



CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

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The future for individual pensions: A round-table discussion with Carl Emmerson (IFS), Steve Bee (Royal London Group) and Pauline Skypala (Financial Times) held on Thursday, June 12, 2008, at Innholders' Hall, 30 College Street, London EC4R 2RH from 12:30-2:15pm.

Given the slow demise of the final salary pension scheme, all eyes are on whether the various forms of personal pension can fill the gap in terms of providing an adequate retirement. It's certainly a key part of government policy, particularly the Personal Account being rolled out in 2012. This will automatically enroll workers (unless they opt out) whose employer does not have a scheme with a 3% and 4% contribution by employee and employer respectively. The first speaker said Government was seeking to make three changes: improve incentives to save; change the default from opt-in to opt-out; and simply the most complicated pensions system in the world.

On the first he said it had improved incentives via indexing and increasing the share of pension payment not linked to income. However that would cost £20bn by 2050, implying extra taxation. On the second point, automatic enrolment risked pulling people into a pension who shouldn't be saving that way. The figures showed that the average worker who chose not to join their company scheme earned £16,235 and had zero assets while someone at a company without a scheme had £13,715 and zero respectively. Low earners, in other words. These people would be better advised to pay off debts or invest in an ISA than start a pension especially if they were young. Other members agreed. One said savers could access ISAs on demand whereas pension money was locked away. The second speaker warned that once people learned – perhaps from a 40-word story in The Sun – that someone who took out a Personal Account would only be marginally better off than someone who didn't because of the benefits system. The system imposed an effective tax rate of 40%.

One member refuted these criticisms. Millions of people across all demographics were under-providing for retirement. The opt-out clause specifically allowed people for whom it was not right not to take part. There was no guarantee people who didn't take out a pension would take out ISAs. The Personal Account simply helps people do what they instinctively know is right. Still members were unsure: why couldn't the Government organize a work-based non-pension savings scheme? The first speaker said mis-selling was a danger. One can never guarantee everyone is a winner, but the winners would have to outnumber the losers by a large margin to be acceptable.

The second speaker said those lucky people with final salary schemes probably did not realise they were sitting on £1.6 trillion of wealth or £55,000 for each of them. This presented an opportunity, as these schemes were eventually all being shut down. Their members should look to take control of those assets and manage them themselves. This

would fit with the increasing trend towards mixing, retirement and work as people aged. One member asked who was going to come along and manage these assets, perhaps creating another potential mis-selling scandal.

The third speaker highlighted a split within government itself between the Department of Work and Pension's drive towards pushing people into money contribution Personal Accounts and the Treasury's focus on ISAs and the helping the unbanked. One member said the Treasury had, for once, got it right. The speaker said the net effect was no single strategy or source of advice. As for the pensions industry, it is commission-based, too costly and not innovative enough when it comes to delivering products to people. While index tracker funds - the industry standard - are the best way of managing a long-term equity pensions, the industry needed to look at innovations such as exchange traded funds, multi-asset funds and the balance between equities and bonds close to retirement. People don't have the right information to make decisions.

One member asked why the Government did not simply axe all tax breaks, such as 40% tax relief for top earners, and use the proceeds to jack up the state pension to £125 a week if that was its ambition. Another member said it was politically impossible as all the losers would be key voters who would suffer the losses now but not see the benefits until they retired. The roundtable organiser said she was confident people would adapt to find ways to mix pension and work incomes in retirement. It was perhaps the only optimistic note in an otherwise gloom-laden roundtable on the future of individual pensions.