

Rethinking retirement

Pensions World held a round table on the future of retirement chaired by editor Stephanie Hawthorne. **Ceri Jones**, financial journalist, reports



Jones flexibility and choice

Participants:

Stephanie Hawthorne
chair and editor of
Pensions World



Jonathan Watts-Lay
director,
WEALTH at work



WEALTH at work
KNOWLEDGE | EXPERIENCE | OPPORTUNITY

Terry Faulkner
group head of
pensions, Rexam



Jane Samsworth
partner,
Hogan Lovells



Michael Reed-Smith
Corporate &
Consumer Director,
Pensions,
Prudential



PRUDENTIAL

Pensions World With the Department for Work and Pensions (DWP) suggesting 10m people are now expected to live to 100, how does the panel think longevity, complexity and insufficient employee savings will impact employees?

Jonathan Watts-Lay People usually do not think through the impact of longevity. They do not think about how much income they will need for that period of time. Having to think about it is a relatively new phenomenon. As well as lacking the security of final salary schemes which many were members of in the past, the double whammy is this big rise in life expectancy.

I remember the days when large companies could let staff retire at age 50, such as IBM for example – that was a fantastic period! But today people will need to work longer to achieve the standard of living they aspire to in retirement and they will have to save to achieve their aspirations just as someone in their twenties or thirties will aspire to buying a flat or a house.

PW Are current difficulties putting people off saving for retirement?

Jane Samsworth In my view, the impact of longevity and inflation puts people into a fugue state, because they know deep down that if they examine the issue in detail then the whole thing will be too distressing. So they put on the blinkers. “I’ll downsize and sell the house,” they say, “or carry on working as long as possible.”

It is also important to think about what happens at the other end of retirement, such as care homes and sheltered accommodation. A lot of people do not want to rely on the state, but private care can cost thousands of pounds. Under these circumstances it is very

easy to say: “Sufficient unto the day is the evil thereof.”

PW So you think they put it into the “too difficult” file?

Terry Faulkner People do not understand the seriousness of the situation. Longevity destroys the security of the money you have put aside in the past. The Office for National Statistics Pension Trends tell us that before, in 1981, the life expectancy of a male aged 65 was 14 years, but by 2051 it will be 25 years. That’s an 80% increase, so crudely you might deduce you need to put 80% more in your pension pot. Few people grasp this.

Michael Reed-Smith We identified similar issues in research with pension customers recently – most had held a pension investment for many years but thought their investment was performing poorly when in fact it had performed very well. The problem was the projected retirement income within their annual statements – most customers were sold a pension on the basis of the income it would provide when they reached retirement. Unfortunately, due to a number of changes in the assumptions that underpin the projected income at retirement within their annual statement, not least the important fact that people are living longer, customers are being left confused and worried about what their retirement will look like.

Like most things, the problem is communication and getting people to engage. For those in their late forties or fifties who have largely neglected their retirement planning, it’s pretty scary when you realise what you need to do and how long you’re likely to need income for in retirement.

In addition to what you contribute to a pension, we shouldn’t overlook the importance of having the right investment

strategy in place. Most members will have joined the default fund or have selected a lifestyle option linked to a fixed age at some point in the future, even though this is likely to be misaligned with their actual retirement date when it occurs. Our experience tells us that most members of DC schemes are not engaged in the investment decision, which again highlights the importance of effective communication with scheme members.

PW Who is ultimately responsible for pension provision – the employer, employee or the state?

Watts-Lay Auto-enrolment will help bring together all three – by definition, all three have to contribute. Certainly all three have a vested interest. The employee clearly; the government has a vested interest because rising longevity means that – without mass immigration – there will be fewer people of working age trying to support those in retirement; the employer also has an interest because – despite the element of near compulsion – most employers still want to be seen as offering good benefits. However, the dynamics of that mix are likely to change in future, gradually moving up the agenda as the general population get older.

PW Does the panel think the age of paternalism dead?

Samsworth Is not paternalism another way of saying “enlightened self-interest”? I think we all – as taxpayers – are responsible for a basic level of pension provision and it should suit us all to contribute accordingly. We’ve spoken before about the pact between the generations. But I also believe that pensioners should be prepared to help themselves, for example, by selling their house rather than thinking they can necessarily pass on their wealth to their children. I also like the idea of a minimum pension of £140 per week.

Of course, the employer should be able to design the package of benefits it wants. If the popularity of pensions makes an employer think it has to provide one in order to make the remuneration package attractive, then the employer will include one.

