The future for UK pensions and savings

TOWRY LAW CORPORATE SALES CONFERENCE

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Topics for Today

- Switch from DB to DC
- Important Aspects of DC
  - **Contributions - incentivising savings**
  - **Investment - trustee responsibility**
  - **Annuities - market reforms**
- Challenges for future

Switch from DB to DC - unstoppable!

- Was this always inevitable?
- Longer retirement periods
- Increasing cost and uncertainty
- Schemes maturing
- Complexity and regulatory burdens
- Soft target for policy makers and employers

Disadvantages of DB

- Only as good as sponsoring company
- Old fashioned final salary emphasis
- Not good for leavers, low earners, shifts
- Employer can stop at short notice
- Contributions not transparent
- Solvency

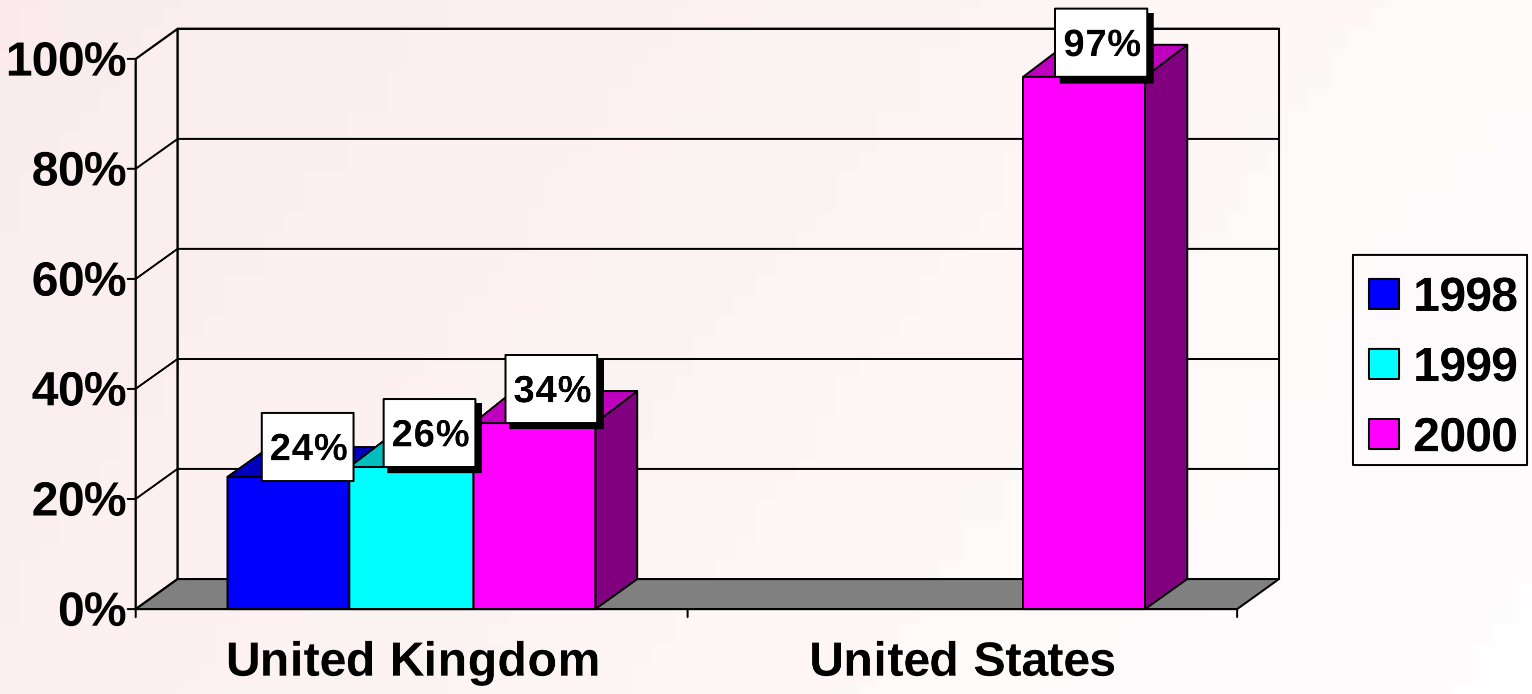
Disadvantages of DC

- To Member
  - Lower employer contributions
  - Poorly designed investment options
  - No certainty of retirement income
  - Risk with individual
    - But ultimately with State - you and me!
- To Employer
  - Not much

