

Pensions

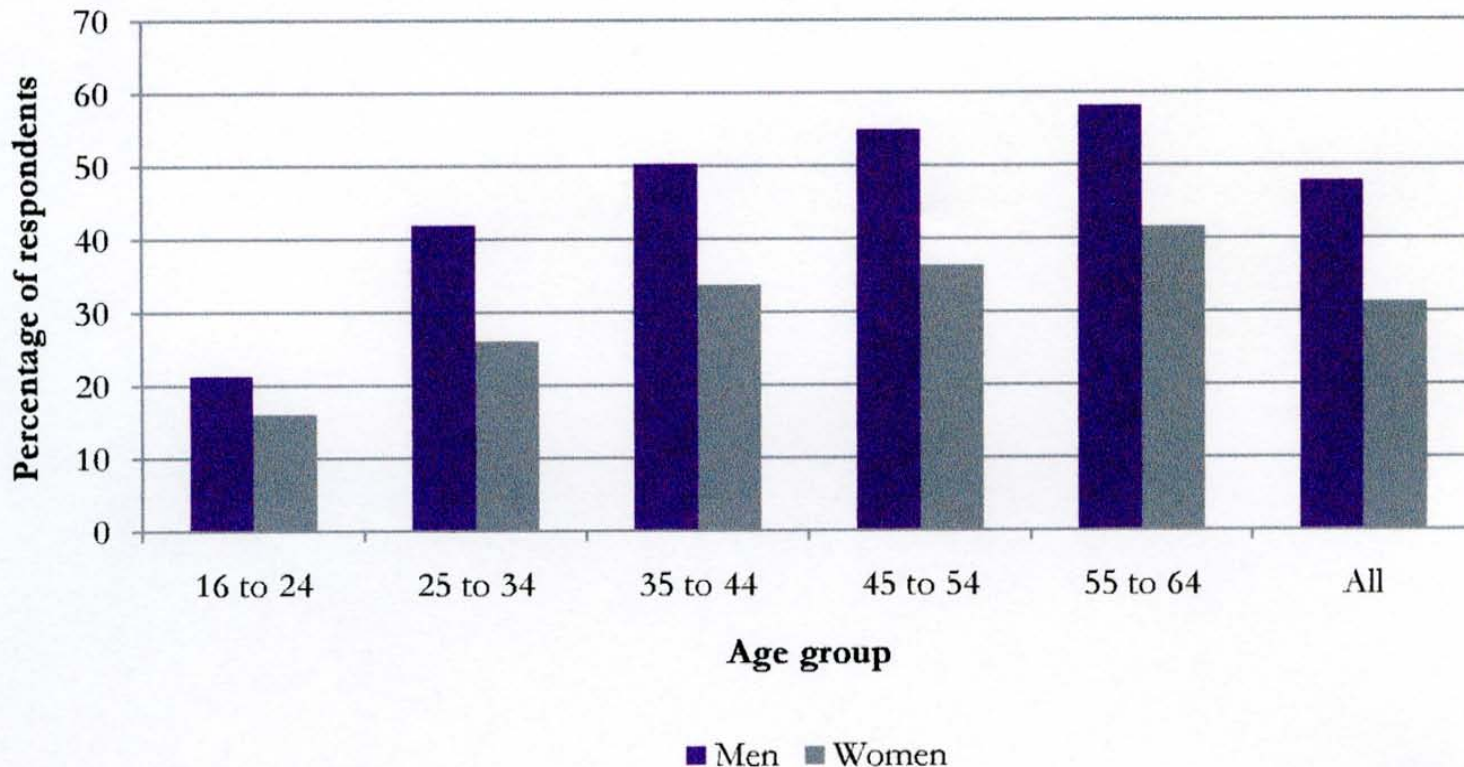
“doing nothing not an option”

Pensions – “doing nothing not an option”

- Pensions a very complex and currently very fast-moving topic – with very personal and strongly held views..... So very emotive....
- Involves us all – public sector and private, young and old, male or female, trade unionist or not.....
- We would all like to anticipate an enjoyable old age, in prosperity, thanks to a good pension rather than old age in poverty
- But currently a major risk of “pensions apartheid”, and a very divisive issue for society as a whole
- Tonight is a review – so everyone take a step back !

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Chart 3.I: Percentage of respondents who understand enough about pensions to make a decision about saving for retirement^a in 2006-08



Source: ONS, *Wealth and Assets Survey*.

