DIFFICULTIES OF RETIREMENT INCOME PROVISION

1. **" A crisis of longer life"** (The title of a 1998 paper by Daykin and Lewis)

1.1 From the mid 1950's until the early 1990's UK pensions actuaries framed their advice against the expectation that males would retire typically around age 65 and then live for a further 14 years or so – and that their spouses would die (of grief) some 7 or so years later. State Pensions commenced at 65 for males and 60 for females and the normal retirement dates for most occupational pension schemes were generally similar – with the exceptions of schemes for Public and Financial Services sector workers – and provisions for Senior Executives.

1.2 The State made pension promises to its working population and in the occupational sector many retirement benefit schemes were "funded" - on actuarial advice - on the basis of these mortality expectations.

1.3 The "reality" in 2016, however, is that British pension actuaries expect 65 year old males, now retiring on pension to live on average for more 22 years, retiring females aged 65 to live for 24 more years and with prospects of further increased longevity for their successors. **This means that pensions for such retirees will be payable for over 50% longer than was anticipated when pension problems were framed or when the bulk of funding was made.**

1.4 It is not surprising therefore that:

a) The British State pension ages are scheduled to rise to 68 for both men and women – and that promises to working women to pay pensions from age 60 were broken well into their careers and

b) The bulk of British tax relief on pension contributions is given to fund past service deficits in defined benefits schemes, many of which may not deliver on pension promises and

c) **Insufficient pension contributions are being accumulated for the current workforce – this is the new "elephant in the room"!**

2. Everything has changed

2.1 In developed and developing economies working patterns have change out of all recognition. Industries and individual employers emerge or fade away. As a result of this and of increasing mobility and international trade, employees change jobs – and location of work – frequently.

2.2 A direct consequence of this is that no one employer can expect or be relied on to fund retirement income – and that few employers will wish, afford or be capable of delivering any sort of guaranteed pension outcome.

2.3 Faced with the five perils of:

a) a longer than expected lifetime,

b) difficulties in or the impossibility of making savings for the future,

c) lower, volatile and unpredictable investment returns,

d) a perceived need to help children and

e) the spiralling costs of long-term care

Many are forced to remain working for far longer than ever before and that retirement is replaced by a "slow retreat" from working.

2.4 As a result of this feature, work opportunities for younger employees are reduced and they in turn will find it harder to make pensions savings.

3. "Traditional" pension scheme models are no longer appropriate.

3.1 In current circumstances, there is no logical reason for any employer now to shackle itself with the burden of giving a promise of a given level of pension. Such promises may be incapable of delivery and their costs may inhibit a company's ability to thrive and succeed.

3.2 The whole concept of pension needs to be redefined as the need for a lifelong level income has been supplanted by the driving forces of continuing but reduced employment at the commencement of retirement and the costs of long term care towards the end of life.

3.3 One possible new definition of a pension is "Variable income to support lifestyle when working income dries up or reduces".

3.4 If this definition is accepted, then pension schemes need to be regarded henceforth as retirement accounts – from which withdrawals are made on individual demand**. As such, they are simply just another "cupboard of wealth" taking their place alongside other savings -** and must be used in parallel.

3.5 In practice, only some form of money purchase pension schemes can deliver the required outcome above – but how to provide these on an administratively acceptable basis and who should pay is debatable.

4. How much is needed?

4.1 In an ideal world, total net income in retirement should be the same as that prior to retirement. In later life possibly more will be needed if long term care costs are to be absorbed.

4.2 Very few pension regimes in the developed world achieve this objective. A survey in 2013 indicated that total pensions payable to citizens of the USA, Germany, France and the UK did not replace even 50% of pre-retirement income – **and that only Greece in the northern hemisphere provided its citizens with a near 100% replacement rate!**

4.3 In the UK – assuming a net of tax long term return of 5% on invested funds and providing for say 2.5% price inflation - a reasonably optimistic assumption basis - for example, one can calculate that for an average male with a female partner 3 years younger free standing funds of the following multiples of earnings would be needed to have been accumulated in order to source similar incomes in retirement to those in work.

a) at age 65 21.7 times

b) at age 70 19.1 times and

c) at age 75 16.2 times

4.4 **Mr Average should expect to use the entirety of these funds in his or his Partner's remaining lifetimes** – and these estimates do not take account of long term health care costs!

