Roadmap for Retirement Reform 2009

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Roadmap for Retirement Reform 2009

By Malcolm Small

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About the author

With a background in law, heavy engineering, and public administration, **Malcolm Small** has specialised in all aspects of management in financial services at senior level for the last 20 years. Classically trained in marketing at Marketing Centre Europe in Brussels, he has also operated as a Marketing Director in IT, preparing software applications for market and following through to product delivery. He spent 14 years with Norwich Union, latterly at operating Board level in Life and Pensions, and five years at Merchant Investors, a specialist high net worth investment and pension provider in Bristol.

More recently, as Managing Director of Lyncombe Consultancy (www.lyncombeconsultancy.com), he has specialised in the regulatory, technical and operational aspects of pensions, and a wide range of other retail financial services. With a particular interest in, and experience of, distribution in the UK, he has been involved in a number of initiatives building new businesses in this field. A past Chair of the Investment and Life Assurance Group, a practitioner trade body, he also has a strong presence in public affairs and public policy work. He is a frequent speaker, and author, on industry topics, chairing a wide range of industry meetings and conferences.

Malcolm has undertaken research on pensions through The Pensions Report and is Chairman of The-Pensions-Net-Work (www.the-pensions-net-work.com); a membership based standing conference in the Net-Work series. He consults in the UK and internationally with organisations interested in all aspects of long term saving and retail financial services.

He is Director of Portfolio and Retirement Planning at the Tax Incentivised Savings Association (www.tisa.uk.com), leading the work of the Association in pensions, distribution and platforms. He is also a Non-Executive Director of B&CE Insurance, provider of pensions and financial services to the construction industry. In addition he is a Senior Policy Adviser on Pensions at the Institute of Directors (www.iod.com) and a member of the Advisory Council at The Pensions Regulator.

Sources

I am grateful to the many people and organisations that have contributed their thoughts and made available their research for the Roadmap 2009 paper. In no particular order and with apologies to those I might inadvertently have missed out, the following sources have been used:

- Association of British Insurers www.abi.org.uk
- HSBC Bank www.hsbc.com
- Limra Europe, “Affordable Retirement – Dreams and Realities?” www.limra.com
- Office for National Statistics www.ons.gov.uk
- The Pensions Reports 2006 and 2007 www.lyncombeconsultancy.com
- Scottish Widows, Pensions and Savings and Investment Reports 2008 www.scottishwidows.co.uk

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Introduction

Longevity is truly the “elephant in the room” for retirement policy.

On the one hand, the very fact that we are leading longer, healthier, more active lives must surely be something to be welcomed. On the other hand, it throws up conundrums that we can only now start to grapple with in the light of emerging experience.

At the end of the Second World War, as the system leading to a state pension at 65 for all with the right national insurance contribution record emerged from the Beveridge Report of 1944, average male life expectancy in the UK was just 67. Median life expectancy was much less, and many men in heavy industry or manual labour could be expected to be dead in their 50s. “White Collar” occupations were prized for good reason; you stood a good chance of actually surviving into retirement and enjoying a reasonable pension income in it.

Nonetheless, if one survived until 65, the time that one could expect to spend in “retirement” was a lot less then than it is today (12 years compared with 19 years), and both state and private pension systems were built around the premise that SOME people would spend a long time retired, rather than MOST people. The question must be asked as to how realistic it is to seek to accumulate sufficient private saving capital to fund a 20 to 25 year retirement from what is effectively a 30 to 35 year working life when retirement saving is feasible, with “retirement” at 65. The same question must be asked of the state system in terms of sustainability.

Additionally, increased longevity has thrown up for increasing numbers of people issues associated with the diseases and infirmities of “super old age” that our grandparents never encountered. How we fund long term care, at home, or in some form of residential care, is one of the most pressing policy agendas relevant to retirement today.

The Roadmap for Retirement Reform 2009 builds on the Roadmap for Pension Reform written by Graeme Leach, Chief Economist at the Institute of Directors, and published in 2005. Most of what was argued for in terms of reform then is either still relevant today, or has come to pass in the intervening years.

Published just after the report of the Pensions Commission under Lord Turner, but before the reforms to the current private pension saving regime introduced on “A” day, 6 April 2006, the 2005 Roadmap argued for much that this paper will. Those arguments will be reinforced where appropriate by evidence that has emerged since then. In particular, recent research amongst IoD members, reinforced by consultative conversations, will be referred to. Additionally, in-depth consumer research conducted under the banner of The Pensions Reports 2006 and 2007 will be considered, as well as published research from a range of other sources.

A significant difference is the use of the word “retirement”, rather than “pension”, in 2009. It has become apparent that a range of interlocking challenges lie ahead and that how we deal with later life is not just about how we build up pension savings,

vitally important though that is. It is clear that these challenges need to be viewed holistically. Reform of one area in isolation will not succeed if unaccompanied by reform of others, we would argue, and this seems to be recognised by implication in implementation of the Pensions Commission reforms.

Our belief, and that of our members, is that those reforms do not go far enough in addressing the need for radical reform in both the state and private pension systems, with a view to making “retirement” a sustainable concept for the state, businesses and individuals.

This paper is not intended as a complete and finished analysis and solution in and of itself and we recognise that there are other valid approaches and points of view. This is evidenced by the supporting expert commentary we have invited for this paper from external bodies, reviewing some of the salient issues in the retirement policy arena as seen by others.

But whichever solution is preferred, we believe that the policy debate needs to start now in order to deliver an overall retirement system fit for purpose in the UK in the 21st century.

Executive Summary

This paper sets out how the UK retirement system requires a radical transformation in order to produce a simplified and durable regime for the 21st century. Tinkering with the current system will not overcome the problems of complexity and pension under-saving. The impact of greater longevity, declining state pension adequacy, savings myopia, under-saving and non-saving pose a very significant challenge.

The problem

Huge and continuing increases in longevity since the last war, which gave rise to the state and private pension systems we see today, mean that we are asking both to fund a "retirement" phase potentially almost as long as the "working" phase. This is simply not economically sustainable, in that we are attempting to fund a 20 to 25 year retirement from assets put aside during what is effectively a 30 to 35 year working life when retirement saving is feasible:

- Average life expectancy at 65 has increased from 12 years in 1950 to 19 years today and is projected to increase to between 22 and 28 years by 2050. As a consequence, the old age dependency ratio is forecast to increase from 27 per cent to 28 per cent by 2040. Rising numbers of people will need costly long-term care in the latter stages of their lives.

The UK's pension system, both state and private, is at present severely ill-equipped to deal with the longevity challenge and suffers from major problems:

- The state retirement benefit system has become arcanely complex, with an enormous range of separate benefits, both entitlement based and means tested, having been built up over many years. We believe these benefits can interact adversely with private pension saving in some cases, and the prospective arrival of auto-enrolment into pension saving from 2012 has served to bring this into focus, although it is a problem happening right now. The system has become so complex that individuals and businesses find it almost impossible to understand.
- The private pension saving regime has likewise become hugely complex, with hundreds of pages of regulations designed to prevent "abuse" of the incentives to save. Defined benefit pensions in the private sector are in terminal decline and the current defined contribution (whether occupational or personal) pension saving "proposition" – tax relieved saving, locked up for years, then some tax free cash and a lifetime annuity – is increasingly unattractive to consumers and arguably inappropriate for 21st century lives.

As a result of all this, and the continuing slew of "bad news" about pensions, we believe that people and businesses have become "disengaged" from retirement saving as we now see it and cynical about all forms of pension, whether state provided or private. They are, instead, either under-saving, or using other vehicles to store value for their long term futures.

The solution

The objective of retirement reform is to re-engage employees and employers in long-term saving. That is the best way to ensure secure and decent retirement incomes. We believe this objective is best met through three principles – Simplicity, Affordability and Realism – which have a better chance of meeting the real needs of consumers in later life.

We welcome the proposals for auto-enrolment and for the system of Personal Accounts in principle. However, we believe that further radical simplification is required. Our attitude is one of: *'let's sort this out once and for all and build a pension system to last the 21st century'*. This report contains three key proposals:

- The state retirement age, in the light of the great increases in life expectancy, and healthy life expectancy, needs to move swiftly to 70. We believe there are great benefits in doing so for individuals, businesses and the state. We think 70 should become the new "default" retirement age.
- The state retirement benefit system should be the subject of radical simplification, with the abolition of means testing and the state second pension helping to fund the provision of a "decent", universal, basic state pension at or above the level of the pension credit. It is time to reform the current three tier retirement benefit system down to two and provide a solid foundation upon which each £1 of private saving will make the saver £1 better off. We wish to work with other stakeholders to study how this might be achieved and how better retirement incomes can be secured, but we are clear that such a move IS affordable if combined with an increase to the retirement age.
- The private pension "proposition" is similarly in need of overhaul to deliver a structure that is simple, comprehensible, flexible and attractive to engage with. In particular, we need to study how a "new pension" might better support the new life events and patterns experienced in the 21st century, especially the increasing need for later life care. As above, we wish to work with other stakeholders in order to open the debate on this issue and to examine what might be done to make the UK's retirement savings architecture attractive and relevant once more.

Supporting our proposals, policy makers need to find ways for people to be encouraged to continue work, where they are able to do so. Employers need to consider ways in which they can better harness the skills and commitment of senior workers effectively. The labour market is rapidly adapting to longer life expectancy, with 1.3 million over 65s already in full or part time employment, and 78 per cent of IoD members saying they will continue working after 65 at either their current or a reduced level.

It is clear that the status quo cannot continue. The current retirement system is not adequate to deal with the enormous increases in longevity and long term care needs. A higher retirement age, a better basic state pension and a genuine incentive for people to save and to engage with retirement savings products are essential if we are to address the enormous challenge to come.

1 Longevity: the calm before the storm

The central element in the pension debate is the increase in longevity, which, of itself, is clearly good news not bad. Average life expectancy at 65 has increased from 11.5 years in 1925 and 12 years in 1950, to 19 years today. The Government Actuary's Department (GAD) projects it will increase to 22 years by 2050 – almost doubling over 100 years. Given that, in 1950, a sizeable number of people did not live until 65, the longevity increase is even greater than the above figures would suggest.

Table 1.1: UK population of pensionable age

Projected number of people in the UK of state pension age (SPA) or older[1[1]]

	Projected number of people of SPA or older[1[2]] (thousands)					
	2008	**2015**	**2020**	**2030**	**2040**	**2050**
Women	7,465	7,197	6,877	7,896	8,715	8,698
Men	4,324	5,264	5,804	6,721	7,396	7,360
Total	**11,789**	**12,461**	**12,681**	**14,617**	**16,111**	**16,058**
Total % of population	19%	19%	19%	21%	22%	21%

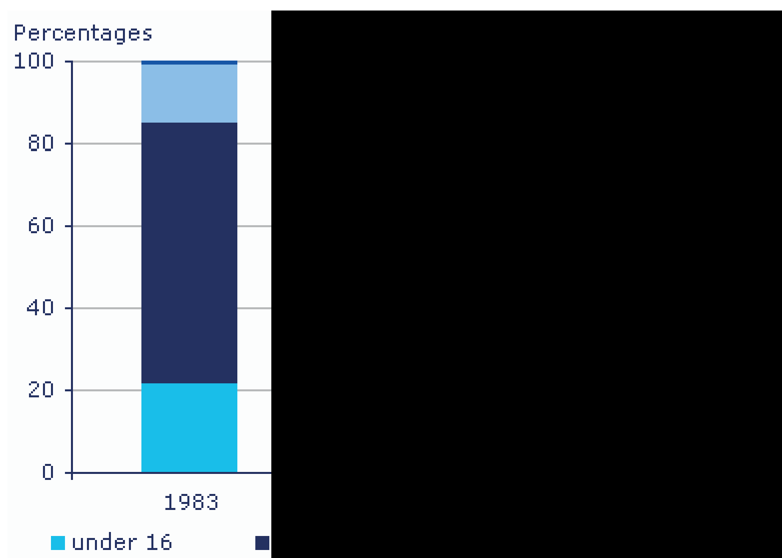
Important: The table above contains projections that account for changes to SPA under the new, post-reformed pension system.

1[1] ONS 2006-based principal projections for the UK www.gad.gov.uk/Population/index.asp
1[2] State pension age will increase in future. SPA is currently 65 for men and 60 for women until 2010. It will then be phased to 65 for women by 2020. State pension age will then increase progressively from 65 years to 68 years for both men and women between 2024 and 2046.

In addition, some commentators argue that the central GAD projections could understate longevity – as they have in the past – and that the increase is likely to be at least one year per decade in the future. The Pensions Commission has highlighted that if average male life expectancy at age 65 continued to rise at the 1980-2000 trend rate, it would reach 28 years by 2050. It should also be noted that some actuaries argue a contrary view that extrapolating higher longevity projections into the future may be mistaken due to increasing levels of childhood obesity.

The ageing population is projected to raise the *old age dependency ratio* (all aged 65+/the number of 20-64 year olds) from 27 per cent to 48 per cent by 2050. Even this projection is based on a sharp slowdown in the rate of increase in longevity, which may or may not prove to be correct.

Chart 1.1: Pensioner population as a percentage of working age population



Population by age, UK, 1983, 2008 and 2033

A slightly different calculation, using the *support ratio* (the ratio of those of working age to those of pensionable age), obviously tells the same story. The support ratio in the UK is projected to fall from 3.3 today to 2.6 by 2031.

Ironically, at the aggregate level, these epic changes are disguised at present because the *total dependency ratio* (all aged either under 20 or over 64/number of 20-64 year olds) has fallen to its lowest level for 40 years. This is because the post-war baby boom generation has depressed the dependency ratio over recent decades. As the Pensions Commission argued, the baby boom has allowed us to ignore long-term realities and thereby miss an opportunity to reform the pension system long before now.

Other factors have also encouraged an air of complacency. First, the indexation of the basic state pension (BSP) to prices instead of earnings resulted in long-term fiscal projections which contrasted dramatically with the situation on the continent. Second, the pension system is clearly ‘working’ for the majority of those in retirement at present. Many current workers look on their retired parents and see them enjoying relative affluence in retirement. This may have fooled many into believing that they too will have the same experience. Unfortunately, as the investment literature advises, past performance is not necessarily a guide to the future.

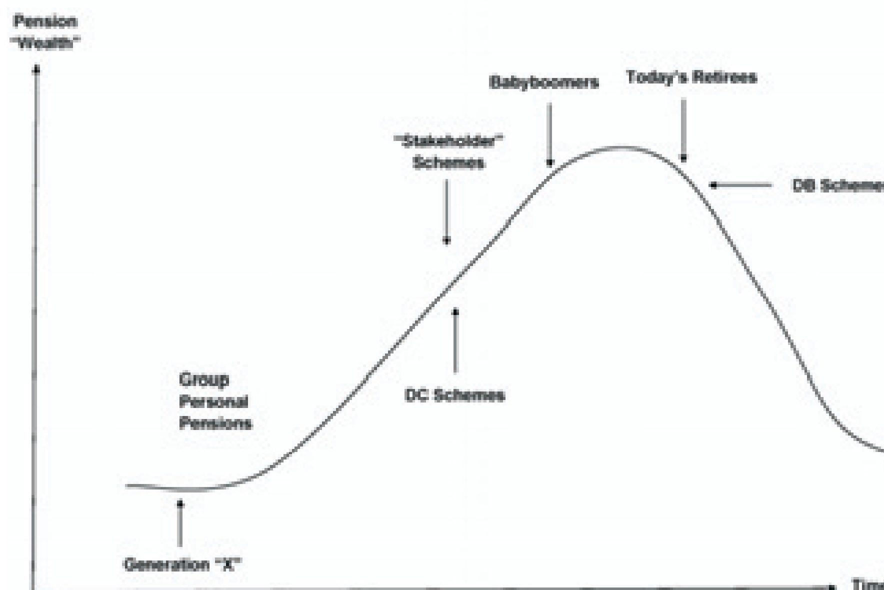
Individual experience of the pension system – from examining parents’ standard of living in retirement – remains positive largely due to the success of final salary pension schemes in the UK over the post war period. People look at their parents and naturally ask ‘what crisis’? Total replacement – state and private – rates in retirement are currently high by historic standards, at around two-thirds.

However, there is evidence from recent research that the population are waking up to the challenge of funding retirement. They are increasingly aware that their provision

for it is inadequate, and understand the scale of the financial problem. Dispiritingly, many feel that they are simply in no position to attempt to climb the mountain – and they may well be right, certainly at the current state retirement age.

We have just seen a generation go through to retire on relatively generous defined benefit pensions, which have accounted for the relatively high replacement rates referred to above. The outlook for the generations behind them is much less certain, and this is illustrated in the schematic below.

Chart 1.2: The pensions tsunami



There is much more published work on the increases we are likely to see in longevity going forward, as the advances in medical science continue to flow. A prime example of this is the development of statins as a treatment for nascent coronary artery disease, which has changed the life expectancy of the smoking population in particular. Male smoker mortality is increasing at the rate of 5 months per annum, with an average life expectancy today of 73, as against 79 for the male population as a whole.

Going back to the introduction of the state pension system in 1947, we have already seen that a two year differential existed between the state retirement age for men – 65 – and average male life expectancy at that point – 67. Were this differential to be maintained, then the male state retirement age TODAY should be around 78! This ignores the typically longer life expectancy of women and, indeed, the policy response has been to raise the state retirement age for women to 65 over a period of years.

Increasing longevity is also a global issue, with the US Census Bureau estimating the number of citizens aged 65 or over trebling from 106 million today to 329 million by 2040.