Advantages of DC

- To Employer
  - Certainty of cost
  - Avoid regulatory problems
  - Increased visibility and flexibility
  - **Reduce costs with lower contributions**
- To Member
  - Portability
  - Control over own funds
  - More transparency
  - More flexibility
  - Possible guarantee

Percentage of companies now using a DC plan



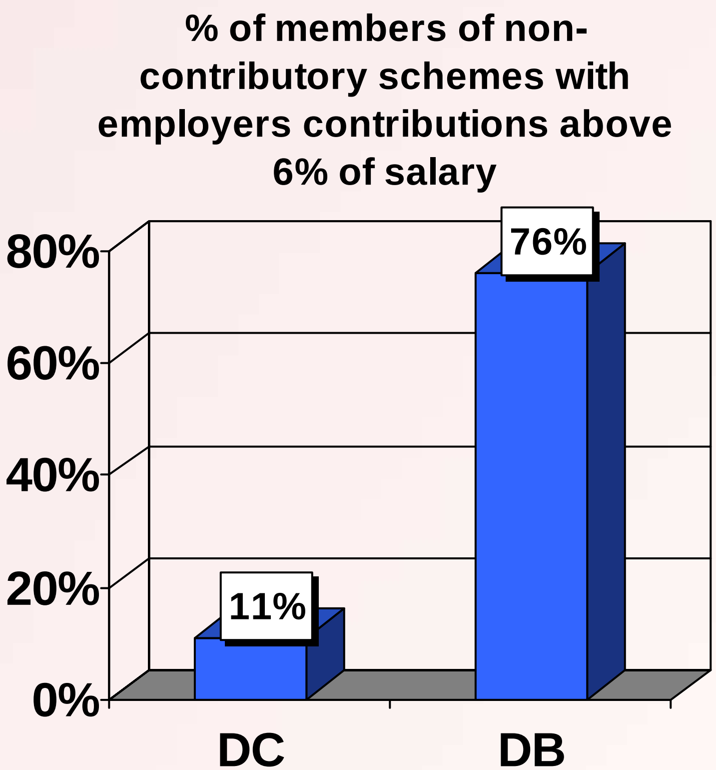
Source: Greenwich Associates

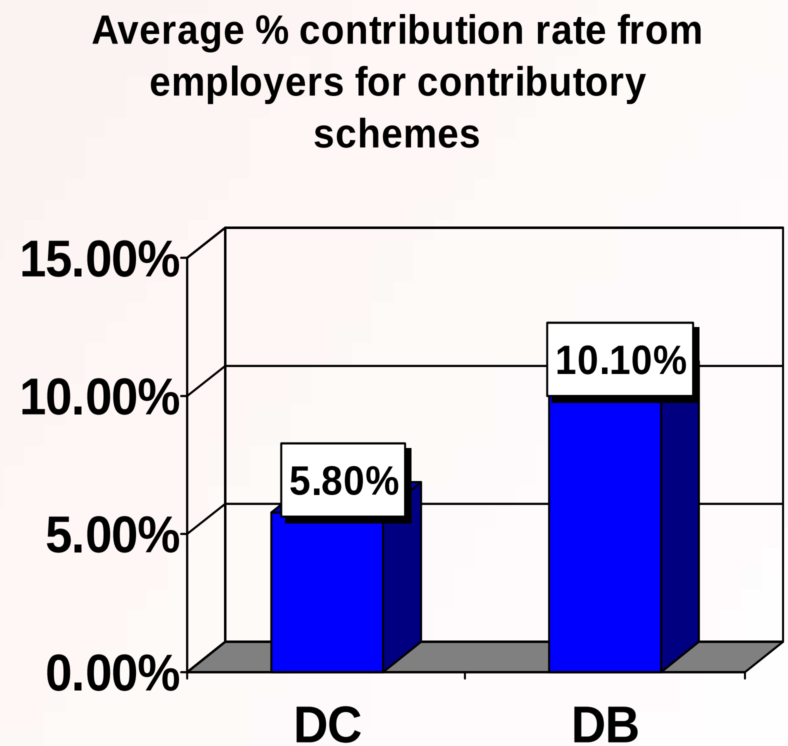
Key Issues For DC Pensions

1. Contributions
2. Investment performance
3. Annuities and post-retirement income regime

Contributions

Government needs to investigate level of employer contribution





Contributions Needed to Achieve a Pension of Two-thirds of Final Salary

Age at commencement of contributions (Male)	Required contributions (% of salary)	Maximum contributions permitted by current legislation (% of salary)
25	10.9	17.5
30	13.4	17.5
35	16.8	17.5
40	21.7	20
45	28.9	20
50	40.8	25
55	64.1	30
60	129.8	35

How Can DC Work Better? Higher contributions

- Improve awareness of contributions needed
- Simplify regulations
- Improve savings incentives
- Offer better investment options
- Incentivise advice
- Reform annuities

UK Savings Situation

- Good retirement savings culture - mostly occupational DB
- UK State pension very low
- Policy move to individualism and DC
- => risk of inadequate pensions, rising cost of State support, more poverty

More People Need to Save

- Risks/difficulties of saving are greater than risks/difficulties of NOT saving
- Lots of barriers
- Lots of disincentives
- Not enough incentives

Aims of Government Savings Policy

- Spread benefits of savings/assets to all
- Encourage higher and more regular savings
- 60/40 to 40/60 for pensions

Current Savings Incentives

- Generous pensions tax relief - costs £13bn, half to top 10% of taxpayers
- Range of tax free products
- BUT
- Tax relief not much incentive (if any) for lower income groups - favours the rich

Tax Relief Makes Rich Richer

- **<u>20% taxpayer</u>**
- puts in £12pm, 30 years
- Government adds £3pm on top
- Total from Government over the 30 years = £1,080
- Pension pot (5% growth) **<u>£12,280.47</u>** (+184%)

- **<u>40% taxpayer</u>**
- puts in £12pm* NET, 30 years
- Government adds £8pm
- Total from Government over the 30 years = £2,880