From Hutton Report

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- The “tool kit” – mathematics, demographics, and some definitions
- The issues...
 - The state pension
 - The private sector
 - The public sector
 - Variations between UK and manx government actions.....
- Conclusion – our government fails the tests of leadership and of “a fairer society” - apathy, complacency, ignorance and self-interest – and a lack of vision for the future and for society
- The urgent need for a major, independent review of manx pensions policy in general, following which, action by government – with support from employers, pension providers, and by us all as responsible citizens

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- Fundamental to an understanding....
 - The mathematics of compound interest and time....
 - For example - **£100** deposit at **10%** annual interest

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- The mathematics of compound interest....
 - **£100** deposit at **10%** annual interest
 - Earns **£10** in Year 1, giving a total of **£110**

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- The mathematics of compound interest....
 - **£100** deposit at **10%** annual interest
 - Earns **£10** in Year 1, giving a total of **£110**
 - Earns **£11** interest in Year 2, giving a total of **£121**

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- The mathematics of compound interest....
 - **£100** deposit at **10%** annual interest
 - Earns **£10** in Year 1, giving a total of **£110**
 - Earns **£11** interest in Year 2, giving a total of **£121**
 - Earns **£12.10** interest in Year 3, giving a total of **£133.10.....**
 - And so on.....
- The important point – the “extra” earnings of compound interest add up – but only over the long-term....

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- Example
 - Applied to actual pension contributions of **£100** per month, and a return of **5%** per year
 - After **10** years, gives a fund of ?

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- Example

- Applied to actual pension contributions of **£100** per month, and a return of **5%** per year
- After **10** years, gives a fund of **£15,528**
- After **20** years, gives a fund of ?

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- Example
 - Applied to actual pension contributions of **£100** per month, and a return of **5%** per year
 - After **10** years, gives a fund of **£15,528**
 - After **20** years, gives a fund of **£41,103**
 - After **30** years, gives a fund of ?

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- Example
 - Applied to actual pension contributions of **£100** per month, and a return of **5%** per year
 - After **10** years, gives a fund of **£15,528**
 - After **20** years, gives a fund of **£41,103**
 - After **30** years, gives a fund of **£83,226**

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- Example
 - Applied to actual pension contributions of **£100** per month, and a return of **5%** per year
 - After **10** years, gives a fund of **£15,528**
 - After **20** years, gives a fund of **£41,103**
 - After **30** years, gives a fund of **£83,226**
 - After **40** years, gives a fund of ?

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- Example

- Applied to actual pension contributions of **£100** per month, and a return of **5%** per year
- After **10** years, gives a fund of **£15,528**
- After **20** years, gives a fund of **£41,103**
- After **30** years, gives a fund of **£83,226**
- After **40** years, gives a fund of **£152,602**

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- But “what if” the annual interest rate was **6%**?

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- At **5%**, **£100** per month over **40** years gives a pension pot of **£152,602**
- but at **6%**, it would give **£191,750**
- **And only £116,486 at 4%**

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Lessons to be learnt

- Pensions a long-term investment – the longer accumulating, the bigger the fund generated (so the sooner one starts a pension scheme, the better)
- The impact of compound interest is massive (so “roll-up” is critical)
- The impact of each extra 1% gain (or loss) on the return is also massive.... (so minimising the annual charges incurred is also critical...)
- Any changes in Government policy take decades to be effective..... Long-term not short-term action...

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- Some Demographics.....

