

Fresh Perspectives

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FIXING LIFE EXPECTANCIES

Integrating state and private pensions horizontally

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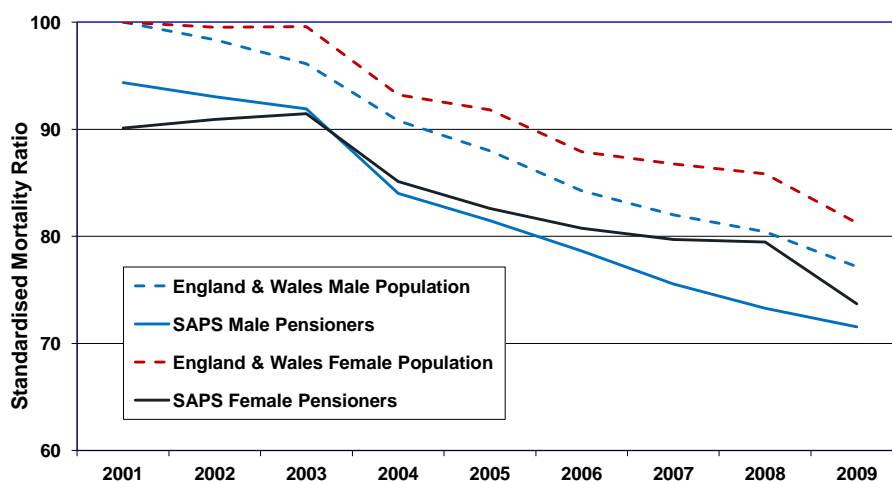
Improving longevity

- A major reason why traditional pensions have become unaffordable
- Longevity likely to continue improving
- *Life expectancy of UK men and women at 65 has changed much since the Second World War*

	1950	1960	1970	1980	1990	2000	2010
Males	76.7	77.0	77.2	78.0	79.3	81.0	82.8
Females	79.3	80.3	81.1	82.0	83.1	84.1	85.4

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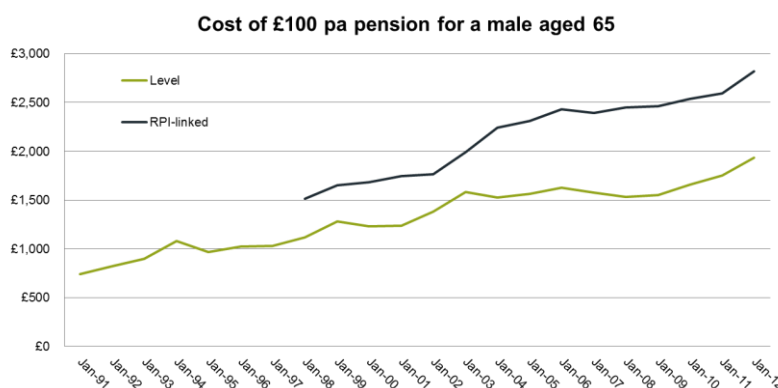
Recent mortality improvements



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Financial impact of greater longevity

- Lower interest rates since 1997 have increased pension costs.....
- ...as have post 1997 guaranteed increases.



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The “perfect storm” post 1997

Longevity was not the only pension woe..