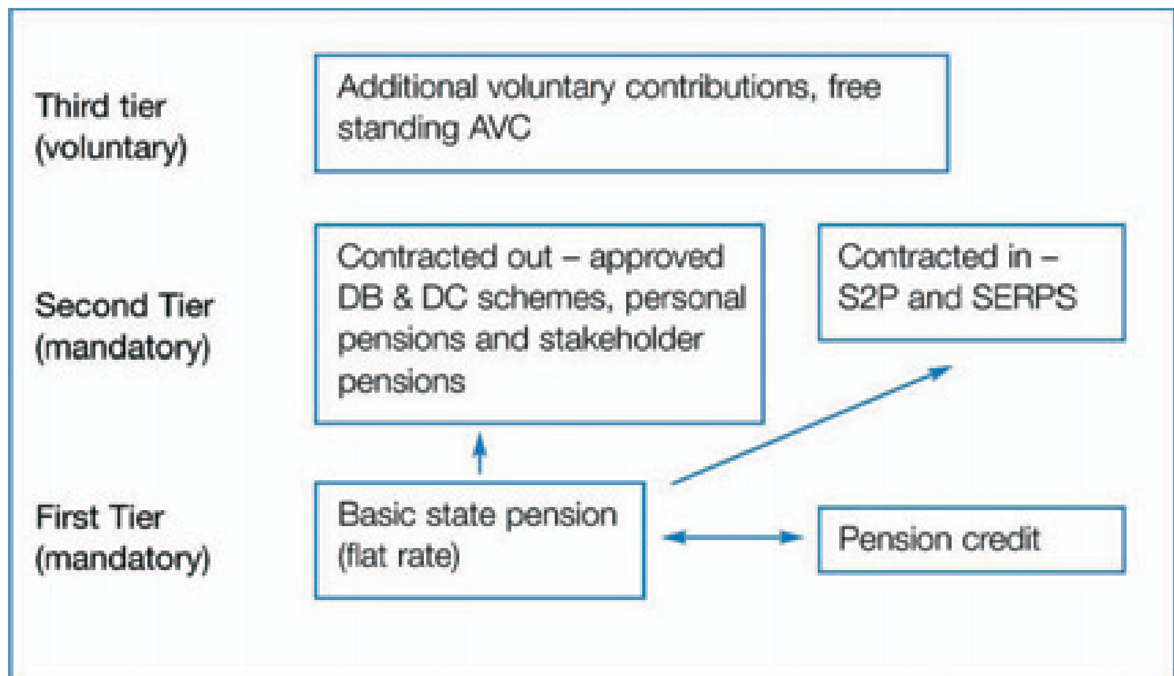
To help deal with rising longevity, the Pensions Commission recommended raising the state retirement age to 68 in stages by 2050. The Government accepted this recommendation and the state retirement age for men and women is set to rise to 68 in stages by 2046. Lord Turner has recently gone on the record as expressing the view that the Commission should have gone for 70, and sooner. Other commentators such as David Norgrove, the much-respected Chair of The Pensions Regulator, have suggested a similar move, and this is a subject we will return to later.

We also need to be honest with people about the challenges increased life expectancy will bring. The Alzheimer's Society suggest that one in three people over 65 today will die with dementia, suggesting an ever increasing forward need for higher dependency on nursing home care. Indeed, the recent Green Paper from the Department of Health, "Shaping the Future of Care Together", published in July, gives some idea of the scale of the nascent problem, projecting figures from The King's Fund suggesting that one in five people in the UK will be aged 65 or over by 2026, and 3.1 million will be over 85 by 2032. An estimated 1.7 million people will have a need for care and support in 20 years' time, it suggests. SAGA recently estimated that a four year stay in a nursing home will cost over £223,000 by 2028.

2 The UK pension system – overview and problems

The schematic below provides a high-level illustration of the UK pension system.

Chart 2.1: The UK pension scene



Whilst this represents the sort of three pillar approach to pension provision seen in other developed countries, the number of arrows and words hints at an underlying pension system, both state and private, of almost mind-bending complexity, laden with unintended consequences. With respect to state and private sector pensions (i.e. leaving aside public sector pensions), there are serious problems in the following areas:

- State retirement benefits (section 2.1).
- Occupational private sector pensions (section 2.2.)
- Personal pension saving (section 2.3).

2.1 The state retirement benefit system

As originally conceived, the state pension system was relatively simple. Entitlement to the state pension was built up through the national insurance contribution record of the individual. Whilst this tended to play against women whose NI records would typically be smaller or incomplete or even non-existent, it was, at least, reasonably comprehensible. The policy aim was to provide a typical “replacement rate” of 25 per cent of national average earnings at retirement for a single pensioner. All with the

relevant record were entitled to this pension, irrespective of other income, and this remains the case today.

This ambition was modest enough, but it was envisaged that occupational pension scheme provision at work would top this up.

And, to a large extent, as we have already seen, this is what has happened – for the generation that has just gone into retirement at least, but with quite large cohorts being exceptions to the rule.

However, the single basic state pension with a full NI record is now just £95.25 a week, providing a replacement rate of just over 15 per cent – not 25 per cent. The abandonment of the rate of increase being linked to earnings, replaced with an inflation link, in the early 1980s, is largely to blame. This link will likely be restored after 2012 – but if it is not, the replacement value is projected to fall to 8.6 per cent by 2035. To top up pensioner incomes, a truly bewildering range of benefits, most means tested, some not, has been introduced in a piecemeal fashion over the years, alongside potential pensioner access to benefits not exclusively designed for them.

Principal amongst these is the system of pension credit. This means-tested benefit tops up the basic state pension to £130 for a single pensioner or £198.45 for a couple.

We can then add in to the mix savings credit, winter fuel allowance, free television licence, age related personal tax allowances, housing benefit, council tax benefit, disability allowances – the list is seemingly endless.

Pension credit is arguably the principal *auteur* in this drama. Whilst it has arguably lifted many hundreds of thousands of pensioners out of poverty since its introduction, it interacts adversely with modest private saving, and especially modest pension saving. Research by the Pensions Policy Institute in 2007 looking at this interaction, in the light of the introduction of auto-enrolment into pension saving from 2012, suggested that up to 40 per cent of the target market – modest to average earners – could gain very little advantage from, or be worse off from, private pension saving. This is a situation which will be made worse from 2012 onwards, but is happening to smaller pension savers right now.

In a nutshell, from an extremely complex scenario, some savers will be putting money into a pension simply to deny themselves the pension credit income to which they would otherwise have been entitled under the current system. A paper from the Department for Work and Pensions seeking to demonstrate that most people will be better off from pension saving relies heavily on the value of the employer contributions envisaged from 2012, contributions which are at least arguably the employee's own money in any case, as deferred pay.

To make matters worse, as a means tested benefit, it must be proactively claimed by the pensioner. DWP's own estimates suggest that at least 33 per cent, or one-third, of those eligible to claim it are not doing so.

The interdependent savings credit means that those with non-pension savings of up to £6,000 will still be eligible to claim pension credit. Quite apart from the modest level of

this credit, those with savings over this level will find their pension credit payments reduced quite sharply owing to the high assumed interest rates obtainable on those extra savings.

The founding fathers of the UK welfare state saw the state pension as an entitlement built up through a lifetime's national insurance contributions, designed to provide a modest, but decent, retirement income upon which private saving could be encouraged. We think that principle should hold true today.

2.2 The private pension saving system: occupational pensions

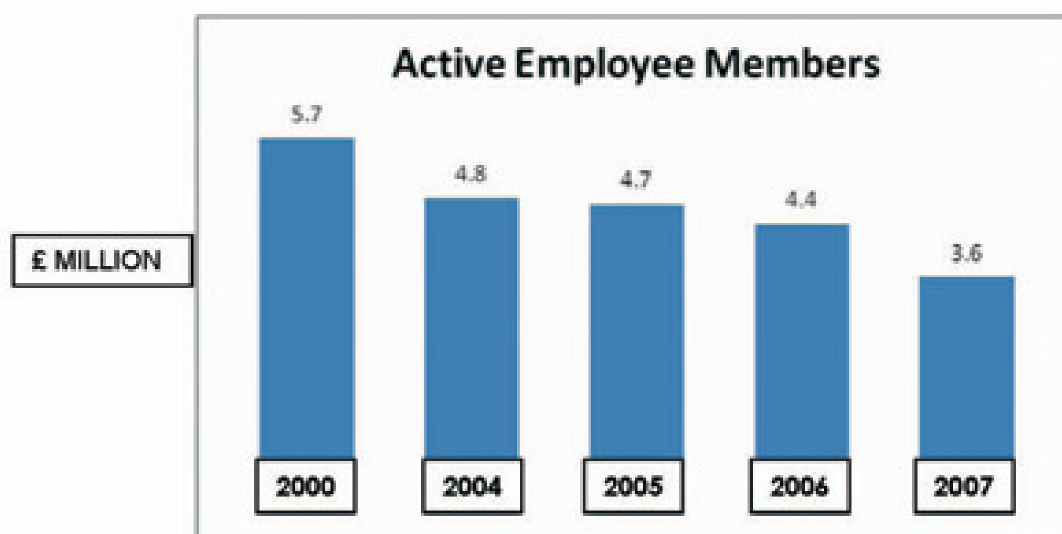
In the UK, the private pension saving system divides into two. Occupational pensions, traditionally provided as an employee benefit in the workplace, and individual or personal pensions, taken out by those with no access to workplace provision, the self-employed or in addition to an occupational pension. Workplace pension provision has evolved from a typical occupational scheme governed by a Board of Trustees into other forms, but the split is useful in analysing what is going on.

Until now, the provision of a workplace pension of any kind has been a voluntary matter between the employer, and employees of that business. At the end of the Second World War and for perhaps 25 years thereafter, almost all workplace schemes in the private sector were operated on a defined benefit (DB) basis, with a pension promise being made as a percentage of the employee's final salary, payable for life. Occupational pension scheme provision peaked in 1967, with over 12 million private sector employees actively enrolled in, mostly, DB schemes. The first defined contribution schemes, where the contribution rate is defined but the resulting pension is not, emerged into the UK scene at that time. A pension was a highly valued employee benefit, with many employment decisions being made on the quality of the prospective pension scheme. Even in the early 20th century, for example, working for a railway company was valued not only for the relative security of employment but also because these companies were early adopters of pensions for their employees.

However, DB schemes have been in structural decline, in the private sector at least, for years, with the trend to closure not only to new members, but existing members, too, well established, as considered below. The Whitbread group is the latest company to announce such a closure at the time of writing and research from the Association of Consulting Actuaries suggests that 9 out of 10 DB schemes are closed to new entrants, with nearly one in five of those closed to future accruals. 22 per cent of employers with a DB scheme are considering moving to a defined contribution basis.

1967 proved to be the high water mark. Since then, occupational pension provision has been in systemic decline, a trend accelerating in recent years, as the chart below illustrates.

Chart 2.2: The decline in occupational schemes in the private sector



To an extent, this chart presents an excessively pessimistic picture in that, according to the Association of British Insurers, around 3 million workers are saving approximately £6 billion per annum into Group Personal Pension arrangements, which are not counted as occupational schemes. Nonetheless, the chart paints a worrying picture in that, at current erosion rates, there will be no occupational schemes left in around seven years time! Now, this is not going to happen, but it is a sign of something having gone wrong.

That "something" is confirmed when we look at the SME sector. Recent research from the Association of Chartered Certified Accountants (ACCA) in this market found that, of the smallest micro businesses, with under five employees, over 95 per cent had no pension arrangement of any description in place for their staff. Even amongst larger SMEs with up to 250 employees, only 32.5 per cent offered a pension – and, of course, participation in pension saving remains an employee choice, for now at least.

We'll return to this theme shortly, but the starkest story has been the rapid decline of DB schemes in the private sector, with only 1 in 14 – and shrinking rapidly – employees now having access to such a scheme. The death of DB schemes now under way is a representation in microcosm of the core issue facing us in retirement policy today – longevity.

The promises made under a DB scheme made some kind of sense when you were pretty sure your workforce would either work for you for most of their working lives if not all, and when you could be pretty sure that many of the blue collar workforce would not live to see retirement age, and that of those of all types who did, the average time in retirement would be 12 years. Average life expectancy for a male at 65 was just that in 1950, according to the Government Actuary's Department, but is now nearly 20 years and was projected by The Pensions Commission to reach 28 years by 2050. Some commentators think even this figure is too low. Funding rates for

such schemes are now typically north of 20 to 25 per cent of salary roll, and rising. The potential time spent economically inactive in what we have understood as "retirement" in the past may be just too long to fund economically.

So, to a sponsoring company, a DB scheme looks like a blank cheque for an unquantifiable liability, for employees who used to work for you for a while, but no longer do so, and for which an approximation of the future liability now sits on the negative side of the balance sheet. Additionally, it is now subject to Pension Protection Fund levies and to regulatory interventions from The Pensions Regulator. It would be a brave employer indeed who took the decision to set up a new DB scheme.

The irony is that it is just nearly 30 years ago when employers, even small employers, were doing just that. My first job on joining a large insurer in 1980 was calculating new business quotations for insured defined benefit schemes, often for very small employers. The mortality tables we used to do this dated, interestingly, from 1949, being over 30 years out of date at that time! It is only in the last 15 years or so that actuarial science has got better at understanding current, and likely future, mortality, through such centres as the Institute of Actuaries Continuous Mortality Investigation. As mortality has become better understood, so the notion of giving a lifetime income promise, funded in instalments in advance, has seemed increasingly uneconomic.

Of course, there will probably always be some organisations whose ethics, or other factors, demand the provision of a DB pension for staff. But, as their competitor organisations successfully recruit and retain staff using a DC scheme at perhaps half the funding rate, shareholders will ask increasingly searching questions.

One of the policy responses to the decline of occupational pensions and workplace pension saving has been enshrined in the 2008 Pensions Act, which set out the framework for employees, from 2012, to be automatically enrolled, from day one of employment, into a suitable workplace pension arrangement. Where such exists, it can be used, and where it does not, the employer will have the option of using the new system of Personal Accounts. This is a trust-based occupational defined contribution pension scheme being built from scratch to serve the un-pensioned, who, as we have seen, will mostly work for SMEs.

However, employers are only one side of this particular coin. Employees need to be committed to pension saving, too, and all the evidence from the ACCA research referred to above, and from The Pensions Reports 2006 and 2007, is that they are, in many cases, not so committed. At the end of the day, if employees don't demand a pension plan, or don't value it, the employer is unlikely to offer one in a voluntary environment, and there may be strong implications for the success, or otherwise, of auto enrolment when it happens.

2.3 The private pension saving system: personal pensions and employee attitudes

The introduction of Personal Pensions in 1988 created a new market, from which others have proliferated, such as that for Self Invested Personal Pensions (SIPPs) and Group Personal Pension Plans (GPPPs), both of which have enjoyed great

success in recent years. Arguably, they have become the pension saving vehicles of choice for individuals and employers respectively. The former allows the plan holder to direct the investment content of the pension, within wide limits, and the latter allows employers to provide a simple, contract based, pension plan for staff. Stakeholder pensions, introduced in 2001, are a low cost version of individual and group personal pensions, but are from the same stable. Since "A" day in 2006, employees have had the freedom to invest in a personal pension alongside and in addition to, any pension provided by their employer.

So far, so liberal, although it is worth noting in passing that the introduction of personal pensions also gave rise to a "mis-selling" scandal, which saw hundreds of thousands of people moving from occupational schemes – especially DB – with a range of valuable benefits attached, to a personal pension unable to provide those, or the perceived "guarantees" associated with DB. Time has proved some of those "guarantees" to be illusory. Nonetheless, the resulting publicity did nothing for the reputation of "pensions" with the public.

And here we come to the nub of the problem, which appears from the research to operate at three levels. The first is the reputation of pension saving, the second the structure of the current pension saving "product", and the third issue is affordability.

"Disengagement" from pension saving is evidenced across virtually all published consumer research on the topic over the last 10 years, and is certainly clear in The Pensions Reports and the Scottish Widows Savings and Investment Reports. People have been subjected to one negative after another regarding all forms of pension saving over the last decade or so. From the pensions mis-selling crisis in the late 1990s, the failure of the Mirror Group pension scheme, the Equitable Life near-collapse and a slew of occupational scheme failures at the turn of this century, the news has been unremittingly bad. Worst of all, the "trust" that used to exist in employers as providers of pensions, the legacy of paternalism, has evaporated. People just don't believe that pension saving is anything other than a bad bargain, likely to see you lose out badly.

The effects were picked up by the Pensions Commission, with 9.6 million people not saving enough for retirement and 54 per cent of those not saving at all – at least, not into a "pension". There are, after all, many ways to save for the long term with a view to retirement, building up capital in asset classes such as residential property or direct equity investment which do not sit easily within a pension "wrapper". However, the deep suspicion that many harbour towards anything with the label "pension" on it is a major barrier to progress.

Second, there is emerging evidence that the whole pension "product" structure is now unattractive, as a saving vehicle, to the people we need to get saving for the long term. The proposition to pension savers is essentially tax relieved contributions, locked up until retirement, then some tax free cash and an annuity for life, also subject to income tax. In the consumer focus groups associated with The Pensions Report 2007, we worked through how a pension plan operated. The more we explained, the more they understood, the less consumers wanted to have anything to do with saving into a pension. When we explained how an annuity worked, the fireworks really started. The realisation that the pension fund died with the annuitant made people

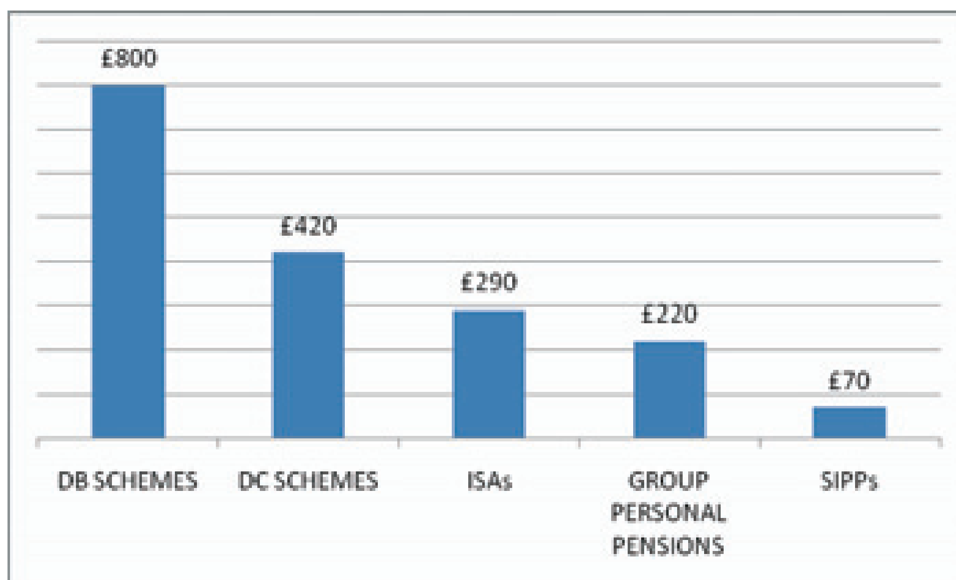
angry – "legalised robbery" was one of the milder expressions used. To add to all this, Ned Cazalet, a respected industry analyst, suggested in his Life 2008 report, that pension saving actually produces negative internal rates of return for many savers!

