CHANGING THE FUNDAMENTALS OF RETIREMENT AND PENSIONS

PROBLEMS OF THE CURRENT SYSTEM

AND

POSSIBLE SOLUTIONS

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WE NEED TO CHANGE THE CONCEPT OF RETIREMENT...

Retirement should be thought of as a 'process' rather than an 'event'.

Retirement and pensions policy has lagged significantly behind changes in mortality and health status of society. Fundamental ideas have not been re-appraised

The cost of current retirement and pension policies is likely to be unsustainable in the longer term and it is a waste of human resources.

Retirement at one age for all is not appropriate. Many older people would like to continue in employment, but have early retirement forced on them. These people still have much to contribute to the economy, yet are being paid NOT to do so.

Industrial restructuring and pension fund surpluses in 1980's led to forced early retirement. Labour force participation among 50-65 year olds has fallen significantly. This is not socially desirable, is economically wasteful and does not address individual differences.

Policy should be encouraging people to work longer. This may require more flexibility in working hours – as has been possible for working mothers, for example.

Gradually cutting down, rather than suddenly stopping work is much healthier and should be economically more efficient. Perhaps phasing in retirement, gradually cutting down by one day per week, retraining workers to move to less demanding jobs within same company etc.

Retirement should relate to inability to work, not to chronological age.

Suggested policy response:

**Begin debate on re-education regarding retirement. A 'process' not an 'event' –
a 'journey' not a 'destination'.**

Encourage more part-time and job-sharing opportunities for older workers (as for women with young children) i.e. *gradual retirement,* perhaps on partial pension. A Survey on opinions on these issues would be useful.

Provide more re-training for workers laid off in their 50's, who still want to work and do not want to be forced to take lower pensions at a relatively young age.

Shift the general pattern of retirement - i.e. incentivise longer working life (pay much higher pension to those retiring later, introduce age discrimination legislation)

Introduce a flexible band of retirement ages, (e.g. 55-75) - depending on health and financial status, thus recognising individual differences. Or perhaps introduce a new 'target age' range for retirement of 65-70 or 70-75.

WE NEED TO CHANGE THE BASIS OF OUR PENSION SYSTEM...

Need wholesale reappraisal of the current system and its fundamentals

People can spend more years drawing out a pension than they spent paying into it! This is unsustainable and financially impossible to provide good retirement income

Pension policy is lagging significantly behind the improvements in mortality and health status (average life expectancy for 60 year olds is now 80-85!). We need to bring policy into the 21st Century

Mortality improvements plus trend to earlier retirement mean costs of providing pensions as we know them today are likely to become too onerous

Pensions were originally designed to replace earnings when a person can no longer work (normally in 'old' age), but, since the 1980's, companies have used their occupational pension schemes to encourage older workers to leave the labour force early, to aid industrial restructuring. These workers would normally want to keep working, rather than rely on low pension income

Public sector pension schemes are particularly geared to encouraging early retirement and paying people to stay out of the labour force. These people could (and often do) keep working for many more years. What a waste!

State pension provides only basic minimum support for those no longer able to work. The system is outdated - receipt is tied to a chronological age, still based on mortality trends of 50 years ago!

Current UK pension system is very complex and has become increasingly so in recent years (lots of tinkering). Massive volume of Inland Revenue rules and limits controlling contributions paid in and benefits paid out – much too complicated

Do the current earnings limits on pension contributions make sense? Why shouldn't a 30 year old be allowed to put the same proportion of income into a pension as a 55 year old? In fact, why must the tax system subsidise certain percentages of earnings? Monetary amounts may make more sense thank replacement rates

Why should higher earners get more tax relief to provide for their pension? It is the lower earners who need to be encouraged more – the better off will probably provide for themselves anyway. What would be the implications of offering the same tax relief for all pension contributions, up to a certain monetary limit e.g. 50% for the first £x of contributions, 40% for the next £x and so on.

People are scared of putting their money into a 'locked box', therefore more incentives for long term savings are needed (and emergency borrowing facilities?)