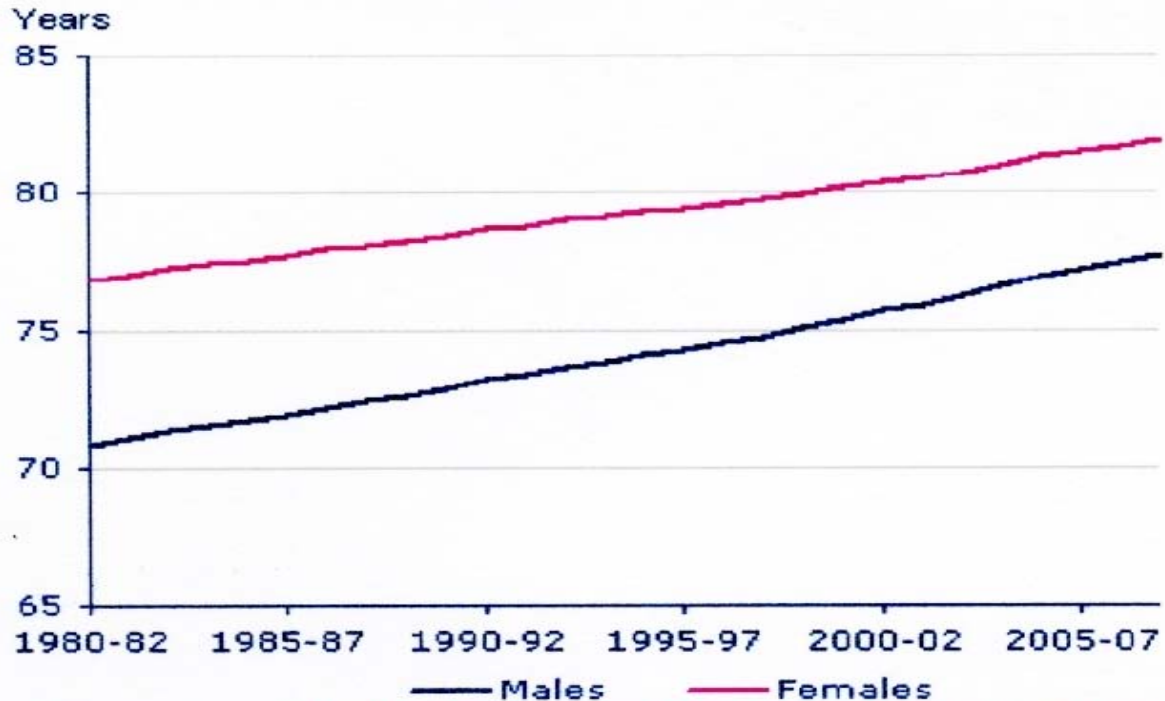
- Longevity – on average, we are living longer....
- Due to better diet, improvements to health care with better medicines and treatments
- 1 in 6 of today’s population will live to be 100
- Life expectancy now :