We then tested some different savings vehicles for retirement through operating description only, unlabelled. The most popular vehicle for retirement saving was the description of an ISA, the least popular the description of a pension. Consumers found the requirement to buy an annuity, the taxation of pension income and the inability to pass pension saving between generations (even subject to tax) the biggest turn-offs. The impenetrable jungle of rules and regulations supporting the UK pensions edifice was also a major turn-off. People will buy, and remain sold on, simple products they can readily understand. Complexity leads to disengagement – unless there are compelling reasons to engage.

The linkage in current policy thinking between the requirement to purchase an annuity, and the granting of tax relief on pension contributions, was elegantly laid out in a paper from HM Treasury in December 2006 www.hm-treasury.gov.uk/d/pbr06_annuities_293.pdf but it is at least arguable that this linkage gives rise to the complexity consumers are averse to.

The chart below shows the current distribution of pension and ISA assets held in the UK.

Chart 2.3: Pension and ISA assets in the UK



Sources: NAPF, STANDARD LIFE, SUFFOLK LIFE, TISA

It is interesting to observe the substantial sums now held in ISAs after only a relatively short period of their existence. As indicated earlier, an ISA is a product readily comprehensible to the average consumer and it is hard to escape the conclusion that this is a vehicle now being used to accumulate long term, retirement-oriented savings, irrespective of the perceived attractions of tax-relieved pension saving.

And, of course, there are a range of other methods of building up capital for later life from Life Insurance based saving through buy-to-let property and inheritance to residential property equity amongst others. The latter has declined sharply as a source of potential funding in recent months and recent research from LIMRA shows most people viewing equity release with some suspicion. Nonetheless, it remains on the table as one in a series of strategies people are prepared to consider, other than conventional “pension” income, when approaching the issue of retirement capital, as evidenced in The Pensions Reports 2006 and 2007.

However, people have a broad recognition that they have not done enough for the future and they are concerned about this. The table below from the LIMRA research illustrates this point.

Table 2.1: Concerns about future pension provision

	Strongly Agree	Agree	Neither Agree not Disagree	Disagree	Strongly Disagree
I am reasonably satisfied that I will be able to retire on a decent pension.	7%	14%	32%	21%	26%
I am concerned about my likely standard of living when I retire.	22%	22%	29%	16%	12%
I like my pension to be with a well established company.	29%	24%	32%	6%	9%
I rarely think about future returns.	15%	13%	35%	17%	19%

With only 21 per cent thinking they will be well provided for in retirement and 47 per cent concerned, we can get some idea of the scale of the problem.

The same research shows people to be suspicious of the future intentions of government with regard to pensions and an anxiety to be self-reliant.

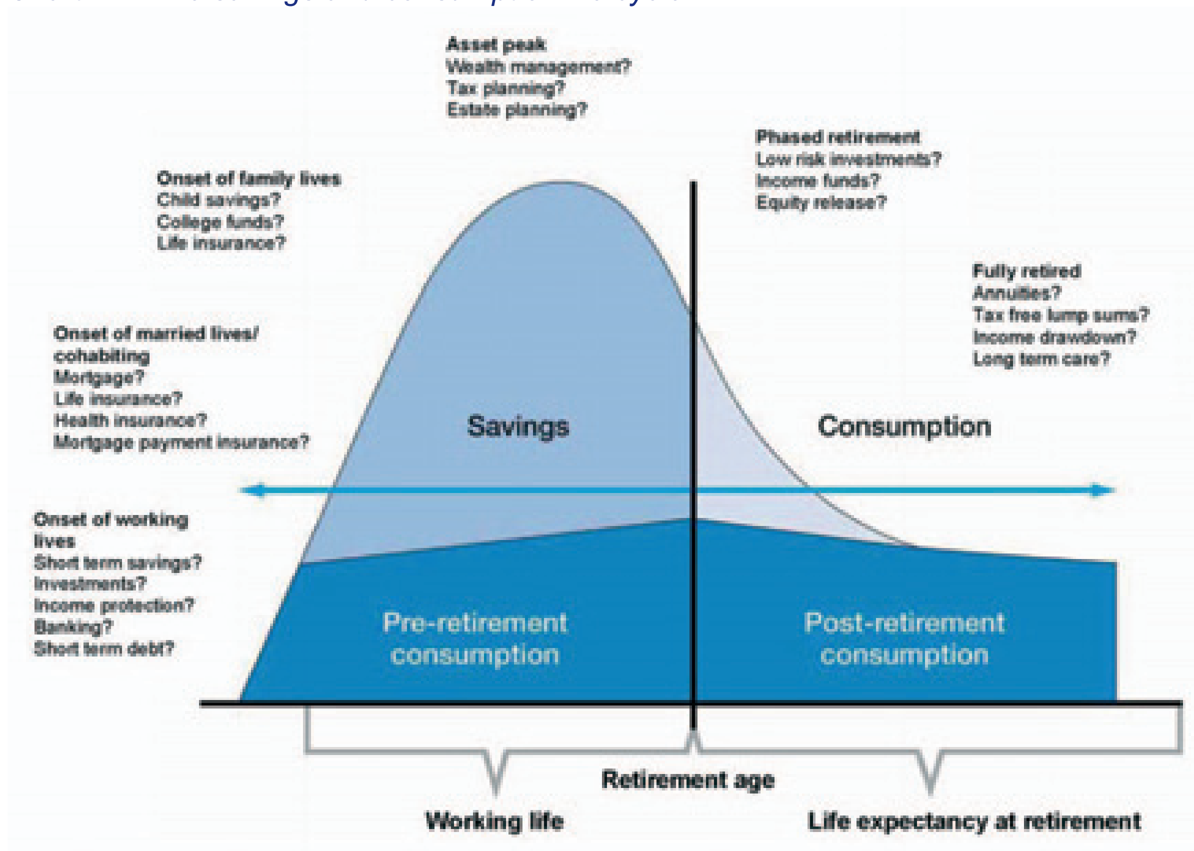
Table 2.2: Reasons for saving

	Per cent in agreement
I want to generate a nest egg so I can enjoy some independence in retirement.	49%
I don't trust future Governments to maintain a reasonable level of benefits, should I fall ill, or during my retirement.	37%
I don't want to be reliant upon State benefits or provision.	35%
I want to ensure that my family will be well provided for should either I or my partner die.	30%
I want my children to have a chance of University education of similar training.	15%
I don't believe in saving.	3%
None of these/don't know.	22%

No less than a combined 72 per cent of respondents either don't trust government to provide in the future or don't want to be solely reliant on such benefits as there are. Recent turmoil in global markets has apparently increased the thrift motive, and yet the same research reports that 25 per cent of the sample say they can't afford to save. Current historically and relatively high levels of personal secured and unsecured debt would seem to confirm this assessment. The savings culture of the post-war period has been replaced by a credit culture over the last 20 years or so – as I can personally testify. This is the "affordability" issue referred to earlier, and is a subject of social policy we cannot tackle directly here. It will require cultural change of a significant order to overcome, and clear messages about what government can do as well as what the individual is expected to do.

However, it is worth spending some time considering how societal changes have influenced our perceptions of what is possible when we contemplate "retirement". The chart below from HSBC's "the Future of Retirement" report 2009 represents something of a traditional view of saving and expenditure patterns in working life and beyond.

Chart 2.4: The savings and consumption life cycle



The problem with this representation, useful as it is, is that it does not fully encompass the life experiences of today's population in developed countries. Were we focussing on a typical, model, "nuclear" family situation, all might be well. Equally, if we were looking at settled, long term, work patterns, the same might apply.

But we are not.

The experience of many "baby boomers" is of multiple employers or periods of self-employment, interspersed with a series of personal relationships resulting in two, or more, families with the attendant financial pressures all this brings. This contributes to the limited, or non-existent, ability to save that we have already seen and can result in people passing the current state retirement age still encumbered by debt. Indeed, we are seeing the emergence of what is called the "sandwich generation", with financial responsibilities to children, as well as to parents perhaps in need of costly care. Furthermore, this is a generation which will enjoy better health, for longer, and with higher lifestyle expectations than any generation preceding it. The 75 year olds we see today will bear no resemblance to the 75 year olds we will see in 20 years time.

This returns us to the question raised earlier about the real practicality of accumulating sufficient capital to "retire" at 65 and remain economically inactive thereafter, which is the way that "retirement" has traditionally been viewed.

The tables below illustrate the outcomes we might expect from a range of scenarios based upon the 8 per cent aggregated pension saving level envisaged as being the basic benchmark level from 2012.

Table 2.3: Illustrative retirement saving outcomes

Earnings growth %	1	2	3
Capital growth %	2	2	2
Sum invested	49992	59993	72554
Accum. Fund	71394	83995	99630
Flat annuity	4284	5040	5978
Indexed annuity	2856	3360	3985

Assume nil Inflation.
Assume £100 p.m. initial contribution, indexed by earnings.
Assume 6% level annuity rate.
Assume 4% indexed annuity rate outcomes after 35 years.

Table 2.4: Illustrative retirement saving outcomes

Earnings growth %	1	2	3
Capital growth %	3	3	3
Sum invested	49992	59993	72554
Accum. Fund	86351	100607	118182
Flat annuity	5181	6036	7091
Indexed annuity	3454	4024	4727

Assume nil Inflation.
Assume £100 p.m. initial contribution, indexed by earnings.
Assume 6% level annuity rate.
Assume 4% indexed annuity rate outcomes after 35 years.

Table 2.5: Illustrative retirement saving outcomes

Earnings growth %	1	2	3
Capital growth %	4	4	4
Sum invested	49992	59993	72554
Accum. Fund	105227	121443	141302
Flat annuity	6314	7287	8478
Indexed annuity	4209	4858	5652

Assume nil Inflation.
Assume £100 p.m. initial contribution, indexed by earnings.
Assume 6% level annuity rate.
Assume 4% indexed annuity rate outcomes after 35 years.

If these numbers look inadequate, it's because they are. Received wisdom within the pensions community for many years has been that a saving rate of 15 per cent of salary, year in and year out throughout working life, is necessary to stand a fighting chance of achieving a 50 per cent replacement rate at state retirement age. Indeed, the Australian government has over recent years made strenuous efforts to get individual voluntary contributions to their "Super" scheme, over and above the 9 per cent of salary compulsory contribution from employers, up towards the 15 per cent mark.

Even then, the recent market reverses have hit prospective retirees hard in that country, as here. A perusal of employer related web sites revealed a commentator suggesting that "bargains" were to be had employing senior workers who were having to defer their retirement plans and carry on working. The LIMRA research already referred to found UK employees in the same boat. With DC fund values still worth up to 40 per cent less than they were in 2000, depending on asset allocation, and annuity rates at historic lows, there are no easy choices for many.

Furthermore, the situation with annuities is possibly about to get worse, and we already know what people think about them! The Solvency 2 Directive now emerging from the EU Commission for implementation in 2011 is designed to ensure uniform standards of capital adequacy across European financial institutions, including insurers. Insurers in the UK provide annuities, which are a much smaller feature of the retail financial services landscape in most other member states. Implementation of the Solvency 2 Directive as currently cast, might see conventional annuity payments decline around 20 per cent in value, as more capital needs to be deployed to back them. Irrespective of whether this happens, the structural outlook for annuity levels seems likely to be depressed in the light of continuing low yields on the government bonds upon which their rates are based.

So, for many, continued employment or other value-generative economic activity beyond state retirement age is simply a fact of life, with the ONS estimating that 1.3 million over-65s are in employment, and rising. A review of the research reveals this to be a reality that people recognise, with varying degrees of enthusiasm. This

quotation from the LIMRA qualitative research is typical when considering “retirement” plans.

“*Keep working for as long as possible. No definite plans for retirement in place.”*

Whether we like it or not, or whether they like it or not, the senior workforce is with us and growing rapidly. We will look at this issue in more detail later.

2.4 Conclusions

We believe that:

- Employers and employees have become disengaged from pension saving, with employers no longer viewing provision of a workplace pension scheme as a worthwhile “perk”. Employees are suspicious of pensions, having seen a string of bad news items, and with negative personal experiences of them.
- Employees recognise the issue of retirement financial provision, but are baffled by the current state and private pension saving systems. They do not view a “pension” as the only solution, but are prepared to use a range of options to meet the challenge, including equity release and continuing employment.
- The current retirement saving structure we call a “pension” appears unattractive, in and of itself, to prospective savers. It also fails to meet the needs of later life, particularly care costs.
- The arrival of auto-enrolment in 2012 will go some way to addressing the retirement saving “gap”, but we believe that the aspiration of funding a prosperous “retirement” of over 20 years is unrealistic given life patterns experienced in the 21st century.
- Private saving interacts adversely with the current means-tested retirement benefit structures. Although the precise circumstances in which it does so are a matter for debate, and the numbers of people likely to be affected similarly so, there is no doubt in our minds that this is the case.
- Increasing numbers of people will work beyond state retirement age, through both choice and necessity. The unreality of funding a 20 to 25 year retirement from capital accumulated during what is an effective 30 to 35 year working life when retirement saving is possible, is becoming apparent. We, as a society, must prepare for this.
- DB pension provision will continue to decline in the private sector, being replaced by DC schemes of various kinds at lower funding levels. We do not believe there is any way back against this trend, which we believe to be irreversible, with only four companies in the FTSE 100 having DB schemes open to new members. This will increase public antipathy to the pensions “apartheid” regarding the pension schemes available to the public sector compared with the private sector (discussed in Chapter 6), the subject of an excellent paper by my colleague Corin Taylor.

3 Principles for retirement reform

In this section, we take a look at what we believe are the guiding principles that should frame our proposals for retirement reform. These principles are complementary to, and build upon, those set out in the 2005 Roadmap paper, recognising the reforms introduced in the Pensions Acts of 2007 and 2008, following the final report of the Pensions Commission. They are also derived from a wide ranging review of the available research, bearing in mind that it is the view of employees that is vital: even after the arrival of auto-enrolment in 2012, they will still be the ones choosing whether or not to engage in pension saving. We support this freedom of choice and have argued against compulsory pension saving in the past.

The current “disengagement” of employees, and consequently of employers, from retirement saving is strategically undesirable. It leads to lower retirement incomes and potentially greater reliance on the state, implying higher future tax burdens on individuals and business, both of which we believe to be best avoided.

The objective of retirement reform is to re-engage employees and employers in long term saving (section 3.1), since that is the best way to ensure secure and decent retirement incomes. We believe this objective is best met through three principles:

- Simplicity and clarity (section 3.2).
- Affordability (section 3.3).
- Realism – meeting the real needs of consumers in later life (section 3.4).

3.1 Re-engagement of employees and employers in long term saving

We have already seen how workplace based retirement saving has been in structural decline in this country and the Pensions Commission Report analysed this in some detail. The result will be a generation under-equipped financially for retirement, whenever that eventually comes. Auto-enrolment into pension saving is designed to head that threat off at the pass, although numerous commentators have questioned whether a contribution rate of 8 per cent of “band” earnings will be adequate. However, there is a wider question here that needs to be answered, and which we believe can only be resolved through the other principles guiding our proposals. That is, just how do we get employees, and then employers, to understand the issues surrounding “retirement”? How do we get them to take appropriate actions to deal with those issues? How do we get away from the negativity, bordering on hostility, towards pension saving evidenced, for example, in The Pensions Reports?

As we have already seen, employees appear, in many cases, to understand that there is a problem looming; they just can’t understand how pensions work, whether state or private, and can’t find their way through the fog to a solution they believe is safe, that they can understand and engage with, and which meets their needs, as they see them, in the 21st century.

3.2 Simplicity and clarity

The success of ISAs as a savings vehicle shows that people will save into a vehicle they can understand and which delivers attractive outcomes to them. Despite the fact that the tax breaks in an ISA are very limited, people understand how they work and see them as meeting their needs. We know that where people understand how financial products work, they will buy them and stay engaged with them. Simplicity and transparency of operation are central to this. Unfortunately, “simple” and “clear” are not words that can be applied in any meaningful sense to either the state or private pension systems as they stand at the moment.

As already indicated, the state retirement benefit system has grown fiendishly complex. Basic state pension (BSP), state second pension (S2P), pension credit, savings credit, winter fuel allowance, free television licences, age-related personal tax allowances, council tax benefit and housing benefit are amongst some of the potential income streams for pensioners. Again, as we have also already seen, by no means all of those who will desperately need the means tested benefits available are claiming them. S2P, although earned as a right, is so complex in terms of its rules and operation that only a pension expert can explain how it works. The current three tier pension system almost has complexity built into it as a design feature.

In a recent survey of IoD members, over 60 per cent reported their view that the current state pension system, including means tested benefits, is too complex, with half that number agreeing with the proposition that the system is now “too complex to be of any real value”. By way of passing illustration, The Pensions Service publishes a guide to the basic state pension which is available on their web site. It is 60 pages long, for just the basic state pension!

The same is true for the current private pension saving system, and the introduction of further complex rules to limit the tax relief on contributions for higher earners will simply add to this. All the research undertaken by the Personal Accounts Delivery Authority has driven them to the correct conclusion that they must keep the scheme, and its operation, as simple as possible if employers and employees are to engage with it successfully. The problem is that, even if they do this, the underlying rules mean that they are facing potential defeat before they start.

If complexity is the enemy of engagement, then lack of clarity is the enemy of action. If people are unsure if retirement saving in a pension is the right thing to do, and safe for them to do, they will take no action or insufficient action. If they are unclear what the state will provide, they will have no foundation upon which to build private savings. The complexity of the current system leads to lack of clarity about what the outcome may be, for good or ill. If all this is true, it will work against auto-enrolment, leading to high opt-out rates and the potential defeat of the policy objectives, which are better financial security in retirement and less reliance on state benefits. Refusal to acknowledge that there could be a problem with the interaction between the current pension credit and private saving is a prime example of this.

In Australia, the relative simplicity of the “Super” scheme, and the personal “ownership” of the assets in individual pots, has driven high levels of popular engagement with the scheme. A perusal of web sites will quickly reveal “chat rooms”

discussing investment strategies that might be adopted by "Super" holders, for example. In comparison, the level of engagement in the UK is minimal.

And complexity is not cost free. Every separate retirement benefit must be administered, coincidentally making it extremely difficult for prospective retirees to get a clear picture of their likely income. A truly unified state and private pension benefit statement still looks many years off.