Contribution levels are not sufficient to ensure income security after earnings cease – especially in DC schemes

Annuitisation needs to be addressed to pre-empt problems arising when DC schemes mature in several years' time.

PROBLEMS OF CURRENT UK PENSION REGIME

Changes over the years have left a raft of old measures in place, resulting in an enormously complicated system

Recent new measures have just added to complications of the system (S2P, MIG, Pension Credit, stakeholder)

Means testing is resented and inefficient, as a means of long term support for the elderly. Firstly, it is likely to discourage private provision and secondly, it often does not reach those who need it (only partial take-up due to complex forms, pride, stigma)

Estimates suggest over 50% of pensioners will be subject to means test in coming years

Demographic profile implies rising costs of pension provision on current policies. Government has not realised that it cannot be complacent. Future pension provision from private means is being eroded. Policy action to reverse this is urgent.

Resentment of link to prices, rather than earnings. Basic pension has fallen steadily in value

policy response so far…

Pension credit is supposed to address the disincentive to save problem (but they still only receive 60p extra for each extra £1 of saving)

Link between earned income and pensions broken as stakeholder available to non-earners (a sensible step to help more people to provide for themselves but currently just for rich)

Encourage spread of occupational and stakeholder pensions, to ensure more second tier pension provision (but, so far, employers not required to contribute and not allowed to promote their scheme!)

Further measures to consider…

Could meet government's promise to prevent the elderly from having their income means tested, by abolishing the means-tested requirement for those over, say, age 80 or 85 and those registered disabled. This would ensure full take-up by the most needy. It would be politically popular, would help the oldest pensioners who find it hardest to fill in the required forms. It would, of course, be fully taxable to avoid too much abuse.

Perhaps need to ensure that a certain amount of income from pensions is ignored in the calculation of pension credit e.g. the first £50 per week of pension income is ignored, or make the measure a temporary one for, say, 10 years only. If not, IFA's will be unlikely to recommend stakeholder pensions to the government's target market

How can we encourage people to start saving/investing earlier? Education. Baby bonds to kick-start the savings/investment account.

<u>PROBLEMS OF STAKEHOLDER PENSIONS</u>

<u>Stakeholder is not working as it should. There are some obvious problems with the current design, which we could sort out now and avoid problems later.</u>

Inland Revenue rules have made this potentially simple scheme much too complex.

Why not make stakeholder scheme provision mandatory for ALL employers with over 5 staff? They then would not need to be concerned about assessing whether employees are 'relevant' or not. Setting up a scheme is low cost and the current system of exemptions just makes for more complications. (Exempt employees include the young, the very low paid -under £67 per week, non-domiciled, those not yet vested in or to old to join their company scheme). Surely, employees who are not yet vested in their company scheme, or who are too old to join, should still be able to contribute to a stakeholder and the company scheme could then transfer the contributions to the in-house scheme later.

As an example of the seemingly needless complications: Company GPP schemes must provide a minimum employer contribution of 3% of employees' basic pay to qualify as being exempt from providing access to stakeholder, but there is no required minimum contribution level for occupational schemes. Why exempt certain types of occupational and GPP schemes and not others? Companies are exempt from providing stakeholder access if their occupational scheme offers vesting within 12 months, but vesting must be within 3 months if it is a GPP scheme. Why? Why have different vesting requirements for each type of scheme? This just adds to the complications! Wouldn't it be much simpler for all employers to be required to provide access to stakeholder schemes?

Investment options offered by stakeholder schemes and DC schemes in general, need to be urgently looked at. The current default option of 'lifestyling' may be more appropriate for post employment, rather than pre-retirement.

How about incentives to encourage employers to *contribute* to stakeholder schemes, not just to provide them. (Corporate tax relief? Personal tax relief?) All the evidence shows that when an employer contributes, employees are much more likely to do so too.

Information and education courses regarding investment and savings could be run through the workplace, (perhaps financial services firms making presentations) to improve understanding of investment issues. Making information and advice tax-deductible for employers and the self employed would be useful.