	Men	Women
At birth	78	82
At Age 65	83	85

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Life expectancy

Life expectancy continues to rise

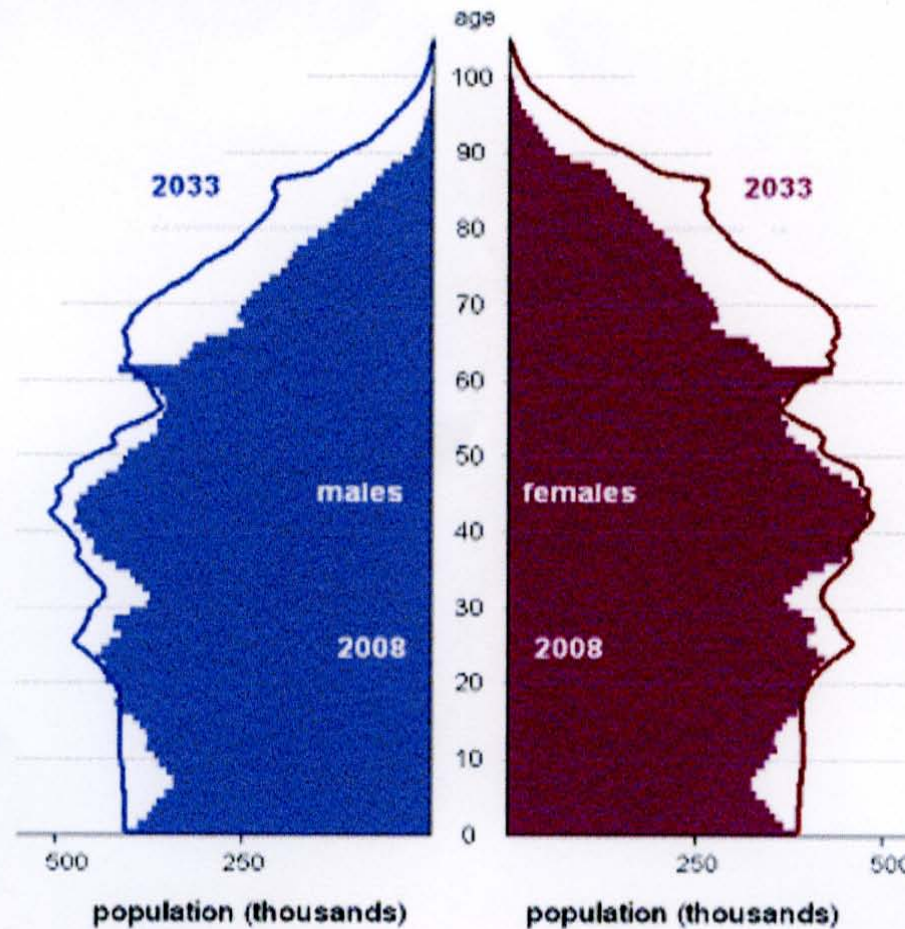


Life expectancy at birth, UK, from period life tables, 1980-82 to 2007-09

Office for National Statistics

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National Projections UK population to exceed 65m by 2018



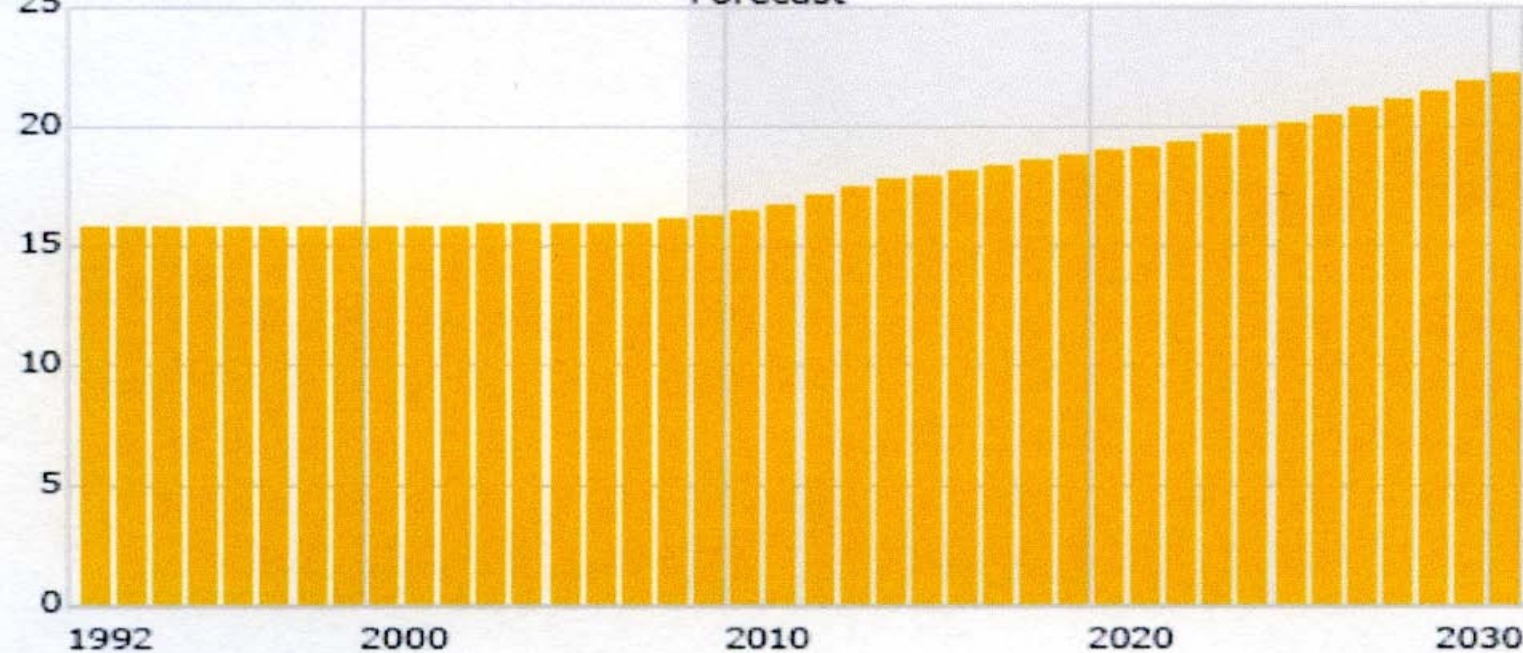
Estimated and projected UK population mid-2008 and mid-2033

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The ageing UK

Percentage of population aged 65 and above

%
25



Source: ONS-

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- Longevity increasing at approx 1.5-2.0 years every decade – which has enormous implications for Government for both pensions and health care....(over 65's c.20% of population but consume 50% of health care budget)
- Basically, more people now over 65 years of age and living longer (with numbers increasing rapidly), whilst relatively fewer of working age to pay for their pensions and health care (adverse dependency ratio)
- Currently 4 workers for every pensioner over 65 – by 2060, it will be 2 workers for every pensioner.....
- Is that affordable and sustainable in difficult economic times and over the long-term ??.....

