POPULATION PATTERNS
Seminar Series

Challenges in the new world of pensions

Sweeping changes to the pension system coupled with longer lives means more challenges than ever for those entering the later stages of life.

As part of a broader demographic series by the International Longevity Centre-UK (ILC-UK), supported by Partnership Assurance Group plc (partnership) entitled *Population Patterns*, this paper examines the challenges facing older people in the new world of pensions that need to be tackled in order to provide them with a comfortable retirement.

Population Patterns aims to identify the drivers on and changes in demographics in the UK, particularly the impact of an ageing population. By engaging in high quality debate about future demographics in Britain and how we respond to changing needs and challenges, ILC-UK and Partnership aim to inform better decisions in the way government, individuals and the financial sector plan for older age and help support consumers throughout the changing landscape of their lives.

The Government has instigated a once in a lifetime shake-up of pensions that has introduced flexibility in the defined contribution (DC) arena and opened up income options for retirees by allowing access to more of their savings through changes to flexible drawdown and trivial commutation rules. The state pension has also been overhauled with the introduction of a flat-rate state pension of £144-a-week from April 2016 (to those who are eligible).

While the reforms have been broadly welcomed they are not a panacea to the problems created by the UK's ageing population and in fact present new challenges.

The challenge: underestimating longevity

While flexibility and choice in pension is a positive change, there is a concern that most people underestimate how long they will live in retirement and therefore do not understand how long their money will have to last for. This means they are at risk of exhausting their pension pot and are forced to live an impoverished old age.

"The challenge is that most people underestimate their life spent in retirement, another fact is the pensioners are the ones most likely to be on low income."

Richard Willets, Director of Longevity at Partnership

Research by Partnership showed 67% of women aged in their early 50s believed they would live for less than 20 years after the age of 65. However Office of National Statistic projections suggest women of this age are most likely to live between 26 and 30 years, revealing just how large the gap between reality and perception is.

This gap could result in a shortfall in retirement income as pensioners spend their money more freely than they would have had if they had been aware of how long their retirement could be.

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Solution:

One solution already mooted by the Pensions Minister, Steve Webb MP, is to use the 30 minute guidance guarantee to provide a longevity estimate based on gender, postcode and whether an individual is a smoker or not. However, there are limitations to guidance including the difficulty in explaining fully the concept of longevity and the need to constantly reassess longevity.

The challenge: under-saving

Not saving enough for retirement is a problem that the Government has tried to address through the introduction of auto-enrolment as well as making pensions more attractive through increased flexibility. However, there are concerns that even with auto-enrolment the combined contribution rate of 8% that will be reached in 2017 will still fall short of the amount needed to provide a comfortable retirement.

There is also a more widespread problem of lack of disposable income meaning people have the opportunity to save less while poor savings rates offered on cash have compounded the idea that saving isn't worthwhile.

"The [economic] recovery is dependent on people saving less and spending more and that is a problem."

Gregg McClymont, Shadow Pensions Minister

There is also a concern that too many people are relying on the state pension to fund their retirement without understanding how much they will have to live on. While pensioner poverty has been falling over the past 15 years, this trend will not continue without increased saving.

Solution:

Engaging consumers in saving at an early age is key but so is explaining to them just how far their pension savings will, or in some cases will not, go. The changes already made around access to pensions should encourage individuals to invest money for their future, safe in the knowledge they will be able to access all of it from age 55. This is where consistency in pension legislation is needed from successive governments to promote trust in pensions.

The challenge: putting pension funds in cash

Being able to access an entire pension fund will be seen as a boon for retirees, especially those who enter retirement with considerable debt. However, for those who are seeing it as a chance to move their money away from pensions entirely there is a concern that they will place the money in a cash account where its value will slowly erode.

Research by Partnership shows 36% of people would put their pension in the bank to use as and when they need. However, as most people are unaware of just how long they will live they risk exhausting their pension pot too quickly.

To put the challenge into perspective, Australia – which has operated flexibility around pension access – is now looking at bringing in new rules to prevent individuals from depleting their money or borrowing against their funds in the run up to retirement.

"Flexibility and choice are clearly desirable and will have positive effect if we encourage greater pension saving, but there is the possibility [retirees] will exhaust their pension savings too soon."

Richard Willets, Director of Longevity at Partnership

Solution:

The lack of understanding around pensions and longevity may be compounded because of auto-enrolment. While savers are not expected to connect with pensions while saving, they are expected to make important life decisions when entering retirement. Employers could play more of a role in the decumulation phase of retirement to help employees secure an income.

"My fear is not that people will spend all their [pension] money because people have worked hard to build up their savings but because most people do not have experience of drawdown and they have small pots…they will take it as cash and it will sit in their current account."

Gregg McClymont, Shadow Pensions Minister

The challenge: older people in the workplace

Recent figures from the Office of National Statistics reveal over one million people aged over 65 are in work. However, benefits like the state pension still make up over 40% of an average pensioner's income – a figure that has varied little over 15 years.

The demographic make-up of the UK reveals an ageing population where by 2037 one in four people will be aged 65 or over. With a quarter of the population relying heavily on the state to fund their retirement, the cost will become a larger burden on the working population.

While the Government is steadily increasing the state pension age, and has plans to link it formally to longevity, more needs to be done to encourage older people to stay in work and stay contributing to the economy.

Not only will working-age taxpayers feel the brunt of an older population but a failure to address the need for people to work longer could result in a reversal of the gains made in pensioner poverty over the past two decades.

Solution:

While the number of pension-age people in work has increased due to necessity there still needs to be a fundamental shift in how people perceive retirement. The idea of flexi-retirement as a concept, with people jumping in and out of retirement, could be a solution to the problems of undersaving and also to more modern family structures that see older people taking on more caring duties, either for grandchildren or other family members.

In order for this concept to suceed, workplaces and financial products need to be more flexible and accommodating to changing lifestyles in a way that both business and individuals can benefit.

"Life expectancy is increasing and personal resources need to last longer, and retirement will become more flexible and working life will be longer."

Professor Les Mayhew, Cass Business School

"We need to get more older people working to support the income for people who are out of the workplace."

Ben Franklin, Senior Research Fellow at International Longevity Centre UK

Points to consider

- Increasing longevity means savings have to last longer but lack of understanding of life expectancy means a greater risk of running out of funds
- Greater access to pension funds combined with lack of pensions trust could lead retirees down a problematic path of depositing their savings in cash
- Individuals need to understand the risks of saving too little and that the state pension is a safety net, nothing more
- The need for more flexible retirements, enabled by employers and financial products, will be a necessity

Final thoughts

The new world of pensions that has been set out by the Budget is radical and presents a number of opportunities for both retirees and the pensions industry. However, with greater flexibility and opportunity comes greater responsibility and pensioners will need more help than ever to guide them to the outcomes that are most suitable for them.

By fostering greater understanding in individuals, providing more flexible ways to accumulate and decumulate money, working with employers and encouraging greater innovation in the retirement industry, tomorrow's pensioners will be better able to achieve a comfortable retirement.

Population Patterns

ILC-UK, supported by specialist insurer Partnership Assurance Group, are undertaking a series of events exploring the impact of demographic change on public policy. The Population Patterns series,#populationpatterns, explores the long-term challenges demographic change will have for government.

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