3.3 Affordability

We have already seen that the ability to save is limited for many consumers; the pressures on household budgets today are extreme, but recent data suggests that, for the first time in many years, consumers are starting to pay down debt and save more. So, it is not a hopeless case. As mortgage rates have fallen, it seems that many people, chastened by potential job insecurity, are saving the difference between what they would historically have paid, and what they pay now. Combined with people's recognition of the retirement savings challenge, there are grounds for potential optimism for the future.

But savings don't seem to be translating into pension saving. Recent research by Prudential suggests that 16 per cent of workers paying into a pension have reduced or halted their contributions in the last five years and the ABI pensions new business figures have shown a sharp fall this year.

However, we need to understand the scale of the current task. Estimates from Hargreaves Lansdown suggest that a 30 year old will need to save £286 a month, assuming 6 per cent per annum net compound investment growth, to provide an RPI revalued retirement income starting at £10,000. For a 40 year old this rises to £487 a month. Of course, this could be split between an employer and employee contribution, but for most financially-pressed employees today, these figures are likely to be aspirational. On the national average wage, a 40 year old would be waving goodbye to nearly a quarter of after-tax income. Furthermore, the assumed annual growth rate of 6 per cent may also be aspirational. The past 12 years have seen next to no positive return from UK equity markets, traditionally the "received wisdom" place for long term saving, and annuity rates are currently depressed with no sustained increase expected any time soon – arguably the reverse.

Longer working lives improve the ratio of workers to pensioners (and therefore the public finances, other things unchanged), facilitate the build-up of larger pension funds and also improve annuity rates for those retiring at a higher age.

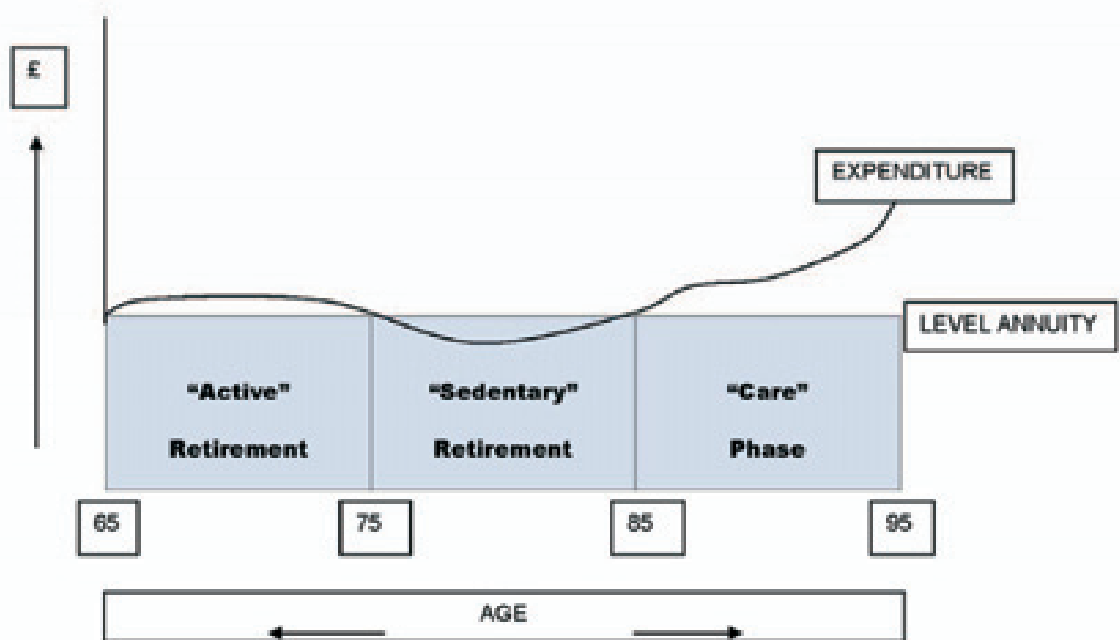
The power of compound arithmetic on pension funds for individuals rapidly approaching retirement is huge. A £300,000 pension fund at 65 could increase by £50,000 (at approximately 5 per cent per annum compound growth) if the holder worked an extra three years – without any additional contributions.

Equally, any reform proposals have to be affordable by the state. This is especially true given the severe damage to the balance sheets both of UK plc and of the Government, which will be the legacy of the "credit crunch".

3.4 Realism – meeting the real needs of consumers in later life

We need to be honest with people about what they need to do to build up retirement assets, and we need to be honest with them, too, about the challenges increased life expectancy will bring. Any reform we suggest will need to take account of what will be an increasing certainty for many – that they will require either home support or, even more costly, nursing home care, typically in the latter stages of their lives. Indeed, expenditure patterns in retirement generally are not constant and arguably look something like the diagram below.

Chart 3.1: Expenditure patterns in retirement



As can be seen, there are broadly three stages that we might typically expect. The first is an active period of retirement, with outgoing activities and economic consumption. The second is a more sedentary phase, with less outgoing and expenditure, with the third reflecting some element of care costs.

Now of course, this is just a representation. People's actual experience at different ages will vary, but it serves to illustrate the way in which a level pension or annuity may not serve the different stages well – especially the need for care in later life. Theoretically, of course, saving in the "inactive" phase could help defray these costs, but this ignores the needs of pensioners to, for example, replace central heating boilers and cars, to name just two. It would seem that increased flexibility might be needed here.

In Australia, the retirement income vehicle we understand as "income drawdown" can be used throughout retirement as a source of income, and, indeed, occasional lumps of money. Annuities are available in the Australian market, but are seldom used. This is also the case in the United States where only small amounts of money are used to

purchase retirement annuities. The UK has over 55 per cent of the global conventional annuity market, a direct result of the requirement to secure an annuity income by age 75, subject to some little used exceptions such as Alternatively Secured Pension. Income drawdown, where a regular income is taken from the fund while still in the ownership of the retiree and still invested in underlying assets, can only be undertaken to age 75 in the UK. At that point, most people will need to take out an annuity.

We have already observed that people’s lives are changing rapidly. A sharp rise in the number of over-60s getting divorced has been observed, for example, and a stroll through the Director’s Room at the Institute of Directors on any given day will reveal a large number of what look like “Senior Entrepreneurs” developing businesses with colleagues. These could be new developments, as the “baby boom” generation, unlike any other before it, takes a completely different view of the “Third Age”.

3.5 Conclusion

These three guiding principles – Simplicity, Affordability and Realism – leading to the overall objective of re-engaging employers and employees in long term retirement saving – will inform the radical recommendations for reform we will propose in Chapter 4. In consulting IoD members on their attitudes to potential reform, we were surprised by their appetite for quite sweeping change. It should be remembered that overall IoD membership is not unrepresentative of UK society as a whole; not all Directors are high earners. However, it could be argued that our membership is perhaps more financially literate than society as a whole, which is borne out by the high response rates to our research and an evident interest in the issues of retirement saving, for example, not characteristic elsewhere.

4 Retirement reform proposals

In the 2005 Roadmap paper, we argued for truly radical reform of both state and private pension systems and we do so again in 2009, with some important additions. We welcomed the Pensions Commission report in 2005 as representing a thorough analysis of the challenges facing the UK in respect of the inadequacy of private retirement saving in this country. The IoD, along with almost all commentators on savings policy, wants to see more people making better provision for an eventual retirement. Much of what was recommended by Lord Turner and his team has gone on to be legislated for; but much of what he addressed was in the private saving sector.

We do not believe that reform can be effective in just one of the two sectors. The public and private systems interact, and must be viewed holistically if true change, beneficial for employers and employees, is to be achieved. We think it is interesting that one of his recommendations that was not acted upon was for a permanent Pensions Commission, which would provide impartial and authoritative advice on retirement policy to the government of the day. It is often said that pension policy needs to be taken out of the political arena, and we think there may be value in that proposition. The current morass of state benefits is an example of a collection of short-term "tweaks" that have morphed into long term policy.

Before we move into our proposals for reform, we need to make one point. The IoD does not have at its disposal teams of analysts capable of dissecting the complex and interrelated infrastructures underlying the state pension and benefit system, or the private equivalents. All we can do is make macro-observations, indicating directions of travel. This paper is intended as the start of a journey, not a complete set of detailed recommendations; but equally, we will be willing leaders or participants in the debate and analysis to follow.

Our three recommendations for retirement reform are:

- A state, and default, retirement age of 70 (section 4.1).
- A universal, decent, basic state pension and the abolition of means-testing (section 4.2).
- A "new pension", providing an attractive basis for private long term saving (section 4.3).

We will also make subsidiary recommendations, but all will aim to deal with the new realities, as we see them, of retirement in the 21st century. They will all support the above, and the other points we have raised in this paper.

4.1 A state, and default, retirement age of 70

The Turner Report recognised the issue of increased longevity clearly, and recommended that the state retirement age be raised in stages to 68 in 2034. Lord

Turner has recently gone on the record as saying that, in retrospect, he wishes he had been more adventurous and gone for 70, and more rapidly.

And he is not alone. As we have already seen, a number of commentators are suggesting the inevitability of such a move, given the great, and continuing, increases in longevity seen since the last war.

Whilst our own membership's views on this topic are mixed – in a recent survey over 65 per cent thought that the current state retirement ages for men and women are "reasonable" – we support such a move, as we did in 2005, except with greater urgency. The state system, no more than the private system, simply cannot support a mass of economically inactive people for over 20 or 30 years in the long term. However, such a move also enables better pensions to be paid and sustained (see below) whether state or private. The extra five years gained can compound the value of existing private pension funds and allow five years more contributions to be made, as well as making a more generous state pension affordable. The outcome should be better, more sustainable, retirement incomes for all.

Furthermore, there is some evidence that employees are willing to carry on working, in some capacity, to 70 or even beyond. Recent research by Hymans Robertson suggests that public sector workers are willing to consider working until 70, and our own members seem willing to countenance it, too, with nearly 77 per cent planning to continue working at their present level, or at a reduced workload, past 65. This group expect to retire at 70 for the most part, but nearly 20 per cent expect to keep going until 75 or beyond. This is backed up by the outputs from The Pensions Reports, which made it clear that continued employment after 65 is one of the central planks of people's strategies for dealing with "retirement". And, as we have already seen, there are already substantial and rising numbers of over 65s in paid employment.

So, we believe that such a move would be a policy that swims with the tide of people's realities and expectations. Of course, those who had been fortunate enough to build up sufficient private assets to "retire" earlier may do so, but the universal state pension we propose should not be available until 70 as of right.

In fact, we already have a sort of "back door" state retirement age of 70, in that the incentives for deferral of pension to that age from the current 65 are now so attractive that, if at all possible, most people would be well advised to carry on working and avoid drawing their pension. For example, if a person with a basic state pension entitlement of £95.25 a week puts off claiming it for two years, they could expect £115.10 a week instead, representing around £20,500 extra income assuming a 20 year life span after retirement, for the loss of just over £9,900 in pension payments over two years. Alternatively, an attractive lump sum can be built up. There is no reason why such incentives – or even better ones, given the greater ages involved – could not be offered under the new regime to those wishing to defer claiming their pension until age 75.

The fiscal benefit is also clear. We estimate that, if we moved overnight to a retirement age of 70, the annual saving in state pension payments would be £19 billion per annum. This figure ignores the increase in tax receipts from those

continuing in work. Of course, in practice, an increase to the state retirement age would not happen overnight, but would be phased over a number of years.

We do need to make appropriate provision for those unable through illness or disability to carry on working. A commercial plasterer, for instance, is typically unable to work much beyond 50, as the speed required to take the work forward at a satisfactory pace becomes increasingly reliant on ageing muscles or arthritic joints. However, we no longer have hundreds of thousands employed in heavy manual labour; for better or worse, the UK economy is increasingly skills and knowledge based. Those hewing information from servers are better placed to work longer than those hewing coal from a coal face.

We know that the current “default” retirement age of 65 is currently under review with a view to abolition altogether. We would argue that some kind of default age provides certainty for employees and employers, and would suggest that the new default age should be 70, with the same liberal provisions that currently exist for agreement between employers and employees in the case of a desire to work beyond that age. Maintenance of a default would also ensure the continued, and potentially wider, provision of workplace benefits such as life insurance and sickness insurance, both of which play an important role in individual protection and lessening reliance on the state.

4.2 A universal, decent, basic state pension – reforming public retirement benefit provision

As already indicated, we do not believe that retirement reform can be treated other than holistically, an approach also taken in 2005. In that paper, we argued for radical simplification of the current three tier retirement income structure, taking it down to just two – a universal state pension (USP), topped up by voluntary provision such as workplace schemes, supported by auto-enrolment. Means testing would be abolished, as would the state second pension, ending contracting-out, and the savings made used to pay a state pension at, or above, the combined basic state pension and pension credit. The basic state pension for a single pensioner is £95.25 a week, and this is topped up to £130 by pension credit. The top-up for a couple results in £198.45 a week. We suspect that even better minimum entitlements might be achievable, if all the other reforms we suggest are carried through.

We argued for this approach in 2005, and the relevant extracts from that paper are attached as Appendix A1.

Moving to a USP we believe to be easily affordable. The total cost of pension credit we estimate at £9 billion, were everyone entitled to it to claim it, and the abolition of this alone would provide half the cost of the £18 billion per annum required to raise everyone to the level of basic state pension plus pension credit. The savings from abolition of S2P and such things as the Winter Fuel Allowance would deliver much of the difference, and this ignores the savings from moving to a state retirement age of 70 – which could be a dividend to the Exchequer, helping to prepare for higher longevity and higher care costs, and possibly allowing a USP higher than the pension credit level.

It is worth emphasising here that we do not purport to offer a fully costed solution, but rather a suggested direction of travel. We would need to work with other stakeholders in investigating and fully costing this option, and stand willing to do so. The interaction with other means tested benefits outside the "pension" arena, such as housing benefit, would need to be fully understood, for example.

However, we believe that the benefits of clarity, simplicity and the clear call to action for further saving – and the knowledge that this is prudent and safe – are prizes worth pursuing.

4.3 Towards a "new pension" – reforming the way we save for the long term

We have already considered the current pension saving "proposition" – tax relieved saving, locked up until retirement, then tax free cash and a taxed income by way of an annuity. Thus, it is a "tax deferred" structure, rather than absolutely tax relieved, in truth. This design of a long term savings vehicle could be argued to have been set as long ago as 1956, when the Finance Act of that year introduced the concept of retirement annuities for the self-employed. The structure referred to above has remained pretty much untouched since, although it has been the subject of ever-increasing regulation. This has added infinitely to the complexity that confronts consumers attempting to understand how they might best save for the long term.

We have reached the conclusion that the current pension saving proposition is no longer "fit for purpose", is unattractive as a vehicle to those we most need to engage in retirement saving, no longer meets the needs of consumers in the 21st century and should be replaced.

This is a new recommendation in the 2009 Roadmap.

Why have we reached this position?

When we say that the current pension proposition is no longer "fit for purpose" we are considering it in the context of people's real life experiences today, as compared with their lives in, say, 1956. People simply don't stop work one day, slump into an armchair and then die. They have much greater expectations which will be represented in much more variable patterns of expenditure.

We are also considering it in terms of the outcomes it delivers to those engaging with it. We have already referred to the analysis of pension saving undertaken by Ned Cazalet in his Life 2008 report. This suggested that the internal rate of return on pension saving, assuming current structural levels of annuity rates and certain longevity models, for basic rate tax payers is either negative or so low as to be unattractive.

A large factor in this is the rate that can be obtained on a conventional annuity. It is worth saying that market estimates suggest that up to 40 per cent of retirees could get a better rate through a lifestyle or underwritten annuity, and this is to be welcomed, but unless something is done, these rates will get even worse by 2012 with the arrival

of Solvency 2. And we know from the Pensions Reports that consumers view annuities very negatively, no matter what we might think in terms of guaranteeing an income for life, however long that might be. Equally, consumers are rightly risk averse regarding retirement income and for those with smaller retirement “pots” an annuity is arguably the way to go, but there are ways of securing income at low risk other than this.

In countries where annuitisation is not compulsory, and where consumers have a choice of income vehicle, conventional annuities have a low take-up rate. This is not to say that they should not be an option, but in countries such as the United States and Japan, variable annuities have become much more popular alongside other vehicles that we would recognise as analogous to the “income drawdown” option that currently exists in this country up to age 75. Even this latter option as currently constructed here is subject to constraints not evident in its equivalent in, for example, Australia, where variable amounts of income or “capital” can be drawn down to meet specific needs or events.

The unattractiveness of pension saving into the current structure is also evident from research. Alongside the requirement to buy an annuity, it seems that the requirement to pay tax on pension income is a surprise to many, and the fact that consumers cannot access their pension fund in an emergency should they need to. PPI have recently done some work which seems to indicate that provision of early access to the fund for certain events would prove attractive to consumers; this is already the case in the New Zealand Kiwisaver structure, for example. Indeed, until 1988, it was possible in the UK, with a “loanback” facility, subject to conditions, being available on the S226 retirement annuity contracts for the self-employed. This facility was, in experience, seldom used. People seemed to know that the pension “pot” should only be tapped as a last resort, but the knowledge that you could access it if need be seemed attractive.

Another unattractive feature for consumers is the inability, even subject to tax, to pass pension assets between generations. This latter restriction baffles many, as this would in many cases “kick start” pension saving for the next generation, ensuring a better retirement income. We have seen this done through the provision of, perhaps, a stakeholder pension contribution made by affluent grandparents on behalf of young grandchildren; but this is not the same as inter-generational transfer.

The needs of consumers today are much more complex than they were in the past. Many retirees will have to find money to support, for example, university fees for second families, or nursing home fees for elderly parents. Some of this can be found from residential property equity, for example, but the current structure of pension means that it is unlikely to be available from the pension fund. Similarly, a level pension payment is of limited use should care fees need to be met, where capital value might still exist in the fund.

So, we believe that the time has come for a thorough review of the shape of the private pension savings structure in this country. This may, or may not, include replacing the current system of tax relief on contributions with something else, perhaps just tax preferment as in Australia. Doing so would break the link with the effective requirement in the UK to take retirement income from an annuity, one of the most disliked aspects of the current system amongst consumers. The personal tax

relief bill is substantial, with much of it going to high rate tax payers, suggesting that it is not incentivising those we most need to get saving – the basic rate tax payer.