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- Some Definitions

- Defined Benefits

- Pension such as “final salary” (years of service x average of last 3-5 years salary x 1/60 or 1/80)
 - Pension is guaranteed by employer BUT is an uncertain, long-term liability for the company

- Defined Contributions

- “Pension pot” (accumulated from employee and employer contributions to buy a pension annuity at retirement)
 - Pension is unknown and variable, depending on market circumstances at retirement, rates of return on fund invested, type of annuity purchased, etc

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- **Funded vs Unfunded schemes (defined benefit plans)**
 - Company final salary schemes required to be funded (adequate reserves to ensure payout for those eligible, or if in deficit, a plan agreed with Pensions Regulator to achieve funding)
 - State Pension and most (though not all) public sector final salary schemes are unfunded, payout being on basis of “pay as you go” ... from current members + employer + taxpayer

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- Int'l Accounting Standard FRS 17 - legal requirement for companies to report status of their defined benefit pension schemes – whether in surplus or deficit, and by how much
- Company Actuaries required to use similar standards for longevity, returns etc to ensure comparability
- If in deficit, company has 15 months to agree a recovery plan with Pensions Regulator

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- RPI (Retail Price Index) vs CPI (Consumer Price Index)
 - RPI is a measure of inflation using a “typical basket of goods” which includes housing costs (rents, mortgages etc)
 - CPI also a measure of inflation but excludes housing costs
 - RPI generally acknowledged to run 0.7% - 1.3% pa higher than CPI over longer-term
 - Those in receipt of pension generally acknowledged to benefit if RPI used for indexation, those paying the pension do better if CPI is used..... (eg changes to State Pension, disputes with BA pilots and Ford, High Court action by public sector unions)

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- The State Pension

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- Basic State Pension :
 - described as “worst in Europe” (NAPF) or “least generous in the western world” (OECD)
 - EU says 30% of British pensioners live in poverty (defined as below 60% national average income) – versus 17% in Germany and 13% in France
 - 53% of Single Pensioners had total annual income of less than £10,000 in 2008/9

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- **Basic State Pension**
 - “Unfunded” – paid on “as you go” basis from current taxpayer contributions via NIC’s
 - Currently, Basic Pension £102.15 for single person, £163.35 for a couple (Manx linked to UK)
 - Basic State Pension subject to number of years of NI contributions – not universal benefit so women (in particular) may not qualify in full
 - Number of qualifying years reduced in 2010 to 30 years contributions (from 44 for men, 39 for women) – but cost paid for with increase in State Pension Age

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- Basic State Pension
 - Default Retirement Age (65) being abolished from October 2011 – to encourage working longer
 - Currently expected that both men and women will have a common retirement age of 66 in 2020
 - And of 67 by 2034 – 2036 } subject to Hutton
 - And of 68 by 2044-2046 } subject to Hutton
- Hutton proposes automatic link to life expectancy which if enacted could mean anyone now in 20's /30's may not retire until 70-74 years old.....

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- As of April 2012, Basic State Pension is to be indexed (inflated yearly) using CPI, not RPI as previously
- UK Coalition proposes “triple lock” inflation index using CPI, earnings or 2.5% - whichever is highest
- But since RPI historically is higher, to possible / probable long-term detriment of pensioners.... though re-instatement of link to earnings is a good move for pensioners

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- In UK
 - Top-up of Basic State Pension possible in UK with means tested pension credits – giving a minimum pension of £137.35 per week to single person, £209.70 for a couple – and more if eligible for SERPS or S2P, etc
 - Problem that approx 35% of pensioners do not claim their entitlement under pension credits
 - And means testing hits those with modest savings (why save?)
 - And entire scheme and process very complex....
 - With considerable confusion as to pension expectations at retirement.....

