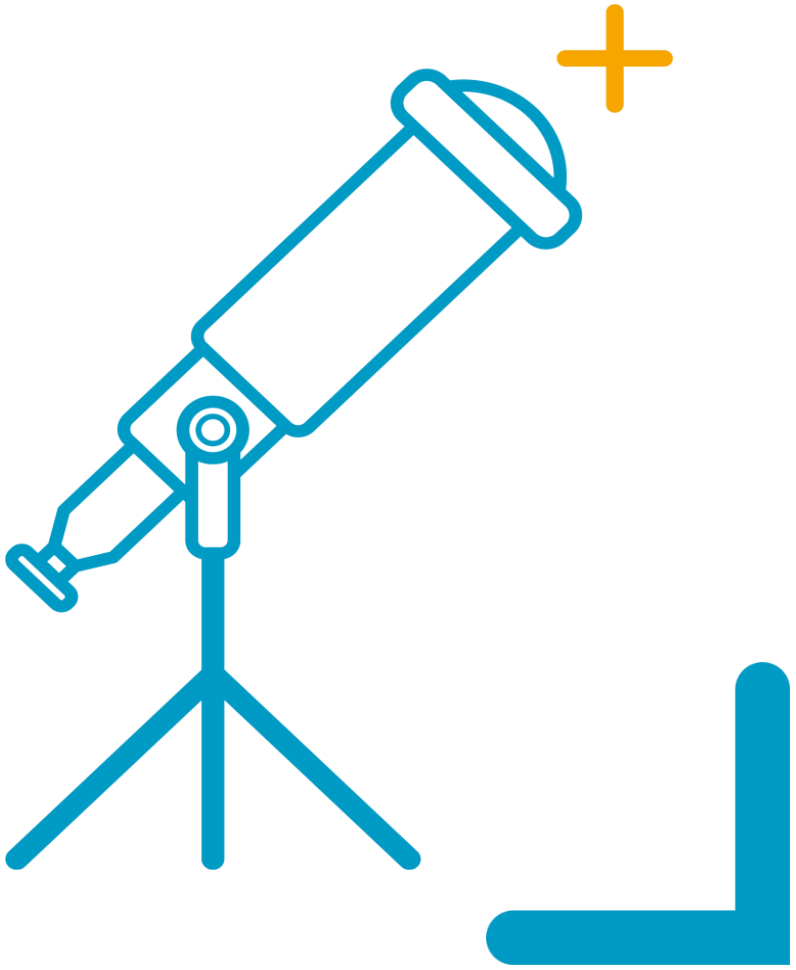
Intergenerational fairness in pensions

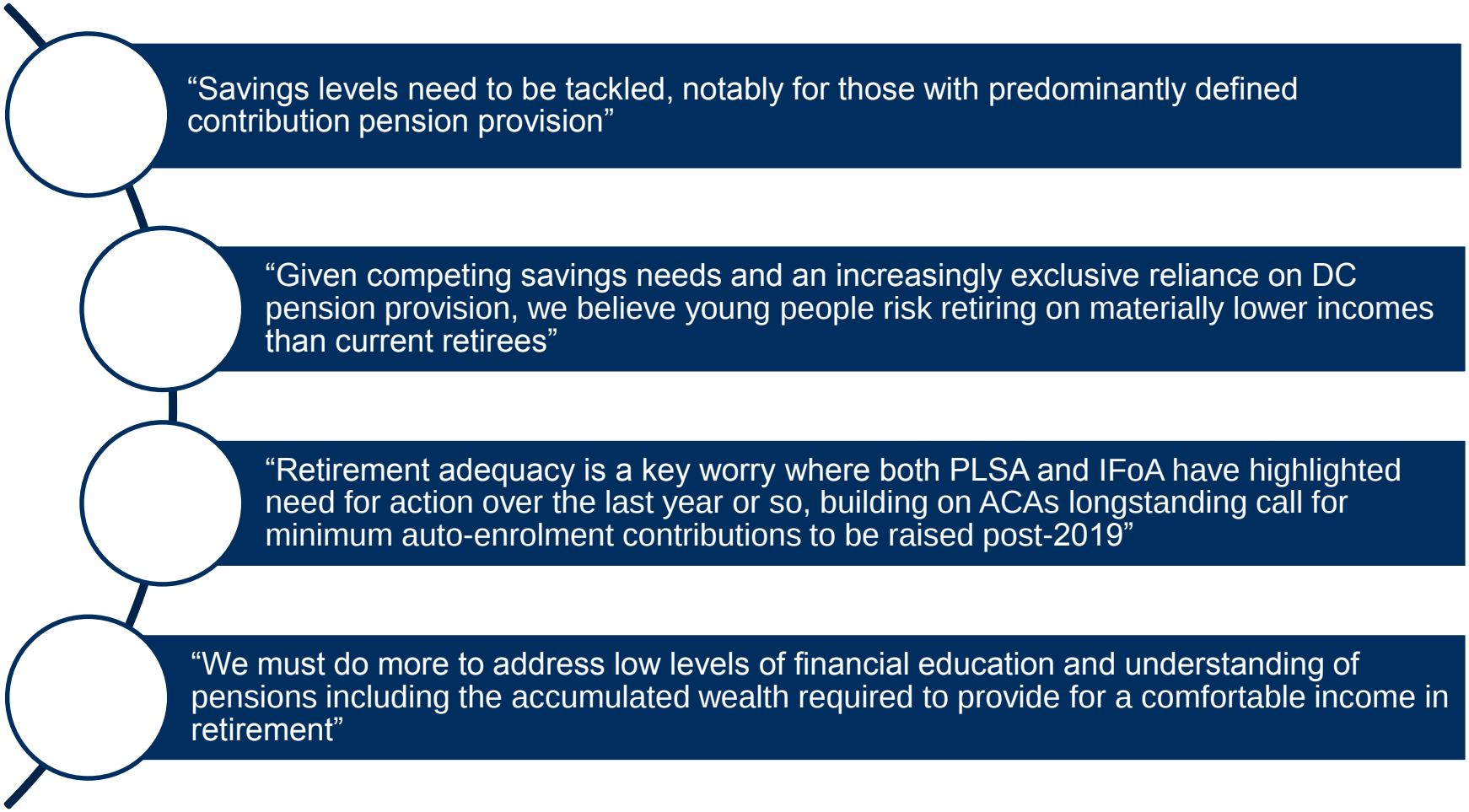


Steven Taylor

1 November 2018

Does pensions have an IGF problem…?

…or is it all about the decline of DB schemes?



DB decline continues, DC contributions remain low

- Fewer than one in five DB schemes now open to new entrants. 55% are also closed to accrual. 5% of DB schemes used for AE purposes
- Around two-thirds of companies use a low cost Master Trust for AE purposes
- Participation high, but contributions low
- Addressing this requires a **"supply-side"** and **"demand-side"** response

2018 (2017) median contributions rates (ACA survey)

	Employer	Employee
Contract Based DC	6% (5%)	3% (4%)
Trust Based DC	6% (5%)	4% (4%)
Master Trust	1-2% (1-2%)	2% (1%)
Defined Benefit	21-25% (21-25%)	6% (6%)

Supply-side issues

- AE minimum contributions are unlikely to meet retirement expectations for most people. Worrying narrative that AE minimum plus State pension is sufficient?