- Pension pot (5% growth) **<u>£16,373.96</u>** (+279%)
  - *tax reduction of £4 on £16pm cont.

New Savings Incentive System

- Tax relief gives highest incentive to those who would save anyway
- Replace tax relief with ‘government grants’ to top up saving
- Everyone to receive same incentive for same saving - monetary limits

Illustrative Estimates of New Savings Incentive System

- **Withdrawable ISA** - up to £2,000pa,
  - tax free on withdrawal
- **Fixed term ISA** - up to £5,000pa 20% +
  - taxed on withdrawal

Pension	- first £1,500	50%
	- next £1,500	40%
	- next £3,000	30%
	- next £10,000	20%
	- next £10,000	10%

- taxed on withdrawal

DC Investment Performance

- Investment performance important:
  - in DB affects SECURITY of pension
  - in DC affects AMOUNT of pension
- Need for:
  - Education and guidance
  - Best practice guidelines
  - US “Safe Harbour” regulations

DC Investment Products

- Suitable range of products
  - 23% no choice
- Well-developed default options
- Diversification to include:
  - Active
  - Passive
  - Alternative assets
  - Guaranteed products

Trustees' Choice of Providers in DC

Big responsibility. Big risk!

- Should depend on three main factors:
  - Availability and quality of advice
  - Broad range of investment products
  - Level of charges
- Past performance should NOT be over-riding factor
- Be careful with annuities!

Annuities - What's Wrong?

- Crisis of confidence
- Market not functioning well
- People need advice
- People get wrong annuity and lousy rate
- Works better for rich - specialist advice
  - But they complain the loudest!

Annuities Could Work Better

- Need to alter public perception
- Death benefits
- ‘Money back guarantee’
- Already allowed in drawdown
- NO NO’s
  - Age 75
  - Capital extraction

Challenges for Public Policy

- Preserve and expand savings culture
- Simplification
- Offer fairer and better incentives
- Remove disincentives
- Reform annuities
- Help DC provide decent pensions

Challenges for the Industry

- Restore confidence in financial services
- Keep higher earners saving, despite lower incentives
- Design products to appeal to middle/low income groups
- Less jargon
- Keep it simple!

Let’s have your questions!

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