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## Macroeconomics of Pension Funds

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## Research agenda

- Rise and fall of DB pensions
- Ethics of pension scheme advisers
- Financial literacy
- Psychology of retirement decision making
- Corporate value of retirement savings
- DB vs DC social impact
- DB vs DC financial impact
- Macroeconomics of Pension Funds

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## Motivation

- Closure of DB schemes and the move to an end game
- De-risking and the move to matching assets
- Micro-level decisions that are taken in isolation
- What implications do pragmatic firm level decisions have for the economy as a whole?



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## Piecing it together

- Sources of retirement income:
  - State Pension Provision
  - Personal savings for retirement
  - Personal savings not for retirement – easy to access
  - Occupational public sector pension
  - Occupational private sector pension
  - Healthcare costs – largely ignored

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## Context

- A key objective of government – retirement savings
- Saving for retirement is also a rational thing to do
  - Consumption smoothing
  - Reduce cost to the State
- DB/DC/State – it is not clear how this mix provides intergenerational fairness in the current system

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## Who bears the risk?

- DB – A risk sharing agreement to a corporate debt
- DC – The individual with a loss of risk pooling
- The Pensions Protection Fund
- Government
- Intergenerational risk transfers
- Who is responsible for the overall problem?

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## Characteristics of pension funds

- Economic stabilisers (DB but not DC)
- Pools of capital – invest in companies or government
- Appropriate investor
  - Effective financial intermediary
- Ease the burden on employers, individuals, government
  - Intergenerational risk transfers
    - Risk pooling

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## Pension funds as pools of capital today

- \$2,700bn of UK pension fund investment
  - \$2,000bn of UK DB pension fund investment
  - \$700bn of UK DC pension fund investment
- \$1,200bn of equity investment by UK pension funds
  - \$500bn of domestic equity investment by UK pension funds
- \$1,000bn of bond investment by UK pension funds

Source: Towers Watson Global Asset Study 2013

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## Pension funds as future pools of capital

- De-risking: \$1.2tn of equity potentially being sold over time
  - £500bn of disinvestment from UK Plc.
- Regulatory pressure to de-risk(?) at scheme level – forcing maturity
  - De-risking is purchasing UK government debt (by accident or by design?)
- Matching assets – limited capacity in the market
  - (£1.7tn estimated buyout liability for DB schemes – source: PPF 2012)
  - Government trying to reduce debt
- Who fills the gap if UK pension funds don't buy UK equity?
- What does this imply for UK Plc., UK growth and governance?

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## Future of the DB actuary ...

- £1,700bn size of buy-out cost
- £10bn per annum of buy-out business written per annum
- Increased demand impacts prices – vicious circle
- Insurance company buy-out is “value destroying” (profit margins and restrictive investment policy)
- Legacy DB schemes require management
- Liability matching (minimal risk) portfolios, capital investment decisions

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## Pension funds as an appropriate investor

- The role of trustees in DB
  - Capital investment decisions
  - High levels of liquidity
  - Scope for large illiquid investments e.g. infrastructure
- The role of individuals in DC
  - Passive DC may lead to poor macro investment decisions
  - Behavioural biases in individuals when DC investments are made
  - Risk preferences & default funds

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## Consequences for individuals

- Retiring on insufficient pensions – who picks up the tab?
  - £7,488 flat rate State Pension + auto enrolment “protects” low earners
- Current annuity market, rates of saving and the tax system
  - No incentive to save
  - Compulsion to buy “gilt backed” annuities in retirement
- The lucky generation – intergenerational fairness and social contracts
- It's not about pensions – cost of ill health care – the transfer is huge

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## Who makes investment decisions?

- Buying government bonds
  - Increased Government debt – not necessarily a bad thing
  - Government makes real asset investment decisions
  - Investment in infrastructure – supply side policy (cf increasing demand)
  - History of regulation encouraging government borrowing in difficult times
- Buying equity
  - Investment decisions made by companies (better governance?)
  - Less government control

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## Challenges for Government

- Public sector and State pensions – mostly unfunded
- Debt and taxes – impact on growth – sovereign default?
  - Who hurts from sovereign default?
- Public sector social contract
- Who should make the investment decisions?
- Realistic limits to reserving e.g. resisting EIOPA
- The PPF and TPR – changing economic circumstances
- Incentives to de-risk Vs. incentives to invest in the real economy
- A role for properly designed defined ambition? (best endeavours)

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## Challenges for the Profession

- Public interest – government, employers and individuals
- Inter-generational risk transfers
- Design of retirement savings – pension and healthcare
- Real investment decisions – companies or government
- Individual outcomes – setting expectations
- Managing the DB legacy – sustainable solution
- Managing the DC legacy – financial literacy, power to the consumer
- Creating the sustainable fair retirement solution

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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