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- In UK, the state pension now considered too complex, a burden administratively, uncertain and unclear for recipients, so under review
- Latest Green Paper in UK includes proposal for a new, more universal State Pension of £140 for single person (£280 for couple), to replace current pension + pension credit complexity

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- **The Good News**
 - Much simpler, more understandable, and with clearer expectation of eventual pension
 - Women, lower-paid, and those with modest savings likely to benefit, in particular
 - Means a “savings culture” can again be encouraged

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- The Bad News

- only from 2014/15, and only for those retiring thereafter (leaving current pensioners on existing system)....
- likely that those currently contracted out (in final salary schemes, self employed, and public sector workers) currently getting benefit of reduced NI contributions would pay NI at higher (standard) level – but getting increased pension in return
- employers with final salary schemes likely to face higher NI contributions, forcing more to close their schemes

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- Consultation only, so unable to reach any conclusions as yet – but at least UK Government is aware of the issues, and looks to be facing up to the long-term difficulties

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- Isle of Man
 - no means tested “pension credits” (but additional personal allowances and pension premiums)
 - But, Manx supplement (currently £49.85 per week) if eligible (10 years manx NI contributions or 5 years + incapacity benefit to qualify)
 - Single person getting supplement entitled to £152.00 per week, couple to £243.05
 - Problem for those without supplement.... (approx 4500 on IOM, facing high manx cost of living)
 - Problem for Government in that the Basic Pension and Supplement now costing £141million per year – and growing rapidly due to our ageing population and inflation.... Whilst Govt Budget now very constrained ... so unlikely the supplement will become universal in short term....
 - And UK Green Paper, if enacted, probably means end of manx supplement

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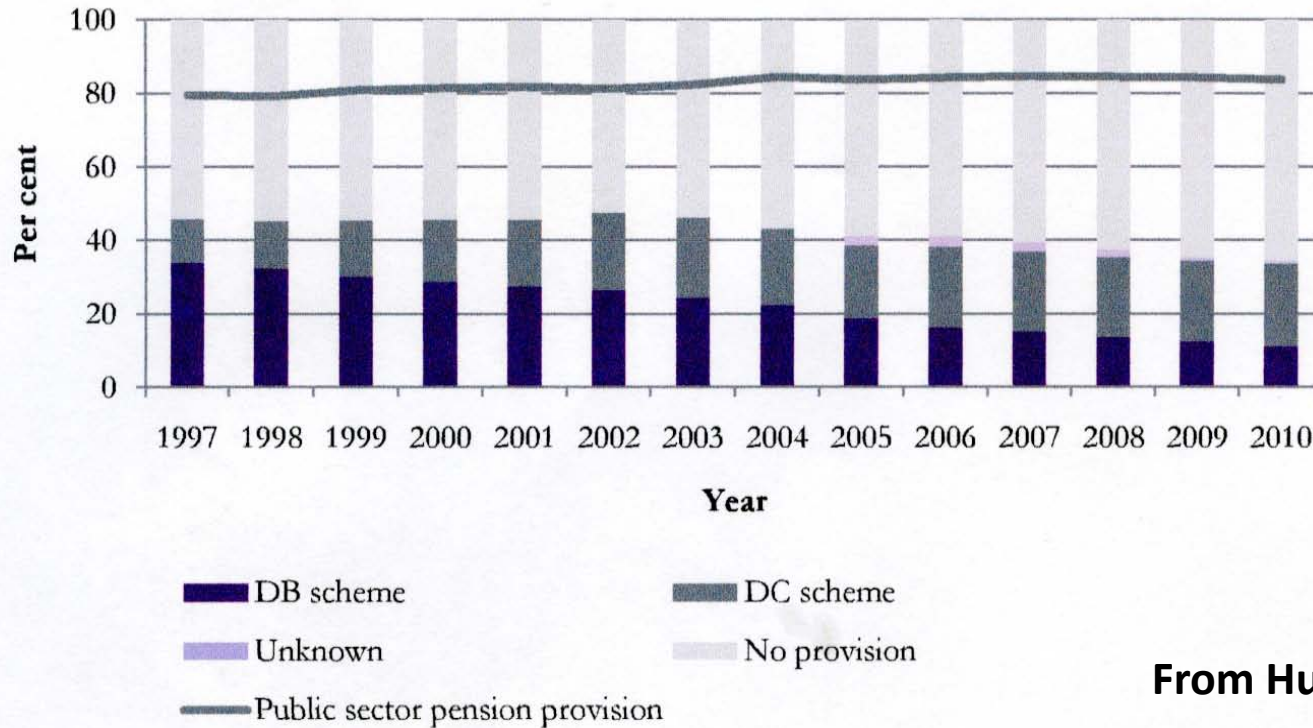
- BUT reality is that State Pension, even at £140 per week is still +/- Poverty Level
- So still the need for everyone to make proper provision for retirement with an additional pension.... either company or personal

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- **Employer Pensions – public and private sector**

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Chart 1.D: Membership of employer-sponsored pension schemes among UK employees



From Hutton

Source: Annual Survey of Hours and Earnings.