We don't profess to know what the "new pension" will look like architecturally, but we do believe the time is right to start the journey to find it. Simplicity, flexibility and comprehensibility would appear to be the key success criteria in any new design. After all, if the Exchequer isn't giving much money away in the form of tax relief, fewer rules are needed to prevent "abuse". We suspect that whatever emerges from this journey will look a lot more like an ISA than the current "pension". The Scottish Widows UK Pension Report published in June 2009 revealed that 38 per cent of people believed that cash savings, including ISAs, were the best way to build up retirement assets. Just 30 per cent thought a pension was the best way.

In designing the "new pension" we will also have to think, as already indicated, about how it might better contribute to the issue of long term care in later life. As it stands, an annuity payment each month is of little help when it comes to funding residential care, for example. Research by the Department of Health supporting its recent Green paper on long term care found that half of all 65 year olds today will have to find at least £25,000 to meet care costs in later life. As more people enjoy the benefits of a longer productive life in terms of active health and social interaction, these numbers will only rise.

However, this is not a journey we are equipped to undertake on our own. Once again, we need to work with other stakeholders to survey comparative schemes around the world, and to decide how best to construct the "new pension" for the UK. Of course, we could do nothing, and leave the current pension saving structure to collapse under the weight of its own regulation, and to wither on the consumer's vine.

There are, after all, many ways of providing for later life, and we already suspect that people are making choices for provision other than a "pension". Investment Bonds are a life insurance product holding around £300 billion of assets, and their structure is especially useful for the provision of retirement "income". Buy-to-let property also fulfils this function, although its popularity has waned in recent years. Direct investment in collective investment vehicles is also much more attractive than it was following the recent changes to CGT, with the potential to make use of the annual allowances as well. The Prudential Equity Release Index suggests that pensioners now own £654 billion in residential property equity across the UK. This is a further potential source of both capital sums and "income", and will surely grow in importance in the years to come, with much clearer and safer products, and extended regulation, making for gains in consumer confidence. Even the Child Trust Fund could be viewed as a potential source of retirement funds if invested into a suitable vehicle. Life insurance has largely been forgotten as a savings vehicle, but it has attractions as a source of funds for retirement.

However, we believe that there is a need for a dedicated retirement savings structure that is relevant, attractive, simple and easy to understand and engage with.

That is not what we have at the moment, and this may have some implications for the success of auto-enrolment in 2012; if people do not like or understand the structure they are put into, they are probably more likely to "opt out". We want more people

saving more money for later life and we look forward to participating in the policy debate and the journey to the “new pension”.

5 Extending working lives

5.1 Trends

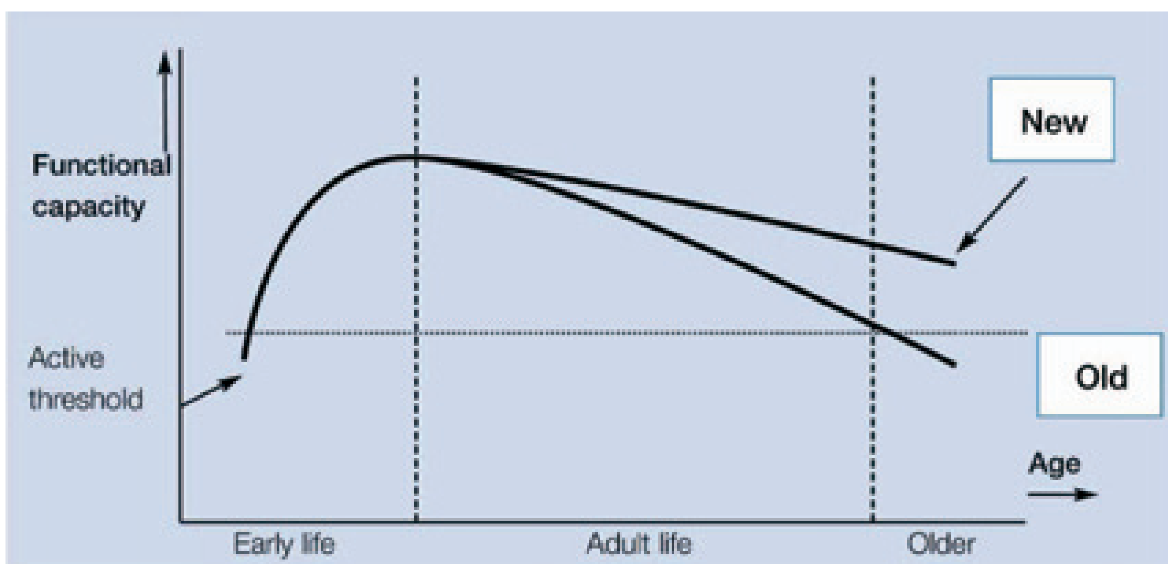
The demographic messages are clear. Over the coming decades the 50-64 age band is projected to shift from the smallest to the largest group in the population of working age. This means that the experiences of older workers will have a growing influence on the performance of the labour force as a whole.

One of the key features of the IoD's proposals for pension reform is the need to raise the basic state pension to a level which removes the need for means testing. In the absence of other changes, this, together with a rising number of pensioners and a falling support ratio (the ratio of the number of people of working age/pensionable age), will provide strong upward pressure on state pension spending and taxation.

In order to counter the rising pension burden the most obvious and direct solution is to respond with an increase in the state retirement age. Cost factors alone would not necessarily justify such a move. But cost in conjunction with greater longevity does provide a solid basis for reform. Moreover, a higher state retirement age is more likely to be acceptable politically if it is tied to a higher basic state pension.

Longevity and active ageing – the period of active years during retirement – are likely to increase further in the future, making a link between life expectancy and the state retirement age an important ingredient in pension reform.

Chart 5.1: The lifecycle and extra active years



5.2 The challenge

Raising the state retirement age to 70 is not a silver bullet. In order to be truly effective it will need to work with the grain of supply and demand conditions in the future labour market. By raising the state retirement age the Government will be sending out a very strong signal to younger workers that they will have to plan for longer working lives. Similarly, companies and other organisations will need to address the issue of managing an older workforce.

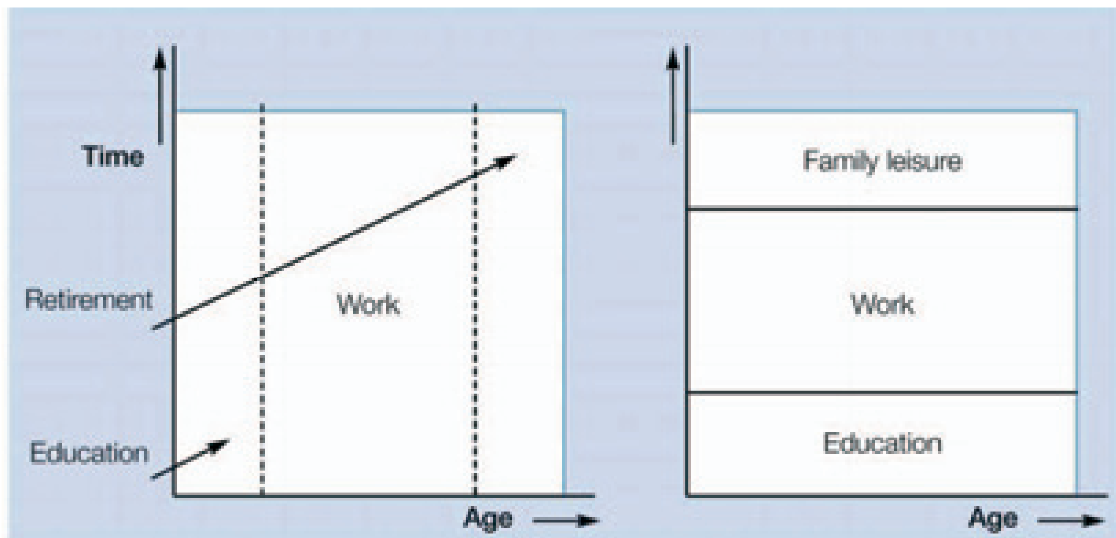
The baby boom generation are now beginning to retire and the way this generation has changed society over recent decades suggests that it is equally likely to change the nature of retirement in the future. Boomers will behave differently in retirement to their parents – the cohort effect. The cohort effect states that people retiring over the next 20-30 years are very different from those currently in retirement. They have had far greater opportunities to study, travel and enjoy the leisure society. They have also experienced change as a constant feature of life. Consequently the idea that retirement will be different in the future will not surprise them. In fact they are likely to embrace the concept.

Charts 5.2 and 5.3 below illustrate the concept of differing retirements. The sequential model in Chart 5.2 is likely to be replaced progressively by the strata model in Chart 5.3, whereby work, education and other activities occur throughout life with the result that a retirement age in the traditional sense is only reached when people become physically inactive.

Retirement is a relatively recent idea. In the 19th century most people worked until they dropped or could be provided for by their extended family. We certainly do not want to go back to the future, but the idea of retirement does need to be re-considered. We need to stop viewing retirement as a fixed point in the future. Instead, the concept of retirement needs to become more fluid.

Labour market statistics already show that people over the age of 50 are more likely to be self-employed than other age groups. Third age entrepreneurs could become far more apparent for those of retirement age in the future, and this is an area which should be the subject of greater study, as the IoD is uniquely well placed to capture this emerging demographic.

Charts 5.2 and 5.3: From vertical to horizontal – changes in the lifecycle



The IoD has already called for an end to forced retirement. In its initial response to the Pension Commission the IOD reported that over three-quarters of IoD members opposed staff being compulsory pensioned off when they reached a certain age. The introduction of anti-discrimination legislation is likely to encourage companies to re-assess whether their age related policies are on a par with those concerning the position of women and ethnic minorities. However, we think that some kind of default retirement age – probably 70 in line with our proposals above – may still be useful.

Moving towards a society of higher retirement ages will not be simple. International experience suggests that countries with higher per capita GDP have lower rates of labour force participation, because rising affluence provides a strong incentive to substitute leisure for work. When talking about pensions one is thinking decades ahead and over such a period, substantial increases in real incomes are possible. Against this backdrop it is quite plausible to argue that future pensioners will be happy to accept a lower replacement rate – compared with previous generations – simply because their absolute level of income affords them the lifestyle they desire. As noted above, there is a huge uncertainty as to what will happen.

5.3 What do people want to do?

The current state retirement age is seen as the 'natural' time to retire, possibly because the economics of the availability of the state pension, added to private saving, make this a realistic prospect. The ONS recently estimated that over 1.3 million over 65s are in full or part time employment and this number will surely rise. Recent research amongst IoD members suggests that nearly 25 per cent will continue working at their present level after state retirement age and that 53 per cent will continue working, albeit at a reduced level. Only 15 per cent plan to stop work altogether.

However, for many, retirement at 65 will simply not be an option unless they wish to subsist on the basic state pension and means-tested benefits, with an associated dramatic drop in income levels. Research by the Association of British Insurers in November last year suggested that nearly 10 million people were not saving into a pension at all, with many millions more not saving enough. This has led Standard Life to suggest that many will have to work to between 74 and 86, if they are to have a worthwhile private pension to look forward to.

The Centre for Research into the Older Workforce (CROW) at the University of Surrey reports that four-in-five workers under state retirement age would consider working after they retire from their main jobs. This study speculates whether the higher figure reflects generational change and/or changed financial circumstances in recent years.

The CROW study identified three distinct groups of workers, each with a different set of attitudes to work and retirement:

- **Choosers:** workers with very positive work attitudes, high qualifications, high income and/or high status. Such individuals are much more likely to consider staying in employment post retirement, due to a sense of mission and personal drive. DWP research also suggests that professional and creative workers are the most likely to be ‘choosers’.
- **Survivors:** survivors have finance as the key motivation to continuing in work beyond retirement. Survivors are often in low income jobs. Most survivors are often working full-time (possibly not by choice), still paying off mortgages and have poor pension entitlements.
- **Jugglers:** jugglers have chosen to combine work with other roles and are opt for work post retirement, providing it is flexible to fit in with their other commitments such as leisure and/or family. The majority of jugglers are women and many would consider voluntary work after formal retirement.

The reasons for expected late retirement were (multiple responses); to improve my financial position 50 per cent, enjoy job/working 43 per cent, to keep fit and active 35 per cent, could not afford to retire earlier 24 per cent, to improve pension 18 per cent, didn’t know what to do when stopping working 11 per cent, to retire at the same age as husband/wife/partner 10 per cent.

The ONS has recently reported Labour Force Survey results showing that nearly half of older people (50-64) in employment say they want to work fewer hours. However, when asked in a separate question if they would like to work shorter hours for less pay, older workers were the least likely to say that they would. These results suggest that people will only reduce their working hours if their expected lifestyle can be maintained.

Looking across wealth groups, the 2002 English Longitudinal Study of Ageing found that labour market inactivity rates for people below the state retirement age were U shaped – the lowest wealth groups were the least likely to be working, but the wealthiest individuals were also less likely to work than those in the middle of the wealth distribution. ONS data also suggests a correlation between lower earnings and poorer levels of participation in pension saving.

The association of private pensions with 'early retirement' was also stronger for those with defined benefit rather than defined contribution schemes. These findings reiterate the obvious point that financial circumstances dominate the decision as to when to retire. If finances don't permit retirement, and ill health does not prevent people from carrying on working, people will seek out ways to carry on in either full-time or part-time employment.

5.4 Raising the employment rate of older workers – employee incentives

A larger pension fund is the most obvious incentive to working and saving longer. Estimates of the savings gap vary but all suggest a substantial gap between actual savings and the level required to meet income expectations in retirement.

The traditional life cycle model suggests that households will borrow in their 20s and 30s, as they raise a family and acquire a mortgage. Subsequently, during their 40s and 50s they move through the age of accumulation as children leave home and the mortgage is paid off. However, there is good reason to believe that the timing of the lifecycle has now shifted. Children are arriving later and they are dependent for longer – due to the costs of further education and the need to provide a deposit to get a foot on the housing ladder.

If people find it difficult to save when they are younger (up until their mid-late 30s) the sensible alternative is for them to save more later in life. In other words pension saving continues up until 70 instead of 65 (or less) at present. Table 5.1 illustrates the sharp acceleration in contribution rates owing to any delay in starting to save for a pension.

Table 5.1: Required contribution rates into pension scheme

Starting age	25	35	45	55
Contribution rate %	17%	24%	37%	72%

Contributions as % of salary for a male worker to achieve a pension of two-thirds of final salary at age 65. Assumes 2% real earnings growth and a real return on assets of 3% per annum. Source: Aspects of the Economics of an Ageing Population, House of Lords Select Committee on Economic Affairs, 2002-03.

Saving for a longer period has a substantial impact on the size of any final pension fund. Table 5.2 shows the final value of £1,000 invested at 5 per cent and 10 per cent rates of return, over a period of 1-40 years. Table 5.2 demonstrates the huge impact on final pension fund values when comparing saving over 40 years compared with 30.

Table 5.2: Future value and compound interest

Years	Age	5% per annum return	10% per annum return
1	65	£1,050	£1,100
10	55	£1,629	£2,594
20	45	£2,653	£6,727
30	35	£4,322	£17,449
40	25	£7,040	£45,259

IoD estimates

Of course, saving in a pension fund through equity investment is not without risk as we have seen over recent years, and recent declines in pension fund values appear to have made at least some prospective retirees defer taking their pension.

The changes in recent years allowing people to carry on working whilst taking pension benefits is liberal and welcome, allowing a "phased" approach to retirement to be taken.

However, managing this transition process is often difficult. Evidence suggests that the longer people remain in full-time employment, the less likely they are to make the transition to retirement through flexible employment. There is also evidence that older part-time workers are largely based in small firms, probably because these are 'closer to home'.

5.5 Employer incentives

There is a stereotypical view that employers are negative towards retaining older employees. Indeed, according to data produced by the Third Age Employment Network, nine out of ten people engaged in job hunting, over the age of 50, gave up within a year. This is a daunting statistic, but even if this view applied in the past it doesn't mean that it will be equally depressing in the future.

With an affluent, ageing population companies will actively seek out the 'grey pound'. As part of this positioning, companies are likely to try and match the age distribution of their workforce with their customers. Markets may already be changing in this way.

It is not immediately obvious that an older workforce is more or less productive. In an age of manual labour, declining productivity might be associated with age, but in today's largely non-manual workforce the link between age and productivity will be weaker. It will, however, not necessarily have disappeared. The age-productivity link is likely to differ substantially across different sectors and companies.

Flexible retirement whereby employees gradually wind down their commitment from full-time to part-time, over a period of years, could provide an incentive for both employers and employees. There is an acceptance that hourly productivity is very

often greater for part-time workers than full-time workers. Moving towards part-time work for older workers might address the productivity concerns of employers and the need for additional income for employees who cannot afford to stop working completely.

One of the keys to higher employment rates for older workers, in the future, will be to maintain the link between pay and productivity. Wages will need to reflect marginal product. It is quite plausible that in the future, earnings might plateau before declining for the 65+ cohort who remain in work. If productivity declines at a higher age, and wages do not adjust accordingly, the demand for older workers will decline.

The link between skills and productivity also presents a challenge for employers and employees. If people begin to retire significantly later, they will have an increased incentive to engage in training and lifelong learning, in order to remain competitive in the labour market. Research suggests older workers can adapt to technological change and the need to acquire new skills. The ability to adapt is likely to be even more apparent in future cohorts of older workers. Despite this relatively optimistic assessment it is clear that large numbers of organisations fall a long way short of embracing a multi-generational workforce.

Companies will need to effect a significant culture change in order to embrace the multi-generational workforce. Practical steps along this road might include:

- Creating tailored retention programmes aimed at targeting key staff and identifying how their needs can be accommodated by the company.
- Developing phased retirement models that are easily understood across the workforce.
- Identifying 'bridge occupations' which can provide a transition to retirement via freelance, consultancy or part-time employment.
- Recognising the value of human capital held by older workers. Exploit this knowledge base, possibly employing older workers in mentoring roles.
- Building on existing flexible work environments, in order to permit older workers to operate from home, whilst maintaining key social networks with colleagues in the office.
- Introducing training programmes for those in the 50s and 60s cohorts, in order to ensure these workers have the skills necessary to work to 65 and beyond.
- Adopting innovative ideas of best practice learned from other organisations.
- Identifying the need to re-design pension schemes in order to facilitate post state retirement age working.
- Adopting anti-ageism policies in the same manner as anti-discrimination policies for women and ethnic minorities.
- Identifying changes in working conditions which might facilitate greater retention of older workers.

- Recognising that older workers are likely to display greater loyalty than younger workers and so increasing training for older workers might be better for the bottom line.