Faulkner There used to be a stronger partnership between the employer and the state. Companies are beginning to look at

pensions not as a benefit as they did in the past but as an adjunct to salary. In some cases it is not possible to save, such as where there is expensive debt or a high cost of living, even though there is a free employer contribution match. Let us not forget the self-employed who are often omitted from these discussions.

The government influences retirement savings considerably. Ever since the 1980s when personal pensions were introduced, the push has been from a single company collective basis to an individual basis.

I was disappointed that the government is not allowing early access in the build up stage because of significant lifestyle changes – it is one of their poorest decisions in my view. This is a missed opportunity to encourage people to save; many are nervous of saving if the money is completely tied up until retirement.

Samsworth There will be a rash of claims for age discrimination

DC is after all not even a pension.

Reed-Smith I would agree with the rest of the panel that employers are changing their views about pensions – it used to be about retention and attraction of staff but it’s now increasingly about the overall reward package.

In addition, increasing longevity is clearly a key reason why the responsibility for retirement provision is shifting increasingly on to the individual. It’s an interesting debate whether the recent increase in longevity will continue at the same rate as further advancements are made in healthcare and people increasingly focus on healthier diets and improved lifestyle.

Watts-Lay Some gerontologists say that the first person to live to 150 has probably already been born.

Reed-Smith What is surprising is the number of employees who decide not to join their employer’s sponsored pension scheme, even when they don’t have to make a contribution themselves. Effective communication aligned to the individual needs of different customers is critical to ensure they understand the responsibility for retirement provision is moving from the state to them as individuals.

Watts-Lay We work with clients where the employer offers to match the member’s contribution and when we talk to the staff they often say that if the company is giving them, say 4%, then they think that is sufficient.

Faulkner The rule of thumb for DC always used to be that you should be making contributions equal to around half your age. Even that is now way too low – a sensible guide is probably your actual age. But there are many demands on people’s finances.

PW How much has the removal of the default retirement age changed the landscape? How will this impact the workplace and are employers geared up?

Samsworth No. If you look at the introduction of sex, race and lastly disability discrimination legislation, there was a period of time when employers thought they were doing the right thing, but they were doing things we would not consider acceptable today, and then they looked back, say, after five years and thought: “Did we really believe that was appropriate behaviour?”

There will be a rash of claims for age discrimination as employers will still believe for a while that someone at age 65 should shuffle off to do something else. But the move will be better for productivity, generate more tax revenues and be better for older people who will be more mentally stimulated because they will be able to work and share their views with other people!

And it will help put a stop to the phenomenon of invisibility from age 70 – which is roughly that age when people seem to stop seeing you, which must be very distressing when you reach this stage.

PW I am reminded that the first question anyone is asked when they sign up to a new pension is at what age they wish to retire.

Reed-Smith People will likely have to work longer, rather than be in retirement for longer. We have a large number of customers approaching 65 who overwhelmingly say they do not want to stop working completely. They enjoy it, they feel involved and prefer to keep active and busy. I’m convinced as times change and people feel fitter and healthier,

they will want to work for longer and be more relaxed about this.

Faulkner There is a presumption that everyone wants to work longer and in the manufacturing industry this may not be the case, either from the employee's view or from the employer's side.

There are certainly succession issues. In the old days, you retired and someone else took your job. Employers used to keep less well performing individuals on their books because there was an end date when they could retire them and so I expect we will see a huge increase in tribunal cases. If people stay or go part time, then where is the opportunity for young people to come in and have the freedom to create new ideas for the business in the future? My fear is that it will stop the natural evolution of talent.

Samsworth HR departments will have to be more focused on performance at every level. Those who can't perform as well as they used to should be prepared at any age to step down and work at a different level.

Watts-Lay In time the focus for employers will be on the importance of pension saving, because if employees have accumulated a big enough pension pot then they will be able to retire or do something different.

It will be an age of flexible retirement. There are signs of this already. We work for one FTSE pharmaceutical company and only one of their many staff who retired last year did so at retirement age. Their staff have been leaving early because they want to work part time and they may be simultaneously drawing something out of their pension. The removal of the retirement age and the flexibility this will create will ultimately be good for the employee. It will be a lifestyle choice. But I concede this will be difficult for smaller companies.

PW "Workplace savings" – these seem to be the buzzwords this year. Should it just be about pensions, or should we develop a more holistic view?

Watts-Lay Many companies are now thinking about offering a wider range of benefits to attract staff, such as savings vehicles. This will help attract and retain a 25 year old thinking of buying his first car or flat.

Another good example is Sharesave schemes. Many Sharesave schemes were launched three years ago when shares were in the doldrums and so they have been a great success and produced a great return for employees. They are highly flexible – for instance, you can tie them into a flex window and, once a year, employees can take a view as to their requirements.