☹️ ...low interest rates

☹️ ...over-regulation

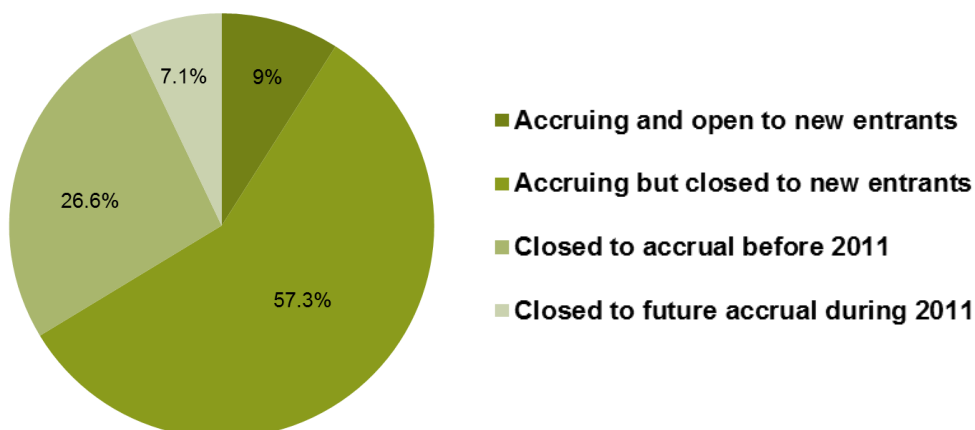
☹️ ...falling stock markets

☹️ ...tax raids on dividends

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DB pension schemes closed



Position of UK defined benefit pension schemes at end 2011
(source: ACA. Workplace pensions: Challenging times. Report of the ACA's 2011 pension trends survey)

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And we all march towards DC pensions

Thought to be affordable but

1. Employees bear the investment risk

2....and the inflation risk

3....and the longevity risk

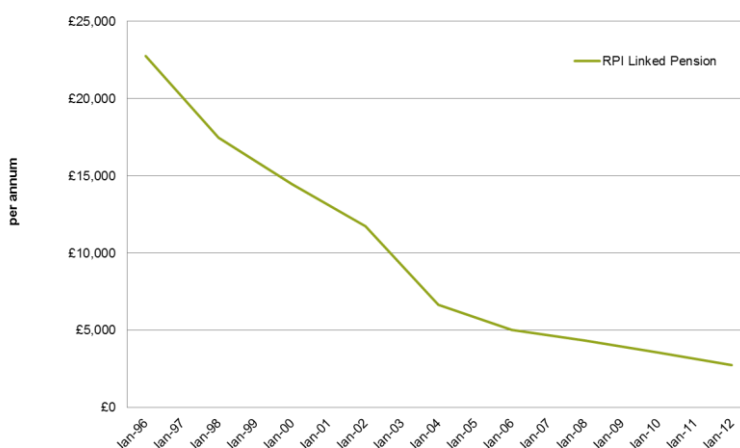
Little attention is being paid to outcomes

This will come home to roost when companies realise the effect of the abolition of the default retirement age

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Historical DC outcomes after 20 years



Rate of inflation protected pension purchased at age 65, after contributing £200 per month into a typical balanced fund (source: Barnett Waddingham calculations)

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Recent outcomes:
10% of NAE for twenty years

January	Retirement fund	Starting pension	Pension Jan 2012
1996	£42,102	£3,330	£5,277
1998	£51,100	£3,383	£5,048
2000	£64,033	£3,810	£5,443
2002	£49,085	£2,783	£3,822
2004	£43,149	£1,924	£2,501
2006	£53,082	£2,187	£2,691
2008	£59,116	£2,412	£2,736
2010	£53,418	£2,105	£2,299
2012	£53,122	£1,884	£1,884

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Barnett Waddingham calculations

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Most DC retirees will be disappointed

Obligation is to ensure
that the risks do not fall
on the unwilling or unable

*Nowhere in the world
do people buy
annuities voluntarily*

“DC pensions hard hit in the slump”

**£60,000 in Nest. I’m sorted.
But it is £36 a week.
Worse still £27 a week after cash is taken**

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Pension protection

- Political uproar after 2000 about those who lost some of their DB pensions
- The PPF “lifeboat” launched
- But by then all ships were back in harbour!