Example	1. High	2. Low
Contributions (age) - 21 to 30 - 31 to 65	 16% 16%	 8% 8%
Pension pot at retirement	£540,000	£270,000
Pension (today's money terms)	£19,200	£9,600
State pension	£8,500	£8,500
Replacement ratio	60%	39%

Key assumptions
1% real salary growth
3% real returns pre-retirement
0.5% real returns post-retirement
Salary at age 21: £30,000
"High" scale assumes 1:1 Er/Ee matching
State pension of equivalent value to current single tier pension

Based on all earnings. Significantly lower if using AE "band earnings"

- Employers increasingly challenging where pensions should sit in reward packages. Paternalism vs "low cost" tension
- Some innovation, but DC remains relatively unchallenged?

Supply-side issues – impact of DB schemes

- 80% employers with DB schemes say there is some impact on DC contributions.
- 84% said DB schemes have some impact on wider intergenerational fairness (including pay)
- This compares to only 36% of employers who said their DB schemes had some impact on “shareholder returns”
- Suggests relationship between DB cost “shocks” and budgets for current (younger) employees in DC schemes
- How should this play into public policy considerations?

Demand-side issues

- Competing savings needs risk "crowding out" retirement savings
- Could it ever be "rational" not to participate?

Example	1. High	2. Low	3. Initial opt out/ High	4. Initial opt out/ Low
Contributions (age) - 21 to 30 - 31 to 65	 16% 16%	 8% 8%	 0% 16%	 0% 8%
Pension pot at retirement	£540,000	£270,000	£375,000	£190,000
Pension (today's money terms)	£19,200	£9,600	£13,400	£6,700
State pension	£8,500	£8,500	£8,500	£8,500
Replacement ratio	60%	39%	47%	33%

Average FTB deposit is c.£32,000.

Paid into a LISA this would take c.9 years to build up (assuming 8% ee conts + LISA bonus)

Miss out on employer contributions

Demand-side issues

- Competing savings needs risk “crowding out” retirement savings
- Could it ever be “rational” not to participate?

Example	1. High	2. Low	3. Initial opt out/ High	4. Initial opt out/ Low
Contributions (age) - 21 to 30 - 31 to 65	 16% 16%	 8% 8%	 0% 16%	 0% 8%
Pension pot at retirement	£540,000	£270,000	£375,000	£190,000
Pension (today’s money terms)	£19,200	£9,600	£13,400	£6,700
State pension	£8,500	£8,500	£8,500	£8,500
Replacement ratio	60%	39%	47%	33%

Average FTB deposit is c.£32,000.

Paid into a LISA this would take c.9 years to build up (assuming 8% ee conts + LISA bonus)

Miss out on employer contributions

X ? ✓ ✓

Competing savings needs

1. House Deposits
Average FTB deposit is c.£32,000

2. Student Loans
9% of income over £25k

3. Rainy Day/ Emergency funds
Three months' salary?

4. High rental costs/ other expenditure

- Where should retirement savings fit among these priorities?