5.6 Is a higher state retirement age fair?

One important critique of increasing the state retirement age needs to be addressed. There is a concern that raising the state retirement age discriminates against lower income groups such as manual workers, who die younger. The gap in average life expectancy at birth between manual and non-manual men is 3.5 years and for women 2.8 years.

The implication for the state retirement age is not clear, since the disadvantage in life expectancy for manual workers is less than the disadvantage to other groups. For example, men die five years younger than women do and smokers die seven years younger than non-smokers do. The role of smoking is significant and actually drives much of the current and future gap in life expectancies by socio-economic group. In such circumstances one could argue that raising the state retirement age might act as a disincentive to smoking.

If the state retirement age is prevented from increasing because of lower rates of longevity in a minority of the population, the cost of the state pension will increase due to greater longevity in the majority of the population.

6 Additional comments

6.1 Public sector unfunded pensions

Public sector pension schemes are not sustainable. Most public sector employees can expect to retire on an index linked final salary pension (up to two-thirds), in many instances well before the state retirement age. The Government has attempted reform of public sector pension provision – which is overwhelmingly defined benefit. The Government has raised the retirement age for new public sector employees from 60 to 65 (except for the funded Local Government Pension Scheme, which already had a normal retirement age of 65). It is also changing the way in which salary related benefits are calculated, in order to reduce the generosity of the current system. Our concern is that faced with trade union opposition, the Government's reforms do not go far enough.

Corin Taylor, Senior Policy Adviser at the IoD, has published a paper studying the scale of this issue and this can be accessed at www.iod.com/pensionsapartheid. For a summary, see Box 6.1 below.

Box 6.1 The need to reform public sector pensions

This box summarises the IoD's recent report on public sector pensions: "The Pensions Apartheid: The problem, the cost and the tough choices that need to be made."

In an ideal world, changes to pension arrangements would not be necessary. But in an age of rapidly rising longevity, pensions will become more expensive unless lasting reform is undertaken. Businesses have had to face up to reality and go through the painful process of scaling back defined benefit pensions. By contrast, recent reforms to public sector pensions have been inadequate, meaning that the gap between public and private pension provision is wider than ever. In the past, lower salaries in the public sector justified more generous pensions, but now that public sector employees are better paid than those in the private sector at all but the highest levels, the pensions apartheid can no longer be defended.

90 per cent of public sector employees are members of DB schemes, while the proportion in the private sector has fallen to just 12 per cent. This is after a decade and a half of economic growth. The current recession will lead to even faster falls in private sector DB membership, as pension funds perform poorly and companies no longer have the cash to keep DB schemes going. But at the same time, unless further reform is carried out, taxpayers may have to find up to £335 billion to bailout public sector pensions over the next 50 years.

The pensions apartheid needs to be bridged by reducing the costs to taxpayers of unfunded public sector pensions and by increasing private sector pension saving. Increases in the state pension age to 68 will do a lot to mitigate increases in the old age dependency ratio – in fact, if the state pension age was increased to 70 by 2056, the dependency ratio would remain where it is today. Hence, the IoD recommends that the public sector normal pension age should be increased in line with the state pension age as a first step. This would reduce the disparity between public and private pensions, but further consideration needs to be given to overcoming the transition costs of moving to DC in the public sector.

The current recession will make the pensions apartheid even greater and the enormous deficits being run intensify the need to reduce long term costs to help bring the public finances back to sustainability. There really is no alternative.

6.2 Greater financial education

A survey of published research will show that the UK population as a whole displays worryingly low levels of financial literacy and this is especially the case with regard to retirement planning. Perhaps this is not surprising, given the complexity of the current system, but it is nonetheless worrying. People seem to have, in some cases, only the haziest idea of the issues around future financial provision. Overall, recent policy seems to have revolved around the idea that if the product costs of a pension are made cheap enough, people will beat a path to the door of pension providers. This started with the price caps introduced for Stakeholder pensions in the early years of this century and is continued in the ambitiously low pricing anticipated for Personal Accounts, which seems likely to put further pressure on margins for private sector providers. This can be arguably a good thing, but one side effect is that it becomes extremely difficult if not impossible to justify the kind of marketing budgets that would alert people to the challenges they face.

However, and separately from this, there remains a prima facie need to imprint the necessity of long term saving on the nation’s consciousness from an early age. The arrival of such initiatives as the “Generic Advice” money guidance resulting from the Thoresen Review is to be welcomed, but we suspect that much more needs to be done in the mainstream educational system to create an acceptable level of financial literacy, possibly by inclusion of relevant modules in early secondary education. The more people are aware of the issues and challenges they face, the more they are likely to engage with solutions to them.

7 External expert commentary

7.1 Long-term care

The Long Awaited Green Paper

"Society is going to need to spend more on care and support, and we need to decide where the funding is going to come from – whether from the state, from individuals or from both."

After a long delay, the Department of Health has finally published its Green Paper on reforming adult social care. It is impossible to disagree with the broad sentiment put forward by the Prime Minister in his introduction, that we need a system which is "*fairer, simpler and more affordable for everyone*". It is hence all the more unfortunate that the Green Paper failed to live up to its lofty ambitions.

The challenges resulting from the UK's ageing population are stark. Projections from the Office of National Statistics suggest that the number of people over 85 in the UK will double in the next 25 years and treble in the next 35 years. While one in five people currently require residential care in their old age, the Department of Health estimates that two in every three women, and one in every two men, can expect to have a high care need at some point during their retirement.

Under the current social care system, the state provides social care only to people with limited means who cannot afford to pay for themselves. Those who can pay for themselves have been expected to do so, using up their savings and the value of their house to pay for their care, until they have only £23,000 left.

There are currently 400,000 elderly people in residential care, with 100,000 new entrants every year. Of these, it is estimated that over two-thirds are paying for at least some of their care costs and over one-third are paying the entire cost. Less than 10 per cent of these self funders receive any form of suitably qualified financial advice when they enter care regarding insurance products that would help prevent them running out of money. The sums involved are large. The average cost of staying in a residential home is £30,000 per annum and considerably more than this in the South East.

In addition to those in residential care, 500,000 adults are receiving care in their own home, with 150,000 paying privately.

The Green Paper sets out three main options for reforming funding, each of which raise more questions than they answer.

Option one: partnership model

Under this option, responsibility for paying for care would be shared between the State and the person who has care needs. It would see the Government providing between a quarter and a third of the cost of care; more for people with limited means. The Department of Health estimates that today's 65 year olds will need care costing

on average £30,000, which means the government would contribute approximately £7,500.

By providing a guaranteed level of payment for everyone, this model will almost inevitably increase the overall cost of long-term care to the public purse. Our ageing population and likely escalations in care costs will only exacerbate the situation. Yet the Government has suggested there is 'no new money'. How can these two realities be reconciled?

The government admits this option will "not fully protect people against the risk of paying high costs[…], and if they are one of the small number who spend years in residential care then they may still have to use almost the whole value of their home to pay for care and support".

Option two: voluntary insurance

In this model everyone would be entitled to have a share of their care and support costs met, just as in the partnership model. People would then cover the remaining cost of their care through a voluntary insurance scheme, offered by the private sector or the State. Government estimates that the cost of insurance could be around £20,000 to £25,000, compared to the £30,000 average cost of care for a 65-year-old.

However, there is little public appetite for a pre-paid insurance scheme as most people are only prepared to pay for care when they know they definitely require it. An opt-in scheme will only be financially viable if uptake is extraordinarily high, and this is unrealistic. Yet the government is only envisaging a difference of £3,000 to £5,000, per person, between a voluntary scheme and a compulsory one which would involve everyone. The sums simply do not stack up at the moment, never mind in future as a higher percentage of retired people require care.

Option three: comprehensive

This option would see everyone over retirement age, with the resources to do so, having to pay into a state insurance scheme, whether they eventually need care or not. Everyone who qualified for care and support would get all of their basic care and support for free. The Green Paper indicates that people might need to pay around £17,000 to £20,000 to be protected under this scheme, payable in instalments or as a lump sum, before or after retirement, or after their death if they preferred.

The Green Paper acknowledges that, as with any insurance system, "some people would have to pay much more than the actual costs of their care and support, while others would pay much less." Making this argument requires genuine political commitment and a real shift in public opinion, otherwise any sort of compulsion will be viewed as a form of stealth tax.

Quite worryingly, it is this option that appears to be finding the most favour. Ironically, the Green Paper already ruled out another option of a general increase in taxation to provide free basic care for all, citing the argument that it would be grossly unfair to expect the ever shrinking number of working age taxpayers to fund the care needs of the increasing old-age population. The so-called "comprehensive" proposal is,

however, in reality a regressive tax on retirement, where everyone in retirement has to pay the same amount irrespective of their means. Even then, it would only fund a proportion of an individual's actual care costs as explained below.

The devil is in the detail

Buried in the Green Paper, almost as an aside, is an admission that all of the proposed funding options "show the cost of care, but do not include accommodation" because we would expect people to pay for their own food and lodging, whether or not they were in a care home". Yet this equates to tens of thousands of pounds per person which would not qualify for assistance.

Both the voluntary and comprehensive options could lull the public into a false sense of security. They will expect that in return for paying into a state backed insurance scheme, all their care needs will be met in full. In reality, not only will they have to pay for all their lodging and food, but also for any needs that go beyond what Government considers to be "basic care".

Back to the drawing board

A fundamental flaw with the Government's consultation approach is that it is being led by the Department of Health and, therefore, considers the problem from the wrong end of the telescope. The Department's remit is to consider social care funding and that is what it has done; considering as a whole the social care funding and other needs of all adults who require social care, whether they be younger adults with learning disabilities or older people with old-age related care needs.

The problem with this approach is well illustrated by the "voluntary" and "comprehensive" funding options which both require significant lump sums to be paid in retirement, completely divorced from any fundamental consideration of how to fund as fulfilling a retirement as possible, whether healthy or unhealthy.

As a further peculiarity of a DoH led approach, the Green Paper considers the needs of England only, devolution setting the framework for different social care structures in the rest of the United Kingdom.

The only sensible way forward is to consider the funding of long term care in old age as part and parcel of a more fundamental, and holistic, review of funding for retirement more generally.

Not everyone in retirement will need care, but an increasing number do. One in five people currently require residential care in their old age, which is anticipated to increase to one in three in the next 25 years.

Although pre-funded Long Term Care insurance solutions are available today, whereby individuals can pay insurance premiums during their working lives to provide an increased income in retirement should they need care, there is little public appetite for this product as most people are only prepared to pay for care when they know they definitely require it. With the demise of defined benefit pension schemes, most people would prefer to accumulate as much as they can afford to enjoy a healthy retirement

and not "earmark" part of their hard earned retirement saving for something they may never need and certainly will not enjoy.

However, once someone is in the unfortunate position of needing residential care in their old age, under both the current system and all three options set out in the Green Paper, they face the very real possibility of depleting their savings entirely. Whilst the average stay in residential care might be three years at an average cost today of £30,000 per annum (much higher in the South East), some individuals will live considerably longer than the average. Examples abound of people in this situation expending £300,000, £400,000 or even £500,000 before becoming destitute and falling back on the state.

Fortunately, there is an extremely effective product on the market today that removes this risk entirely. With an "Immediate Needs Annuity" the individual pays a lump sum to the insurance company when first needing care. This lump sum is only a little more than the cost of care for someone expected to live the average amount of time (typically three years) and guarantees an income to the care home for the rest of that person's life, no matter how long they live. This provides complete certainty to all parties: the individual, the family, the care home and the State.

As an added benefit, the Immediate Needs Annuity is paid entirely free of tax, provided it is paid to a registered care provider.

The major reform required to pension planning is to enable the purchase of an Immediate Needs Annuity to be an allowable purchase from an accumulated pension fund. That way, people could be encouraged to make as much provision as they can for enjoying an active retirement – through savings, property or pension – and then turn to the very effective Immediate Needs Annuity insurance solution if and when they actually require care and are at all concerned about running out of money. The balance of their estate could then be distributed immediately to their family at that point if they so desired; their future care costs having been "advance purchased" through the Immediate Needs Annuity.

For those requiring domiciliary care, a very effective solution can be constructed through a combination of utilising their pension fund, releasing equity from their property and funding an Immediate Needs Annuity.

Finally, if the statutory retirement age were to be increased, not only would individuals have a longer period to accumulate savings for their retirement, but the possibility opens up of switching careers towards the end of one's working life to join the expanded employment opportunities that will exist to support the ever increasing number of people with care needs.

Ian Owen
Chairman, Partnership Assurance www.partnership.co.uk

Biography

Ian Owen M.A., D.Phil, FIA is Chairman of Partnership, the market leading provider of enhanced, impaired and care annuities. He is also Chairman of the A-Plan Group, a non-executive director of Canopius and a non-executive director of the former Resolution life companies.

During a long and varied executive career in insurance, following an initial spell as a physicist, Ian was responsible for various life and general insurance companies, both in the UK and overseas, including CEO of Eagle Star International, Managing Director of Eagle Star Life and Managing Director of Zurich Personal Lines. A qualified Actuary, he has previously served on the ABI LIC and chaired its medical committee.

Married with twin boys (both actuaries!). Enjoys sailing, cars and skiing.

7.2 Some social policy aspects of retirement

The Beveridge reforms pre-dated the dramatic ageing of our society, so treated the issue rather cursorily. Subsequent reforms to the pensions issues and social care agenda have tended to happen incrementally, generally in response to a crisis or system failure – even the Pensions Commission report and this year's Green Paper on 'Shaping the Future of Care Together' fall into this category. Unsurprisingly the end product is something of a mishmash. What is long overdue is a new deal for retirement, which acknowledges the changes in longevity and the expectations around income, care, and lifestyle issues which a new generation of older people will hold. Here lies the rub: sketching an offer to the 25 year old (male on average earnings working full time – beloved by researchers) opens one set of options, but helping today's pensioners and those approaching or already over the state pension age is less easy.

Logically, we could start with the 25 year old, since those 65+ will be largely dependent on public spending to support their retirement. It is a signal of our policy failure in the last half century that 20 per cent of our retired people live below the poverty line. Less than £1,500 savings have been accumulated by 40 per cent of single male pensioners, and by 45 per cent of single females. State pensions and benefits comprise more than half the income of 45 per cent of pensioner couples and 73 per cent of single pensioners.

The current package of pension reforms looks fairly credible to the 25 year old planning to work for the next 40 or 50 years (and as a full-time employee on average male earnings). The breakthrough in the package was to give (almost) universal access to pension schemes and to plant the idea of working longer. The Pensions Commission argued that sustainable pension schemes would require a working life which roughly remained proportionate to life expectancy: we have not been especially clever about predicting life expectancy, but this feels the right approach. But the policy aspiration of longer working lives (a challenge which equally applies to older workers today) is hardly matched by action: it must be addressed more vigorously. We need a better understanding of the issue, and some new tools to promote it.

- Why do people leave work? Are they pushed or do they want to retire? What does the research tell us?
- What work do older people want to do? Do they want to carry on doing what they have done before, or do they want to make a change – it is broadly accepted by HR professionals that a change of role can be an energising factor in people's careers.
- What counselling and education is available to older people wanting to stay in the labour market? Demonstrably, older people use in-work training opportunities less

than younger employees, and publicly-funded training schemes focus primarily on young people.

- What are the growth areas for employment? Are older people likely to be attracted to them? What skills will be required for these jobs, and do we have the training opportunities in place to deliver them?
- Do we need to change the way we package work, with more part-time and job-share options? Is there a new suite of fringe benefits and inducements we should be considering?
- Employers will need help too, particularly small businesses without sophisticated HR and payroll departments. Few will be aware of the help available to support employees with disabilities. Many could find the paperwork of employing part-timers daunting.

The other part of the Pension Commission report which changed the context was auto-enrolment into a mega defined contribution scheme. Auto-enrolment is a word which sounds more comfortable to governments than compulsion, and fits the world of libertarian paternalism – i.e. creating a framework where people are 'free' to make the right choices about their lives. But the big decision was that this new scheme should be defined contribution based, so making the outcome of pension saving dependent on the performance of investment managers. In a big scheme, democratically overseen, this should work, even though it has totally altered the risk-bearing which historically characterised pension schemes. This idea, this new scheme of Personal Accounts, is being started small for perfectly good reasons, but if it succeeds, it will be a major element of retirement incomes in the future. In the absence of any better idea on the agenda, this must be the show in town we are happy to support.

The care issue is another dimension of retirement where existing provision is woeful. Local authorities assessing care needs classify people as having critical, substantial, moderate or low care needs, and 70 per cent of them will only offer help to people in the top two categories. This leaves 1.5 million people in England with care and support needs which the state does not meet. Since 2000, the number of households receiving home care services has fallen by 18 per cent. Even without the pressures (acknowledged in the Green Paper) of demographic change and rising expectations, the present system is coming apart at the seams.

Clearly we are going to have to pay more towards care by one route or another. The issue is one where there needs to be a large degree of shared responsibility, since the risk of needing a significant amount of expensive care is very variable and somewhat arbitrary, but the consequences for an unfortunate individual can be catastrophic. Whatever the route, the payments probably need to be made over a lifetime, since having the income (or capital) available at the point of need cannot be guaranteed for that unfortunate individual. Hence the suggestion that care costs should be linked to pension contributions. The only pension contribution which everybody makes is National Insurance, even when Personal Accounts are implemented and operating.

The difficulty about moving this debate forward is that not everybody is prepared to pay towards the sort of care which the state currently offers. There is a lot of support for giving people the freedom to make their own choices, which is where the partnership concept comes in, with the state guaranteeing a certain provision (either

in cash – direct payments – or in kind) and the rest is left to personal choice. Increasingly, this seems the likely direction of travel for the shape of care services, but the Green Paper tries to ease the pain of a compulsory care contribution by suggesting that it might be met through a capital payment at the age of (say) 60, or even by a deduction from one's estate after death. There would be practical difficulties with this proposal in a mobile society, and in respect of estates, this becomes compounded with housing wealth. It is important to remember too the savings picture (above) of our existing older population.

Part of the reason for the general concern about care costs is that we are projecting existing health and care conditions and multiplying them by demographic change. Thus the Green Paper suggests that we will be providing care to 1.7 million more adults in twenty years time. But to some degree, this is a policy of despair. Can we not look to strategies which reduce or prevent care needs arising? More appropriate housing and more attention to the illnesses and disorders of older age would help: there are an estimated 9 million people in the UK suffering from arthritis. There are between 3-3.5 million people suffering from urinary incontinence – the majority over 65. Investing in dementia research has been very slender, yet on current trends we expect to see today’s 700,000 sufferers grow to more than 1.7 million by 2050. We may not remove the need for care altogether, but a reduction could make a significant difference to the costs of a care insurance scheme.