4.5 If an individual were to set aside and able to save proportions of his income throughout life to provide for retirement income, in a tax exempt environment, then on the assumptions above and assuming that income in working life grew at 2.5% per annum then it would be necessary to set aside the following percentages of income to provide for post-retirement drawings.

	Pension from 65	Pension from 70	Pension from 75
Starting at 25	31.8%	23.2%	16.5%
Starting at 35	48.7%	34.3%	23.8%
Starting at 45	83.4%	55.0%	36.4%
Starting at 55	189.6%	104.4%	62.3%

4.6 Some chance!

5. Pensions Taxation

5.1 It used to be the norm that Governments would provide tax reliefs to employers and individuals on pension savings, against a background that pensions were "deferred pay" and with the twin objectives of a) encouraging pension provision so as to ensure that older citizens would be as little a burden as possible on the State and b) ensuring continuing tax revenues on pensions in payment.

5.2 Typically, reliefs were granted on pension contributions and on the investment accruals – whether income or gains – of accumulating funds.

5.3 Pension drawings, however, were generally taxed as they emerged – with sometimes relief on a pension commencement lump sum. This model may be described as the "EET" model – exempt, exempt – taxed!

5.4 In the UK, up until a decade ago, the Government limited what could be accrued in pensions – initially up to a limit of two-thirds of final remuneration and then from 1989 onwards a Capped final remuneration – ended at £105,600 in 2006.

5.5 Since 2006 – in response to the perception of the potential short term costs of tax relief and recognising the switch to money purchase provision – the British Government introduced a new system of tax reliefs – principal features of which are

a) Pension savings above a certain level at the point of retirement were taxed at a special rate of 25% and

b) Relief would be given on pension contributions up to a certain absolute amount.

5.6 In 2006, the maximum accumulation limit before the special tax was set at £1.5 million. By 2010, this had risen to £1.8 million – but in the last 6 years, as a result of demands imposed by the banking crisis, this limit has been reduced successively to £1.5 million in 2012, 1.25 million in 2014 and to £1 million in 2016. **The limit is reducing in inverse proportion to the actual costs of what is needed!**

5.7 Similarly, in 2006, the maximum annual pension contribution permitted was £215,000. In 2016, the maximum pension contributions has dropped to £40,000 – and for those with high incomes is £10,000!

5.8 So even if you can afford to save sufficient for pensions, the UK Pension rules may not permit you to do so through pension schemes.

5.9 **The pension savings restrictions imposed as a result of the banking crisis will generate a far larger and more sustained crisis as the shortfall in provision for Senior Citizens emerges and becomes apparent in the next few years.**

5.10 Despite a plethora of "equality" laws, those working people aged over 75 are not allowed to save through pension schemes for their old age!

5.11 Historically, the UK has been amongst the most generous of regimes in permitting pension savings but it is clear that many normal British working people, managers and senior executives are unable to save fully for their retirement income – and in most other countries the situation is worse!

5.12 It is worth highlighting that despite the reduced scope of tax privileged pension funds, the legislation and regulation has increased to totally absurd and complex levels. **The sheer incomprehensibility of pension rules and the frequent changes to the system reduce the will to live – and the desire to commit monies to pension schemes.**

6. "Out on your own"

6.1The success or otherwise of retirement provision for individuals "out on their own" will depend on successful management of:

a) Savings

b) Investment

c) Taxation and

d) Other risks

6.2 Individuals in retirement will need advice and solutions on how to cope with longevity risk, fund management and sourcing drawings.

6.3 "Decumulation science" is an important new area to be explored.

7. Actuaries Looking after individuals

7.1Most actuaries advise groups of people rather than individuals – and have assumed as a result that they can predict outcomes pretty well.

7.2 As has been seen above, this assumption has not necessarily been correct – as the combined impact of increased longevity and sustained low fixed interest returns was in general not anticipated sufficiently – with disastrous results!

7.3 7.7 It is much harder to advise individuals. There is no Mr or Ms Average. People do not "drop dead" on time and therefore people are out on their own and need the best possible help and advice to make monies last a lifetime – and perhaps a little longer!

7.4 **The advice has to be given throughout adult life** – how much to spend and how much to save and from where to source drawings! Ideally, this advice should be actuarially given or inspired – but how to provide such expert high quality advice to the masses on an economic basis needs to be addressed.