The case for limited early access

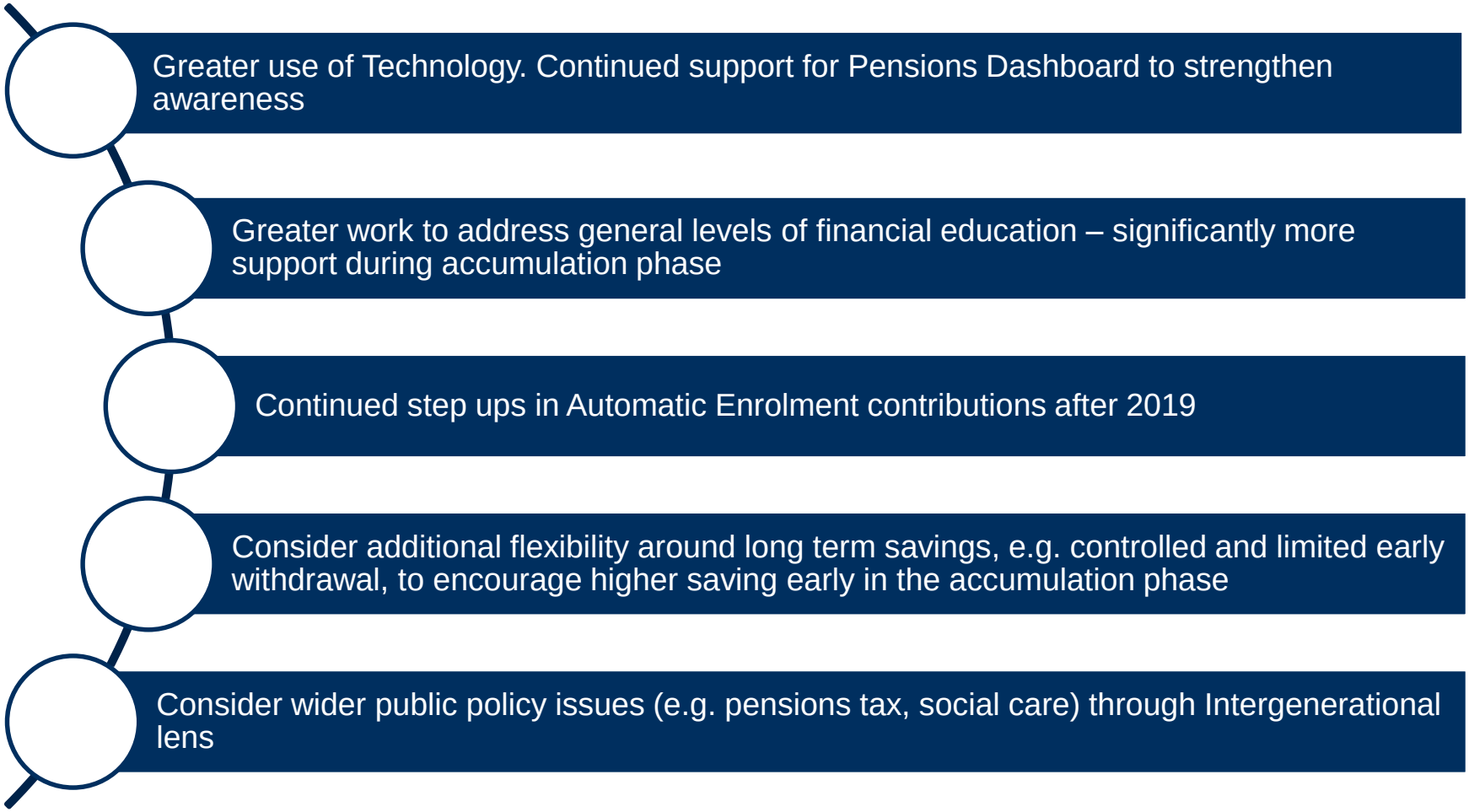
- Facilitate higher savings, without missing out on employer contributions.
- Mirror Freedom and Choice? How would you manage behavioural effects?

Example	1. High	2. Low	3. Initial opt out/ High	4. Initial opt out/ Low	5. Limited early access?
Contributions (age) - 21 to 30 - 31 to 65	 16% 16%	 8% 8%	 0% 16%	 0% 8%	 8% 16%
Pension pot at retirement	£540,000	£270,000	£375,000	£190,000	£460,000
Pension (today's money terms)	£19,200	£9,600	£13,400	£6,700	£16,300
State pension	£8,500	£8,500	£8,500	£8,500	£8,500
Replacement ratio	60%	39%	47%	33%	53%

Assumes 8% EE contributions (c.£30,000 at age 30) withdrawn.

Employer contributions of 8% remain invested

ACA Policy Suggestions



Q & A

Use of our work

Our experts work in pensions, investment, insurance, energy and employee benefits.

Join us at our next event
www.lcp.uk.com/events

Share our insights and opinions on our viewpoint
www.lcp.uk.com/our-viewpoint

Watch and listen to our comments on topical issues
Our YouTube channel

Connect with us for updates
@LCP_actuaries

LinkedIn