The philosophical landscape for the new retirement deal is becoming clearer. In Rumsfeld language, the known known is that we shall have to pay more towards it if we want an adequate pension and some support with our care needs. We also know that these new costs can be contained (but not eliminated) if we can extend our working lives – at least proportionately to the growth of our life expectancies. Furthermore we know that the existing policy designs in these areas are inadequate and failing, and remedial action cannot be left to market forces alone (that would leave too many casualties to be picked up by publicly-funded safety-nets), so political leadership is necessary which can chart a new map to take us forward. The known unknown is how much it might cost, and this has paralysed the political process in seeking to make progress in these areas.

But there is a consensus that seems to be emerging (at least from the cognoscenti). The state will provide a basic pension deal and a basic care package on a universal basis. It will not be gold-plated, but it will be the default position. If you want a better offer, you must look for it in the private sector. The state may enable and encourage you to go there, for example by tax relief on pension contributions, though that specifically is a prima facie case of one state policy working against the objectives of another (equality), so seems unlikely to be the route forward. There is a novelty in this concept. Whereas our longstanding NHS and education policies provide a universal (default) service out of which people can opt if they wish, they can seldom accrue any ‘credits’ from their general tax payments to take with them if they do opt out and go to the private sector. The deals envisaged in pensions and care would seem to be different, largely because the ‘benefits’ in pensions and care are increasingly spelt out in monetary terms, and thus everyone can accrue (or qualify in the case of care) these and then go to the markets for extra deals, topped up by their own money, if they can afford them. This may be what New Labour rhetoric meant when some years ago its mantra was ‘progressive universalism’.

It may have a philosophical lumpiness, but at least this approach allows us to make progress. Yet we have still only solved part of the problem. We have a new deal to offer to today's 25 year olds, even though it may be Hobson's choice. But what are we offering the 55 year old (with few opportunities left to join this game) or the 75 year old with probably no opportunities? There needs to be a transitional strategy, but not too long – in a mobile and global economy, people do not stay in identifiable boxes for very much time. These older people are unlikely to be able to pay adequate amounts from income-generated resources, but could we expect (or should we) ask them to join in with one-off capital payments (or debts, to be set against their final estates)? How we deal with the older population will probably be much more difficult than the message we send to the younger cohorts.

Now, who is going to tell the population that this is what is envisaged for their future? Even the post-Pension Commission package (involving longer working lives and an opt-in to Personal Accounts from 2012 meaning salary deductions) has not yet been explained or sold to the public as a whole.

Mervyn Kohler
Special Adviser, Age Concern and Help the Aged

Age Concern England and Help the Aged have joined together to form a single new charity dedicated to improving the lives of older people.

Biography

Mervyn Kohler is Special Adviser at Age Concern and Help the Aged, having been Head of Public Affairs at the latter since 1984. His original role was to manage the Charity's links with Parliament, Government and the outside world, and to develop the policy position of Help the Aged. As the political and social agenda involving older people has mushroomed, Mervyn Kohler has increasingly focussed on income and financial issues (which underpins so much of the well-being of older people), but he retains an overview of the broad policy field. This, with his twenty-plus years of long service, means he plays a part too as the public face of the Charity, at conferences, seminars and in the media. He is, and has been, on the trustee board of a number of charities and on several public bodies, and currently serves on the Fuel Poverty Advisory Group.

7.3 The wider pensions world

Most people would acknowledge that a trust-based defined benefit (DB) occupational pension scheme is the best employee benefit around. But to deliver on its promise, a DB scheme needs the long-term backing of an employer, both willing and able to bear the costs many years into the future. The dominance of DB has to some extent contributed to its decline; the bigger it became, the bigger the challenges and the greater the controls and security needed.

For many years, the DB market has been in a state of flux, largely as a result of both welcome and unwelcome regulation. In addition to, and often because of, the increased regulatory burden, the cost of running a DB pension scheme has increased relentlessly over the years; and this trend is unlikely to slow in the foreseeable future. Management fees and volatile investment conditions have all played their part in the decline of DB. One of the most significant recent developments contributing to increased cost and risk uncertainty has been the recognition that longevity is

increasing. Each year, over the last three years, FTSE 100 companies have added an extra year to pensioner life expectancy,[1] recognising the cost of increased longevity.

Scheme asset values fell sharply in late 2008, but as bond yields were rising, the impact on scheme deficits was less pronounced. That state of affairs changed in 2009, with large cuts in interest rates and as a consequence, deficits have increased significantly, with UK pension schemes of FTSE 100 companies showing a net deficit of £96 billion[1] in July 2009. Furthermore, changes to accounting disclosure requirements have meant that the increasing cost of schemes becomes visible on the employer's balance sheet. Many commentators argue that the true liabilities of DB pension funds remains understated.

Regulation and guidance, while welcome in many respects, has changed the balance between sponsors and trustees, with trustees having much greater responsibility. Trustees are also being encouraged towards greater caution and to exercise their significant powers; failure to do so can bring criticism from members and/or the regulator. Unfortunately, recent economic turmoil has put serious constraints on credit and weakened the sponsor covenant at the same time that trustees feel required to press employers for more cash.

The increased expense and complexity has caused many scheme sponsors to turn away from DB provision. Scheme closures started in earnest five years ago but have accelerated recently, to the extent that almost 90 per cent of DB schemes in the UK are closed to new entrants.[2] Many are now also closed to new accrual and this trend looks likely to continue. The journey to wind up has therefore already commenced for most schemes.

A recent poll of companies concluded that in five years, only 5 per cent of companies will have a defined benefit arrangement.[3] The introduction of Personal Accounts in 2012 may be an unintentional catalyst for further reduction in DB provision.

Companies are therefore closing DB schemes, but are not typically walking away from employee pension provision altogether. Some closures have been superseded by fairly generous alternative arrangements, for example, by career average schemes to limit exposure. However, the main trend is to defined contribution plans (DC), where the risk is borne almost entirely by the member, who, arguably, may be least able to understand and absorb it. Too few DC members understand their own requirements and many fail to choose or amend their investment choices. Many DC scheme sponsors counter this by including safety nets such as default investment options and/or lifestyling approaches, but no one default will suit everyone and the more tailoring that goes on, the greater the complexity and need for advice, communication and education.

While the attraction of DC to the employer is that the cost is predetermined and easy to account for, the downside is that the average contribution to DC is considerably lower than to DB (around 10 per cent compared to 29.5 per cent for DB).[4] As well as

[1] Lane Clark & Peacock, 2009
[2] June 2009 poll by PriceWaterhouseCoopers
[3] Ibid.
[4] According to a 2009 survey by the Association of Consulting Actuaries

this lower average contribution going in, the level of annuity that can be secured by the DC fund at retirement depends on market rates at the time. There is concern that the introduction of a minimum threshold for auto enrolment in 2012 will lead to a downgrading of current DC provision. It will almost certainly increase the complexity and running costs for employers. The trend to DC is likely to continue for some time, although it may morph into a shared-risk model whereby the employer takes on some risk (typically investment risk), passing other risks (for example, longevity) to members. DB as we know it today is unlikely to experience resurgence any time soon.

However, closing a scheme provides only part of the solution; it does not remove the most significant costs and risks. The employer continues to have responsibility for the benefits already accrued and all the management and uncertainty attached. The trustees still have to manage those risks and members continue to have worry that expected pensions may not be paid in full some years down the line.

The buyout market

Over the last few years, a highly competitive and dynamic market has evolved to provide solutions for companies, trustees and scheme members. The insured buyout market is not new; it has been available to schemes for decades, with large insurers like Prudential and Legal & General dominating the market and offering annuities to schemes on wind up. The huge opportunity, created by solvent employers wanting to rid themselves of the burden of DB schemes, attracted innovative new players, like Pensions Insurance Corporation and Lucida into the market, but also led to some existing insurers, like Aegon and MetLife, diversifying into the new buyout space. These new entrants, in turn, gave the existing players the impetus to improve their game. Innovation and competition now means that employers and trustees have a range of options available to them.

The buyout market showed rapid growth over the there years to 2008, but the financial crisis created a temporary lull and forced many insurers to adapt to changing circumstances. During 2008, almost £8 billion worth of deals transacted – a huge increase on 2007 and 2006, but less than the predicted business level and significantly less than the addressable market for buyout solutions. 2009 is expected to see deals totalling around £5 billion, with an increase in the number of longevity only transactions.

Buyout is the ultimate pension de-risking solution and will continue to be viewed as such because it offers genuine security for members takes risk and volatility off the table for employers and allows trustees to discharge their duties properly and effectively. Buyout with a UK-regulated insurance company gives trustees the security of a well-capitalised organisation coupled with cover under the Financial Services Compensation Scheme, which provides a safety net of 90 per cent of the value of each policy in the unlikely event of an insurer being unable to meet its financial obligations.

“Buyout” is a term used to cover a number of different approaches; which one suits best will depend on individual scheme and company circumstances. The most popular types are shown below:

- **Buyout:** all past and future benefits are secured with individual policies through a regulated insurance company and protected by the Financial Services Compensation Scheme (FSCS). The scheme is wound up and all liabilities are discharged.
- **Partial buyout:** a sub section of the scheme only is bought out. This is only possible in limited circumstances.
- **Buy-in:** the trustees purchase a policy with a regulated insurance company to cover the liabilities of the scheme. The cover can apply to all scheme members or a sub section (pensioners being the most common), but the trustees retain responsibility for the scheme; the buy-in policy simply becomes an asset of the scheme. Buy-in also enjoys the protection of the FSCS. Buy-in can translate to buyout at a later date.
- **Longevity swap:** this is not really a buyout in that only one risk is removed, often only for a limited period of time. Longevity risk is addressed through the payment of premiums to (usually) a regulated insurer in exchange for an agreed future income stream to pay benefits as they fall due. The trustees retain the assets and responsibility for the scheme. A longevity swap is generally regarded as a stepping stone to future buyout, but care needs to be taken to ensure that the arrangement does not preclude later buyout.

Within the common types, solutions can be designed to fit particular needs, for example, phased buyout, variable payment terms, short term risk transfer, profit sharing and insuring data risk.

In addition to insured solutions, there are also non-insured approaches, like the scheme transferring to a new employer prior to buyout. While these can offer certain advantages, they need careful thought and execution, as they are potentially more vulnerable to moral hazard risks.

Schemes can take different actions to reduce risk and many derisking strategies often precede or are combined with buyout to manage liabilities out of pension schemes as efficiently as possible. Examples of other derisking solutions include hedging of assets and liabilities, early retirement programmes, trivial commutation and enhanced transfer values. Each has to be carefully managed to ensure value for money for the scheme and members, but the increase in such initiatives shows the depth of desire to get rid of pension scheme risks.

Despite the adverse effects of the financial crisis, the appetite for buyout has not gone away and in fact many trustees and companies regret not proceeding with buyout before the credit crunch. The buyout market remains competitive with a number of good, solid insurers and financial institutions willing to take on the investment and longevity risks of a pension scheme in exchange for a premium. Most trustee boards have buyout on their agenda and discussions are likely to grow with the completion of the 2008-09 round of triennial valuations and funding negotiations.

The closure of DB schemes will continue, whether or not it is socially acceptable, meaning that virtually all will be on a path to buyout; the direction is certain, the timing less so.

Margaret Snowdon
Operations Director, Lucida plc

Biography

Margaret Snowdon is well known in the pensions industry, with over 30 years experience of consulting on pension strategy to virtually every industry sector.

She is an honours graduate of Glasgow University and spent some time on post-graduate research on retirement and ageing with both Glasgow and Keele Universities and the Scottish Retirement Council. She trained as a psychologist and has lectured and counselled on mental health in retirement. She has studied business management with Ashridge and Cranfield Universities, as well as Harvard Business School.

In her career, Margaret has managed large third party administration service companies and pensions management consultancies and has worked with many blue chip companies on HR and pensions operational strategies. She was a partner with Mercer Consulting and with Towers Perrin before setting up her own consulting business, The Pensions Practice, in 2003. In January 2007 she joined Lucida plc as Operations Director.

Margaret is a Fellow of the Pensions Management Institute, a former Member of Council and Vice President of the Institute. She is Chairman of TPAS, the Pensions Advisory Service, as well as a Fellow. She also advises the Raising Standards of Pensions Administration charity, and chaired the Working Group which piloted and then launched the national Member Survey on service experience. She serves on the FRC Actuarial Stakeholder Interests Group and is a Governor of the Pensions Policy Institute.

In her limited spare time, Margaret enjoys SCUBA diving, sailing and clay pigeon shooting.

7.4 Group Risk

The ABI's latest report on the nation's savings states: "The UK continues to under-save. Half of the working population (over 13 million people) are either not saving in a pension at all, or are not saving enough:

- 9.6 million people (34 per cent of the workforce) save nothing in a pension.
- 3.8 million people (13 per cent of the workforce) save too little.
- 13.3 million people (47 per cent of the workforce) save enough."[5]

This under-saving affects other areas potentially far more devastating in terms of financial distress because timing cannot be predicted – death, illness, accident and disability. These are risks every one of us runs every day of our lives yet the UK life assurance protection gap at the end of 2008, remained at £2.3 trillion (£2,300 billion) and the income protection gap at the end of 2008 remained at £190 billion per annum.[6] With the UK household savings ratio (household savings expressed as a percentage of total resources) having declined from over 12 per cent in 1980 to only 2

[5] ABI, *The State of the Nation's Savings,* November 2008
[6] Swiss Re, *Term & Health Watch 2009,* May 2009

per cent in 2008[7], the loss of a household's primary earner income can be devastating.

Without company sponsored insured benefits, the UK's protection gaps would be even greater – in excess of £3 trillion (£3,000 billion) for life assurance and in excess of £230 billion per annum for income protection.[8] This largely goes unacknowledged yet it saves the Welfare State considerable burden.

Against this background, it seems vital to promote and build upon the contribution that employers and the Group Risk industry make towards limiting the financial impact of these events on individuals/their families – yielding considerable savings for the taxpayer.

What is Group Risk?

Group Risk is an umbrella term for three company sponsored employee benefits: Group Life Insurance, Group Income Protection and Critical Illness cover. Group Risk benefits are often (but not always) fully insured.

Provided in isolation or as part of a wider or flexible benefits package, these employer sponsored products can give employees access to insured protection cover either at a reduced rate or free of charge as they are covered under one "group" policy. This is often more readily available than individual cover since most employees do not generally need to provide medical details before cover is granted.

Group Risk benefits are highly valued as they provide financial protection for employees and their families, yet they are relatively inexpensive for employers compared with some other components of the typical benefits package.

Overview of Group Risk Benefits

Group Life Cover (GL) is the most common employer sponsored benefit in the UK and often represents the sole life insurance provision for low to middle income individuals. GL provides a benefit on an employee's death in service.

Group Income Protection (GIP) provides a continuing income for employees if illness or injury prevents them from working for a prolonged period of time. It can also replace lost income where an employee has to take a part-time or lower paid position because of illness or injury. A GIP policy is used by an employer to cover a contractual promise of long-term sick pay to employees.

Group Critical Illness (CI) cover pays a tax free lump sum to an employee on the diagnosis of one of a defined list of serious conditions or on undergoing one of a defined list of surgical procedures.

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[7] Office for National Statistics, Economic Trends as cited in HM Treasury, *Vision for the Insurance Industry in 2020* report from the Insurance Industry Working Group, July 2009
[8] Swiss Re, *Group Watch 2009,* April 2009

Current Issues/Future Thinking

Changing demographics, increased longevity and the knock on effect of the nation's appalling savings habits will result in an ageing working population with many working far beyond the retirement age they may have envisaged when they started their working lives. This will have profound implications for provision for the health and wellbeing of the workforce.

Default Retirement Age

The Employment Equality (Age) Regulations 2006 made it unlawful for employers to apply different terms and conditions (including benefit provision) on the basis of age. The regulations include a national default retirement age (DRA) of 65 which means that employers can currently require an employee to retire at age 65 provided certain procedures are followed. The DRA was due to be reviewed in 2011 but this review has recently been brought forward to 2010.

Additionally, the Government Equalities Office (GEO) introduced an Equality Bill on 24 April 2009, which will make discrimination on the basis of age in the provision of goods and services unlawful. The Government has committed to introducing an exception to the provisions made under the Equality Bill for financial services, providing differences in treatment are broadly proportionate to changes in risk. However, details of the exception will not be defined until after the consultation period, which closes on 30 September 2009. The Insurance Industry Working Group report (see separate section) states that "the Group is keen that the proposed exception is sufficiently clear not to inhibit the provision of appropriately priced insurance".[9]

At least one Government department has had no set retirement age for some time. Within the realms of pay as you go funding underwritten by the tax payer, continuing benefits indefinitely presents little difficulty. However, for employers utilising insurance products to fund their liabilities and for the insurers providing such products, this is a far more complex matter.

Setting aside potential discrimination for one moment, an actuarial fact of life is that age is a key risk factor for Group Risk protection products that cannot really be legislated against (pun intended) and the Equality Bill consultation document recognises this. Insurance theory dictates that the increased risk of an almost certain payout that accompanies increased age and failing health means that it is essential to be allowed to price a Group Risk product with a finite period of cover i.e. a fixed expiry age where provision of benefits can lawfully cease. Otherwise, these products will become prohibitively expensive even if it is actuarially possible to devise a means of costing an open ended risk with certain payout. (Isn't that called "an investment?)

This is a perfect example of how well-intended policy can have unintended consequences – often the case for Group Risk provision.

From a Group Risk provider's perspective, it is fundamental to persuade Government to retain a DFA (albeit most likely for a much higher age than 65) or, in the event of its

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[9] HM Treasury, *Vision for the Insurance Industry in 2020,* Report from the Insurance Industry Working Group, July 2009

removal, at least to allow an expiry age or event for Group Risk protection benefits. This could mirror the approach that is taken by the State, where for example entitlement to Employment and Support Allowance ceases at the age that State pension becomes payable. This simple alignment would provide defined risk for insurers and clarity and ongoing affordability for employers – thus enabling continued contribution towards plugging the UK protection gap.

Potential Evolutions

In the longer term this may require a change in mindset and compensatory changes in legislation to enable the industry to design new products. For example, is there a case to be made for a combined savings vehicle that pays out in the event of retirement, death or permanent disability, whichever occurs first?