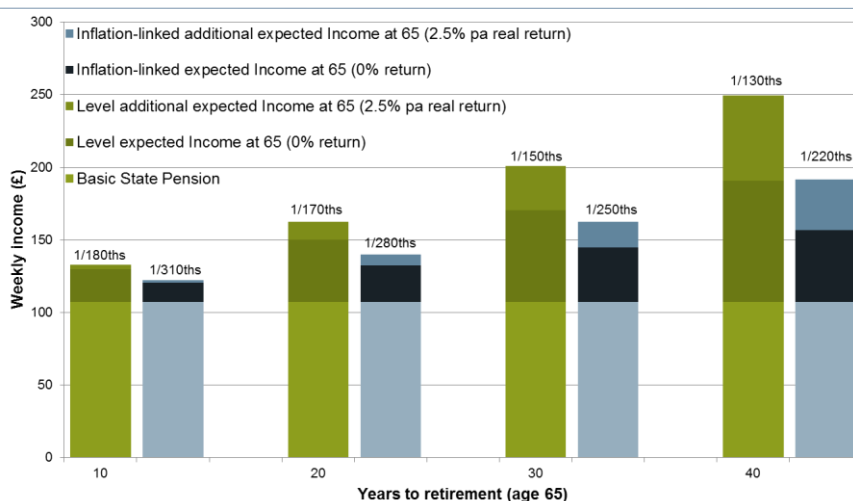
“more pensions being lost in DC than were ever lost in DB”

8% contributions into NEST will not go far

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NEST outcomes



Projected income from NEST for an earner on NAE £461 per week (source: Barnett Waddingham calculations)

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Real outcomes will (probably) be worse

- The open-ended risks of inflation
- Investment outcomes
- Further longevity improvement

*Increasing longevity is a difficulty.
There is realism about higher retirement ages.
And linking retirement ages to longevity is good news.*

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State retirement pensions

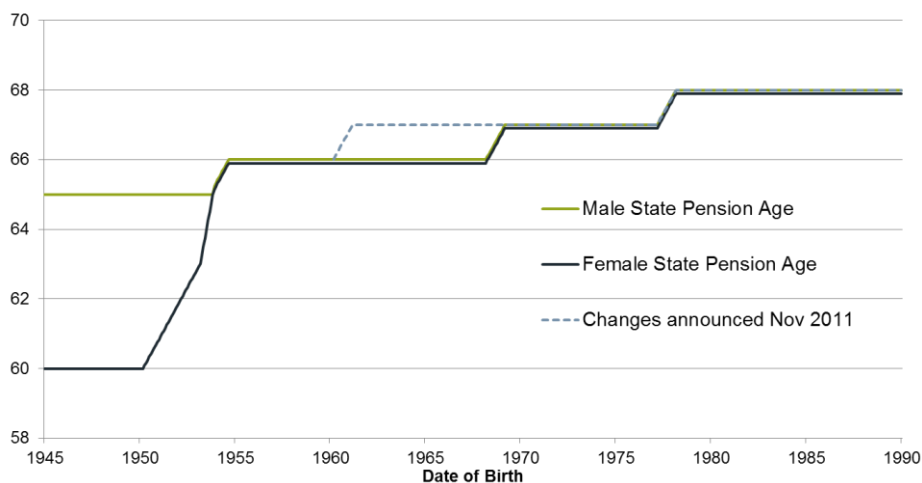
- Reform a priority for Minister Steve Webb
- Enhanced pension of £140 per week from 2015?
- S2P abolished
- Increasing in line with greater of
 - CPI
 - National Average Earnings
 - 2.5% pa

*Most agree that raising state pension ages is a
fair exchange for better state benefits*

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State Pension Ages



UK State Pension Ages (by birth year)

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Decent objectives?

- In a civilised society retired people should have sufficient income to meet their basic needs
- “means testing” was a temporary expedient to address an immediate problem
- *The uplift in state pension at 80 is 25p per week!*
- Who should carry the longevity risk?
Employer? The individual? The Government?

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“Decumulation” of Retirement Savings

- Need to trust annuity providers...
- ...so tight regulation on insurers (Solvency II)
- But security and stability come at a cost
- And older pensioners have no chance to correct mistakes
- Annuities are the only route to safety but human natures mean savers don't like them

We need new annuity designs

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Buying annuities

- Age at purchase
- Sex
- Health
- Increases
- Partner's benefits
- ...and the term

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Post retirement spreading of the pension pot

- Lump sum spend in early years....
- ...and perhaps part-time income?
- But younger pensioners spend more.
- Pensioners underestimate the need for regular increases
- Maybe later retirement is passive?
- But then care and medical costs increase

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Ideas seen in Australia and USA

- At age 65 88% of the fund used to set up a 20 year term annuity (can be drawdown)
- And 12% used to buy a twenty-year deferred annuity

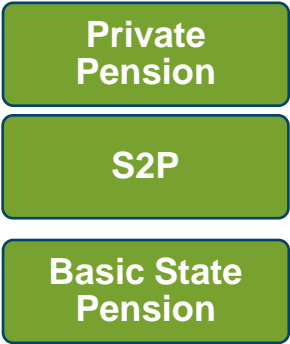
Not very different.