Faulkner There is a move towards employers rewarding their staff with cash rather than benefits. People may not use ISAs because they believe you need hundreds or thousands of pounds to contribute, rather than the tens of pounds you need to invest in other savings accounts.

The perceived value of providing the benefit must be greater than the cost of providing it or the employer would not bother, so I do not see why the big corporate world

Faulkner Pension schemes are now mini tax advisers, an arm of HMRC!

would not offer a range of benefits but it might be restricted to the highest paid. Companies still segregate their benefit provision by seniority.

Reed-Smith Although providing choice can sometimes be a good thing, I am concerned that people don't fully understand what a pension is, what their retirement needs are, how much they need to contribute, etc. Adding in further savings options without the right communication and education could be a recipe for disaster that means even less goes towards saving for retirement. Planning for something important a long way off requires discipline.

PW So you think there can be too much choice and employees may be confused?

Samsworth Small employers may not be able to provide much choice, but it is good for employees to get access to a range of appropriate products. By and large, employees trust their employers because they feel they receive dispassionate advice from the HR department which perhaps they do not feel they receive from financial advisers. HR departments cannot give advice,

of course, but they can answer generic questions.

Watts-Lay Flex benefits can be platform based so the cost can be low even for small employers. There is also much that can be done by rolling one product into another. Using platforms to link benefits is a good way for employees to see value.

For example, linking products such as share incentive plans to pension can allow employees to generate pension pots at little cost where they are awarded matching shares (up to 2:1 with some employers) on the share incentive plan. Later on, the shares can be contributed to a pension. With the benefit of the tax relief, the shares would have to fall a long way for the employee to lose money.

PW Is it onerous for the employer, now they are required to point out the annual tax limits to employees?

Faulkner Occupational pension schemes are now mini tax advisers, an arm of HM Revenue & Customs! The individual's tax position is important, but actually over the long term the tax relief part of contributions becomes less and less significant.

Watts-Lay There are some really great tax benefits for employees and if you could link them together then you can really drive value. For example, some people do not use the childcare vouchers their employer makes available even when they are paying for childcare. So we encourage them to take the childcare vouchers and divert the saving into a matched pension with tax relief. There is a need to communicate these opportunities.

Reed-Smith Yes. Many of our clients say their employees do not value the benefits they provide as much as they would like.

PW So is it an issue of engagement?

Faulkner Education should be about relevance, transparency and giving good examples. Financial education, like insurance, has to be sold, rather than wait to be bought. And we need to explain to people the power of compound interest!

Samsworth There should be more financial education in the classroom, for teenagers and even younger children, explaining everything from what an insurance policy is, right up to funeral planning. It would help encourage self-reliance.

Reed-Smith But people are at different stages and we must recognise they need different levels of support.

Watts-Lay There is a real need for education that is segmented. One pensions brochure is sometimes used for everyone in a company, from the cleaner to the board member, but the information should probably be presented differently, although often the questions are the same – it is only the quantum that is different.

PW How will the removal of the requirement to buy an annuity affect employees? Is it just a side issue for most people?

Reed-Smith At the moment, yes it only affects a small minority. The reality is that buying an annuity is still the most appropriate way of generating income in retirement for the vast majority of customers. Customers want, and need, confidence that they will continue to receive a regular income every month.

Faulkner I agree, and the recent Pensions Policy Institute (PPI) report said that for “for the vast majority of people, buying an annuity is likely to be the safest and most appropriate action.”

The new minimum income requirement (MIR) required for flexible drawdown is odd I think.

These savings are supposed to be for retirement! But these rules won’t influence the choice for the lower pensioned majority.

Samsworth The PPI report suggests that 600–700,000 people aged 50–75 in the UK are already in drawdown or have a pot big enough to use drawdown.

But I noticed they are basing their figures on the assumption that a £100,000 fund, together with other income and assets, will generate the MIR of £20,000.

Watts-Lay Our rule of thumb is that it will cost £300,000 to generate the MIR.

PW Who should be providing retirement advice and should

we more accurately be calling it “retirement information”?

Watts-Lay People need good education at retirement and particularly for the full range of options. I’d say anyone going down the drawdown route and not taking regulated advice would be very unwise.

Faulkner The larger employers would probably make a regulated person available. Another option is to use some of your flex money to pay for advice.

PW Would you say that a lot of the relevant information is available on websites?

Reed-Smith Yes, some websites exist and providers, like Prudential, have a lot of information and education tools in their websites to help customers understand the options available to them.

Ceri Jones is a financial journalist; ceri.jones@btinternet.com

Half page AD
185 x 125 mm