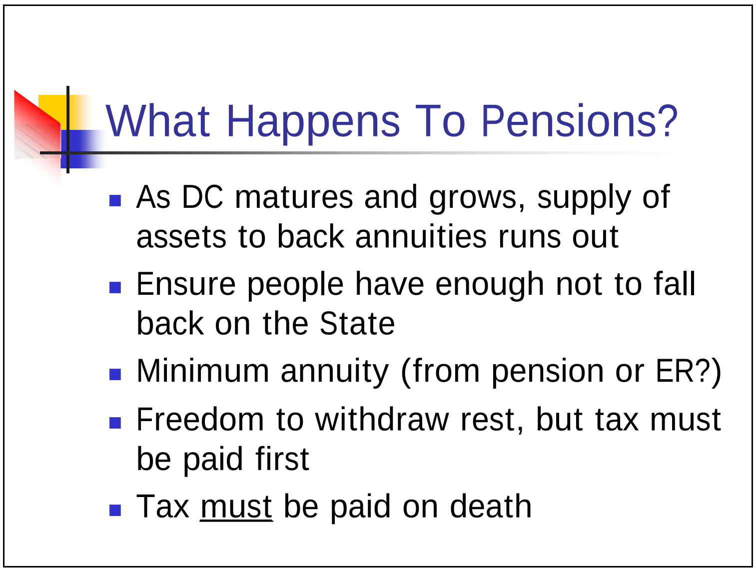


This shows you my suggested ideas for the future of DC pensions. In years to come, it may be that people will be able to choose only to annuitise up to a particular lifetime income level, which would ensure that they need not rely on State support at all. This would entail a concept such as a 'minimum lifetime annuity'. In fact, some would argue that, as long as government savings incentives ensure that everyone has at least this level of income throughout their lives, no further savings incentives are needed. All government incentives could ultimately be targeted to provide a sum that would ensure everyone can look after themselves without State support The rest, subject to being taxed, could be spent or saved as desired.

Actually, it occurs to me that an actuarial conference is an ideal place to ask whether anyone can come up with a set of annual savings amounts which would be sufficient, given appropriate investment assumptions, to ensure that this minimum lifetime annuity could be funded. The annual limits for saving in ISA's and pensions could then perhaps be set with reference to this amount, giving some rationale for the limits chosen. It would be vey interesting to see what figures might be suggested and, any of you who want to try to do this, please let me know your thoughts.



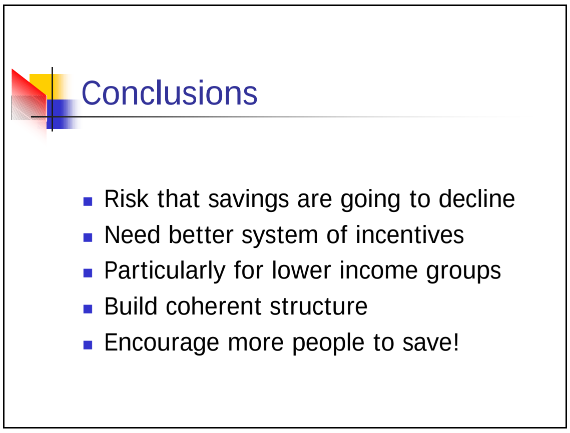
This Slide shows some of my guesstimates for possible monetary limits and the tax treatment for the new system of government incentivised saving products I've mentioned. It's very back of the envelop stuff, but just gives a feel for the type of system I have in mind.



Finally, as we are talking about ageing or supporting the elderly, let me just finish by looking at what the future for pensions might be in this LifeSaver model.

As DC pension provisi9on grows and matures and as the population ages, it's possible that there'll come a point where there won't be enough gilts and bonds to back all the annuities demanded by maturing pensions. It's in this scenario that I could envisage the Minimum Lifetime Annuity being used.

In fact, it may even be that we don't need to force people to actually buy an annuity, just as long as they have enough funds to be able to do so, if they do need to. And we could eve allow this sum to come from equity release, rather than the pension fund. People would then be free to do whatever they want with the rest of the pension monies, but it would need to be taxed on withdrawal and it must be taxed on death, not escape inheritance tax, but be taxed outside the person's estate.



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