But could we pass longevity risk back to the taxpayer?

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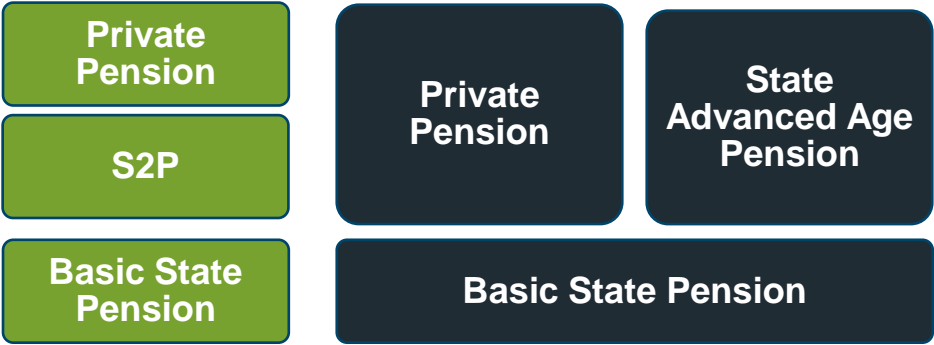
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“Horizontal Integration”



Vertical Integration

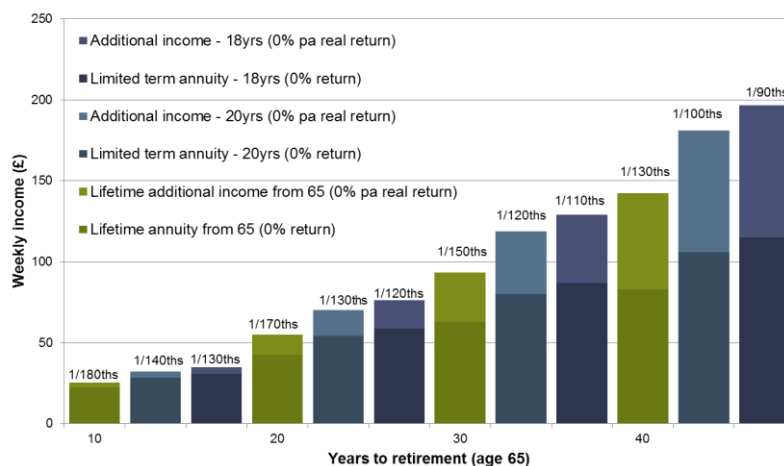
“Horizontal Integration”



Vertical Integration

Horizontal Integration

Fixed term annuities are bigger



Projected income from Auto-enrolment arrangement (term annuity vs. lifetime annuity)
(Barnett Waddingham calculations)

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Covering the final retirement years

- The state?
- Home equity?
 - 80% of over 55's live in their own home
 - And 65% of over 75's and their mean illiquid assets (property) exceed £100,000
- Home equity release not popular in the UK.
Would it work better at later retirement ages?

British Household Panel Survey 2005

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Obstacles

- The extra cost!
- (but would it encourage new DB schemes?)
- Means testing of the uplift at 85 would be unfair?

Not likely to happen soon!

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The Dilnot Commission July 2011

- This set out how Government could dramatically improve the social care system and make it one of which we can be proud.
- Individuals' lifetime contributions towards their social care costs – currently unlimited – should be capped at between £25,000 and £50,000. Dilnot said that £35,000 is the fair figure.
- After cap is reached, individuals eligible for full state support.
- The means-tested threshold, above which people are liable for their full care costs, should increase from £23,250 to £100,000
- *The Commission estimates that its proposals – based on a cap of £35,000 – would cost the State around £1.7billion.*

Both **David Cameron** and **Ed Milliband** called for cross-party talks on the issue

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