7.5 Actuaries, en masse, have little experience with advising individuals – and their current professional training does not equip them well for such. Despite money purchase/defined pension schemes now being the modal form of pension provisions for those working there is little mention of such in the professional syllabus or examinations of the actuarial professions of either North America or The United Kingdom, for example.

7.6 Individuals need actuarial advice more than ever – and actuaries need to be trained properly to provide this.

7.7 In a world, where individuals cannot save for and pension schemes are clearly unable to deliver adequate pensions to most, then there is no reason why the advice of pensions actuaries should be confined and restricted to such schemes and there is a necessity for involvement in overall personal finance and savings.

7.8 But new skills need to be developed and learned! In particular, pensions actuaries will need to acquire far greater knowledge of investment and personal taxation.

7.9 **We have to ask The Beatle's Question "Will you still need me, will you still feed me - when I'm sixty-four?"**

8 People On the Move

8.2 People move around

a) For work

b) For weather

c) For family and

d) For taxation and other reasons

8.3 If this occurs, then ideally, their pensions savings should follow them and it should be made easy to transfer pensions internally and overseas, if required, to mediums and indeed the currency that best suits the individual.

8.4 Of course, this is not the case. For example, it is impossible to transfer an overseas pension into the US from most territories and similarly it is rarely possible to transfer a US pension overseas. **There is a pre-Trump pensions wall surrounding the United States!**

8.5 Within the 28 States of The European Union, only 12 permit transfers – and that right is only for a transfer to a member state of the slightly wider European Economic Area – and even then such cross border transfers may not be possible as a result of a cocktail of scheme or national rules.

8.6 Out of national pride, I would wish to highlight that the UK offers an unmatched regime for pension transfers – in and out.

8.7 As a result of these limitations, an individual who spends time working overseas – or who moves abroad in retirement – could collect a plethora of pensions savings, many of which are not matched or suited by currency, flexibility, investment or tax consequences to his ultimate retirement environment.

8.8 For example, an individual residing in one country could be taxed on the investment accruals in his pension arrangement in another jurisdiction – and in some cases on the accruals of all other scheme members.

8.9 The tax advantages of pension schemes in certain territories could prove extremely disadvantageous if the member moved to another country. In one particular territory, the presence of a resident pensioner with overseas pension benefits can impose tax liabilities on the overseas pension scheme operators.

8.10 In any event, where currencies fluctuate and investment flexibility is limited and tax systems do not align, the resultant provision may prove "unfit for purpose" in providing retirement income.

8.11 Even if individuals remain within the same jurisdiction, individual pension scheme rules can operate so as create a pensions "Sophie's Choice" – take an inflexible fixed income or accept a more flexible but reduced transfer payment.

8.12 In an ideal world, supranational pension schemes would operate to cater for increased international mobility. The reality is, however, that such schemes are:

a) Unlikely to attract the needed tax reliefs

b) Expensive administratively

c) Restricted in investment and benefit flexibility and

d) Finally may deliver benefits which are taxed unfavourably in the territory of ultimate receipt.

9 The Sad Picture

9.2 Henceforth, most people will be unable to rely on pension savings to fund their retirement income needs.

9.3 If they have little or no other savings, then as longevity increases respective Governments will have to assume unacceptable burdens and/or there will be a huge reduction in living standards in old age.

9.4 The pensions advisory community – actuarial and legal - have taken a Trappist stance to this fundamental problem – and have adopted "The Silence of The Lambs" with regard to a potentially devastating crisis, whose first tremors will soon be felt.

9.5 If, for short term reasons, Governments reduce or deny incentives to savings for retirement then their successors will reap a "whirlwind" of coping with inadequate provision for the increasingly large ageing population.

9.6 Working populations of the future will not be able to support their predecessors' retirements – let alone provide for themselves.

10. What can we do?

10.1 Scream out the truth! Remind Governments of the magnitude of the problem – and demonstrate

how short term quick fixes in taxation could lead to long term disaster.

10.2 Develop new pension models to cope best with new needs.

10.3 Train a new breed of actuaries, capable of advising individuals.

10.4 Recognise that provision for middle and old age requires an integrated approach – and apply core skills to overall resources - not just pension schemes.

10.5 Help to destroy the many barriers to international and internal pension portability.

10.5 Ensure that as many as possible are aware of the costs of long life – and how these are best defrayed and

10.6 Carry on working!

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