Or a pension savings scheme that allows withdrawal or borrowing in the event of a period of disability or on redundancy. This would be a variation on the New Zealand, Canadian and US pension savings schemes which allow for withdrawals or borrowing – for a deposit on a first home (New Zealand and Canada), to finance training and education (Canada) or in the event of hardship (US) – but could follow similar principles.[10]

In terms of added redundancy protection, US-style bridging cover could be an option. Ex-employees can, for a reduced price funded by the US Government, remain in the employer's group plan for up to 36 months after leaving through redundancy.[11]

One further potential future product might be one which incorporates both GIP and Employer's Liability cover, given the close links and potential overlaps between these covers and the fact that both products are likely to include an active vocational rehabilitation service.

Insurance Industry Working Group (IIWG) Report

At the end of July 2009, HM Treasury published "Vision for the Insurance Industry in 2020" a report from the Insurance Industry Working Group into the medium to long term challenges facing the industry and the Group's vision for the future. The report recommends:

- Action from the insurance industry, the Government and the FSA to increase customer confidence and trust in the insurance industry and a greater awareness of personal responsibility through financial education.
- Partnership between the insurance industry and Government to better manage risk in society and to improve customer outcomes.
- Working with Government towards helping consumers to increase savings and protection provision and to manage financial distress caused by accidents, ill-health or old age.

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[10] HM Treasury, *Vision for the Insurance Industry in 2020,* Report from the Insurance Industry Working Group, July 2009
[11] Munich Re

- Encouraging capital flows into the UK insurance industry by ensuring its competitive position in the global marketplace is maintained and enhanced.

As an industry, we welcome the Government's acknowledgement of insurers' vital role in delivering welfare provision. In reality, the shift started some time ago, as through Group Risk benefits, employers are already making a significant contribution to meeting the State welfare burden. The Swiss Re Group Watch 2009 report shows, for example, that group risk policies provided by employers currently account for 40 per cent of all insured life cover held in the UK as well as 70 per cent of long-term income protection benefits.[12]

In an era of Welfare Reform, it's also worth noting that the Group Risk insurance industry has pioneered vocational rehabilitation in the UK and this already saves the State considerable cost burden and could play an even bigger role if tax breaks on employer provision were offered to encourage greater take up.

In addition, with Personal Accounts looming, this could be an opportune time to consider some level of compulsion for protection benefits as well as for pension savings.

Contribution to Welfare Reform

Welfare Reform is well underway in the UK. October 2008 saw the introduction of the Employment and Support Allowance (ESA – replacing Incapacity Benefit and Income Support) and the more stringent Work Capability Assessment (replacing the Personal Capability Assessment). Following on from this, Professor Paul Gregg's report "Realising potential: A vision for personalised conditionality and support" made the case that everyone who is claiming benefits should be required to engage in activity to help them to move towards and then into employment with the appropriate personalised support.

Next the Government's White Paper "Raising Expectations and increasing support: reforming welfare for the future" built on the proposals in the Green Paper "No one written off", accepted the recommendations made within the Gregg report, set out the Government's plan for moving to a system that offers more support but expects more in return and confirmed acceptance of the "invest to save" approach put forward by David Freud in his 2007 report "Reducing dependency, increasing opportunity: options for the future of welfare to work".

The Welfare Reform Bill was introduced in the Commons on 14 January 2009 and went through its second reading on 27 January 2009. It builds on the White Paper, consolidating all that has gone before, and proposes to reform the welfare and benefit system to improve support and incentives for people to move from benefits into work.

"The State will provide" is no longer a fallback position. Recent unofficial reports on the first tranche of claimants to go through the Work Capability Assessment for ESA indicate that more than two-thirds of applicants have been rejected.

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[12] Swiss Re, *Group Watch 2009,* April 2009

Additionally, we have seen the publication of Dame Carol Black's review of the health of Britain's working age population "Working for a Healthier Tomorrow", the Government's response "Improving health and work: changing lives" and the NICE guidelines on long term sickness absence and incapacity for work. The Government has also announced its first National Strategy for Mental Health and Employment, for publication in the autumn, set to include expectations of employers, healthcare professionals, organisations and individuals in improving wellbeing in the workplace.

All of these point towards greater responsibility for employers to provide vocational rehabilitation and support to enable employees to stay in the workplace.

Given that vocational rehabilitation is a primary feature of most Group Income Protection (GIP) policies, an employer with a GIP policy is currently able to assess an employee's level of incapacity and to commence a return to work programme long before any assessment for ESA is even due to commence. Additionally, GIP policies often carry additional free or discounted support services (such as absence management, Employee Assistance Programmes, GP help-lines, online health assessments, second opinion services, occupational health etc). An employer with a current generation GIP policy in place will save the State considerable cost burden – both in effort and monetary terms – and this should be recognised accordingly through tax breaks on employer provision or possibly through the same sort of contracting-out mechanism that exists for State pension provision.

Conclusion

Only ISAs and pensions currently attract tax relief. Given our changing demographics and our minimal savings record, as a nation we need to be encouraged to take personal responsibility for our pension and protection provision and to migrate away from the mindset that "the State will provide".

The move to conditionality is already underway in the Welfare Reform arena and the Personal Accounts framework introduces the concept of compulsion but employers have a role to play here too. Often the importance of these crucial benefits is little understood or "mañana" prevails – to take personal responsibility, one must have awareness and incentive. Consumer education/employer communications have a crucial part to play, as does incentivising employers to make provision that can ease the State burden. But equally, some recognition by the Government of employers' contribution to closing the protection gap is well overdue.

Katharine Moxham
Spokesperson for Group Risk Development (GRiD)

Biography

Katharine Moxham, spokesperson for Group Risk Development (GRiD), has over 25 years experience in the group risk market with particular expertise in new product development and strategic counsel.

She started her career in 1977 as a junior clerk in the pensions department at National Employer's Life (NEL) – now Unum – where she gained a grounding in all aspects of group life policies and group pensions.

She then moved to Towers Perrin in 1986 as a pensions administrator specialising in insured products for employee benefit provision and subsequently went on to build up Towers Perrin's insurance practice that evolved into a group risk and healthcare specialism over time.

In 2004, she joined Aon's Group Risk Practice to advise a portfolio of clients on implementing absence management and integrated health, risk and well-being strategy in the workplace.

Prior to joining GRiD, Katharine most recently held the post of Consulting Director of the Health and Risk Practice for JLT Benefit Solutions Ltd with overall responsibility for thought leadership and designing health and group risk propositions.

Katharine became spokesperson for Group Risk Development (GRiD) in May 2009.

Appendix A1

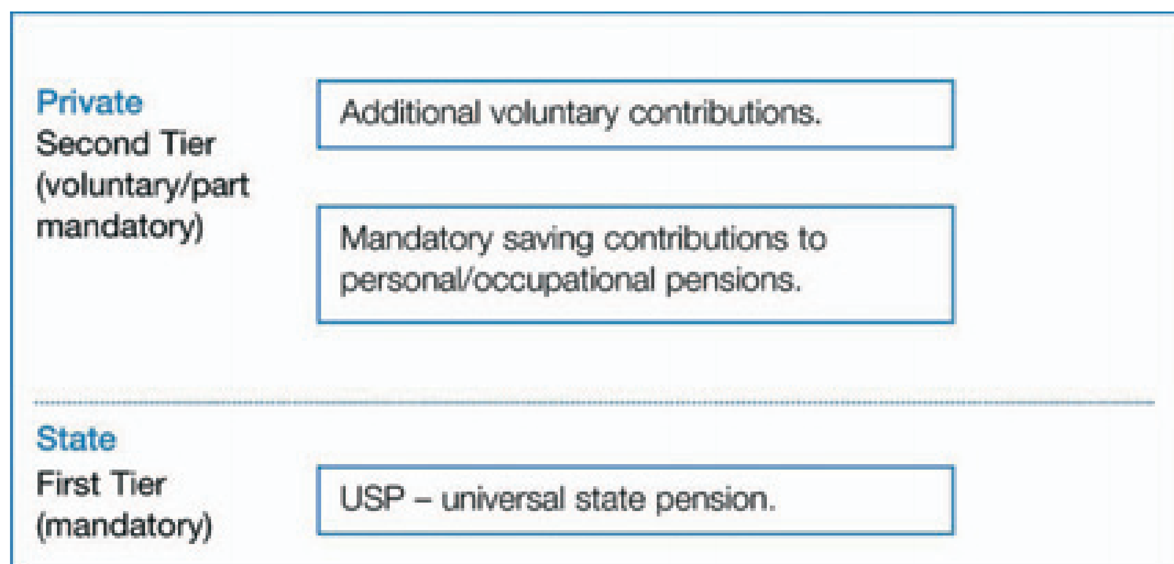
Pension reform model – the new state system

This Appendix reproduces parts of the IoD's 2005 Roadmap for Pension Reform paper.

The need to simplify the pension system has dominated our thinking and the proposed solution is therefore radical. Greater simplicity is not a simplistic cure-all for the UK pension system, but it's surely the starting point:

- A greatly simplified pension system (see Chart A1.1), with the removal of the state second pension from the complex current structure.
- A new universal state pension (USP), combining the current basic state pension and state second pension, set at the level of the pension credit (£130 per week for a single pensioner in 2009-10).
- The abolition of means testing.
- The USP to be indexed by earnings instead of prices – therefore staying constant at 22 per cent of average earnings in the future.
- The USP to be provided on the basis of a residency test, with the loss of the national insurance contributory rules associated with the current basic state pension and state second pension.
- Contracting out to be abolished.
- A progressive increase in the state retirement age to 70.

Chart A1.1: A new simplified pensions structure



A1.1 The new state system

The pension reform model (PRM) reduces the number of tiers in the current pension system (See Chart A1.1) from three to two (although one might say the number of tiers is 2+ because there is a compulsory and voluntary element to private provision in our reform model). In so doing it sets out clearly identified roles for the state and the individual. Individuals will know exactly what the state will pay, based on a simple extrapolation of average earnings growth, applied to the level of the USP.

Individuals will also know when they will receive the USP. Future increases in the state retirement age would be clearly set out far in advance, as was the case already, with the announcement of the equalisation of the state retirement age for women, at 65, by 2020.

As stated already, the key aim underlying these reform proposals is to boost pension saving. The USP provides a platform on which to build private savings and eradicate a thicket of state inspired complexity. Knowing the state pension they would receive, people could work out their own replacement rate and 'misery gap' in the absence of additional private saving – beyond flat-rate compulsion (discussed below).

The USP would remove the means tested savings trap and it would help address the regulatory reticence of pension providers about selling to low income groups.

Raising the basic state pension to the pension credit level is unlikely to damage the incentive to save, because people are already eligible for this level of income.

A1.2 Ending contracting out

A key factor to understand, relating to the ending of contracting out, is that whilst pension funds would no longer receive contracted out rebates, they would not have to provide the equivalent future benefit either – discussed below. The process would be actuarially neutral as pensioners lose with one hand but gain equally with the other.

DC schemes would receive lower contributions if contracting out were abolished, but they would no longer have to replace the S2P either. In the case of DB schemes the lower payments into the fund would be reflected in a lower final defined benefit, to be offset by the higher USP. As a result, there would be no need for companies to make good the loss of the rebate into pension funds.

There are transition issues relating to the re-balancing of national insurance contribution rates between those who were formerly contracted in and out. Table A1.3 shows that some of the re-balancing could be financed by net funding available from the introduction of the USP. Additional resources could be provided by releasing some of the surplus in the National Insurance Fund, together with public spending reductions elsewhere. In the long-term a higher state retirement age could finance a reduction in national insurance rates.

Over recent years, as DB schemes have been replaced by DC schemes, this has changed the nature of contracting out, because whilst virtually all DB scheme

members are contracted out, only one-third of DC scheme members are contracted out – contracting out incentives have reduced over recent years, with many individuals now advised by their financial advisers to contract back-in.

We believe that the fears of some, that the end of contracting out could reduce total private pension contributions, is misplaced. In the long-term the simplicity gains from the removal of SERPS/S2P and contracting out should further add to savings levels. On top of this is the potential savings boost from ending means testing as well.

The ABI have criticised the idea of ending contracting out on the basis that it changes the system to redistributing money from today's workers to today's pensioners, when the pension problem is all about tomorrow. In contrast, the current contracted out system is funded and takes money from today's workers to fund their future pensions. We recognise this criticism, but we believe that the complexity introduced by SERPS/S2P and contracting out is the greater problem.

A1.3 Is a residency test feasible?

The Netherlands, Denmark and New Zealand operate residency tests for pension eligibility, showing that such systems can operate. There are ample means by which people could prove UK residency – Tax Returns, the Electoral Register, Council Tax records, NHS/GP files etc.

There would need to be exemptions and special rules to deal with issues such as working outside the UK and then returning, or asylum cases. This would almost inevitably involve tightening the asylum system. We recognise that introducing residency-based eligibility for a state pension is not without risk, but the residency period could be set sufficiently long to prove that residency was a meaningful concept. In the Netherlands the residency basis is 50 years and in Denmark 40. New Zealand operates a shorter time period, owing to the absence of a population register.

Despite these issues a residency test would surely be more simple to operate and it would overcome the fundamental problem at present, which is how to deal with women and carers, with inadequate contribution records, who lose out from the current system.

A1.4 Is the USP affordable?

Over recent years a number of modelling exercises have been undertaken by the Pensions Policy Institute, PricewaterhouseCoopers and others, to estimate the cost of introducing a universal pension, set at a level to eradicate means testing. These exercises have shown that such a pension is affordable – and long-term could even be cheaper.

When examining the relative cost of our reform proposals it is important to assess the benchmark against which the comparison is being made, and whether it is realistic. Table A1.1 shows the future cost of the pension system based on Government

projections, compared with alternatives for the same system, produced by the Pensions Policy Institute.

Table A1.1 shows that the current system is likely to prove far more expensive than the Government projects and that this needs to be factored into any assessment of the affordability of the USP.

The Pensions Policy Institute estimates that in the absence of other changes (public spending reductions elsewhere, tax increases and/or increases in the state retirement age), introducing the USP would require roughly 2 per cent of GDP extra, to be found by 2050, as compared with the Government's current spending projections. The Pensions Policy Institute estimate the 2 per cent of GDP increase could be completely offset, if the state retirement age was increased to 70 by 2033.

If pessimistic projections of the costs of the current system prove to be accurate, the USP might cost the same as the current system by 2050, even without the increase in the state retirement age to 70.

Table A1.1: Future pension cost projections for the current system – percentage of GDP

Year	Government projection	PPI comparative estimate	PPI upper estimate
2015	5.7	5.5	5.7
2025	5.6	5.5	6
2035	5.9	6.4	7.1
2045	5.8	6.5	7.4
2055	6	6.8	7.8

The upper estimate projections are based on all income taken into account for Pension Credit growing more slowly than average earnings and take-up increasing to 100%. The comparative estimate is based on state pension income growing in line with prices, private pension income rising by less than earnings and more cautious assumptions on the take-up of Pension Credit. (Source: Pensions Policy Institute (PPI)/EEF 2005)

A1.5 DWP projections and the USP

Recent projections by the Department for Work and Pensions reinforce the message that the USP is affordable. The DWP projections show that a USP appears affordable (indeed cheaper) even in the absence of an increase in the state retirement age.

Table A1.2 below shows the future costs of paying a state pension at the rate of the single-person guarantee credit (£130 in 2009-10), indexed to earnings, paid regardless of contribution record and paid at 80 per cent to both members of a couple.

Table A1.2: USP cost projections by DWP

% of GDP	2010	2020	2030	2040	2050
Gross additional cost	1.4%	1.6%	2.5%	3.5%	4.0%
Cost net of savings from abolishing other benefits	1.3%	1.5%	2.4%	3.4%	3.9%
Cost net of abolishing other benefits and Pension Credit					
i) Pension credit income increasing with prices	0.6%	0.6%	1.1%	1.5%	1.7%
ii) Pension credit income increasing mid-way between prices and earnings	0.6%	0.7%	1.3%	1.9%	2.2%
Cost net of tax revenue, abolishing other benefits and Pension Credit					
i) Pension credit income increasing with prices	0.4%	0.5%	0.8%	1.2%	1.3%
ii) Pension credit income increasing mid-way between prices and earnings	0.5%	0.5%	1.0%	1.6%	1.8%
Cost net of tax revenue, abolishing other benefits, Pension Credit, and ending National Insurance rebates and future S2P accrual					
i) Pension credit income increasing with prices	-0.3%	-0.3%	-0.3%	-0.5%	-0.9%
ii) Pension credit income increasing mid-way between prices and earnings	-0.3%	-0.2%	-0.1%	-0.1%	-0.5%

Costings assume SPA remains at 65. Source estimates produced for David Laws, by the DWP, September 2005.

The projections in Table A1.2 exclude any increase in the state retirement age. In the long-term we would aim to use increases in the state retirement age also to finance reductions in employee national insurance. This would occur in parallel to an extension in ‘constrained compulsion’, so as to extend funded provision.

A1.6 Costing issues

The USP is costed on the basis of the offset, as opposed to the addition method. This means that the USP replaces accrued rights for the current BSP and S2P. In contrast, under the addition method, the USP would replace accrued BSP rights alone. If the addition method were adopted, the tax payer would then need to finance the new USP at £110 per week, together with accrued rights to SERPS/S2P on top.

Whilst the accrual of contracted out rebates would end with the introduction of the USP, contracted out rights would continue to be paid from the contracted out private pension in order to provide the total USP level of income.

It is not intended that the USP be paid in full to both partners in a retired household. Instead, it is proposed that couples would receive 160 per cent of the single rate i.e. 80 per cent each.

Of course, the introduction of the USP also means that any low-income pensioners eligible for pension credit, but not presently claiming, will have a significant boost to their income. This is an important gain, given the stigma felt by many to claiming means tested benefits.

There are transitional problems associated with the savings credit, which will require some form of arrangement to mitigate potential losses for low-income households receiving this credit. Part of the surplus in the National Insurance fund could be allocated to deal with this.

Table A1.3: Transitional funding of the USP

Gross cost (using offset calculation)	£9 billion per annum
Gross cost (after adjusting for lower Housing/Council Tax)	£7 billion per annum
Saving from ending contracting out	£12 billion per annum
Net funding available to fund transition costs	£5 billion per annum

(Source: Pension Policy Institute, 2004)