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- Conclusions

- Public Sector

- Very high participation rate (83%+) with Defined Benefits (final salary) pensions, albeit varying terms / contributions

- Private Sector company pension schemes

- Participation has dropped from c. 45% in 1997 to c. 35% in 2010 - meaning more than 60% of employees WITHOUT company pension
 - Company drop-out due FRS17 stringency / liability issues / impact of Gordon Brown’s 1997 removal of ACT dividend relief for pension funds (£5 Billion + per year)
 - Big switch from Defined Benefits to Defined Contributions (“pension pots” - more control, less liability) – but much less pension for members. Only 11% of employees in company final salary schemes in 2008.....

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- In 2010, only 4 companies in UK Footsie 100 and only 6 companies in the UK Footsie Top 250 indices continued to offer final salary pensions to new entrants
- And many / most companies are in process of negotiating changes to existing members to reduce their liabilities (eg CPI rather than RPI indexing, “cap” on indexation, buying out final salaries and converting to defined contributions etc)

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- Office for National Statistics says families on dc schemes “likely to be disappointed with their pension savings”
- Defined contributions pension significantly worse than final salary
 - Price Waterhouse Coopers reckon a 21 year old in private sector dc scheme gets pension of £11,600 at 65 years old versus £28,900 in public sector final salary scheme
 - “Pension pot” of £100,00 currently required to generate £5,000 pa pension for joint annuity at age 65

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- **Workplace Pension Scheme (UK)**
 - Starts in UK in 2012, progressive through to 2016
 - Attempt to auto enrol all employees in a company defined contributions pension scheme (if not already), to ensure long-term savings plan in place
 - Either NEST (National Employment Savings Trust) or company’s own scheme
 - Modest employer contributions at minimum of 3%, with employee putting minimum of 4%, and state (via tax relief) an additional 1% - minimum total 8%
 - However, this very much a minimum – greater savings essential if reasonable pension to accrue...

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- **The Public Sector...**

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- Public Sector Pension Commission (IoD + Experts)
 - PSpC described public sector pensions “as operating like an unstable Ponzi (pyramid) scheme which will only work if tomorrow’s generations are able to stomach the higher cost to pay for the unfunded promises made today”

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- **Public Sector Pensions – Hutton Report for UK**
 - As in IOM, a myriad of different schemes, with varying contribution levels , terms and conditions
 - But Hutton took the evidence of demographic and longevity changes of the past several decades, and pointed out that public sector workers would need to save more than 40% of salary each year to fund their benefits - but this is currently funded with
 - 6% from employee
 - 14% from employer
 - 20% from taxpayer
 - And concluded that current UK pension arrangements are unaffordable, unsustainable, unfair to the taxpayer, and that major reform was essential....

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- But Hutton also said that it was important to ensure public sector employees continue to have access to good quality, defined benefit pensions
- So the Commission proposed a whole series of reforms, which the UK Coalition Government “is committed to implement”, probably in 2014/2015

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- Hutton Report

- Takes as a given the change from RPI to CPI for pension indexation, and an imminent increase in employee contributions
- Confirms that the changes must not be a “race to the bottom”, and that pension promises already made and accrued must be honoured
- Confirms need for an on-going dialogue and honesty / integrity / openness by employee and employers representatives to build consensus
- But also a need for action, not just talk....

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- Main recommendations
 - To replace existing final salary schemes with career averaging
 - Members with benefits to date under final salary will have protection for accrued benefits, BUT will move to career average benefits for future accrual at a date to be agreed

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- Main Recommendations
 - Because of increased life expectancy and the time spent in retirement, Normal Pension Age will link to State Pension Age (65 – increasing to 66 by 2020) and track any future increases
 - Uniformed services (fire, police and armed forces) will move to Pension Age of 60 to recognise the physical challenges of their work

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- Main recommendations
 - Changing retirement age as suggested addresses longevity issue and helps ensure sustainability of pension funding
 - In addition, to protect taxpayers, Hutton recommends a “cap” (as a percentage of pensionable pay) for taxpayer contributions to public sector pensions –with automatic stabilisers to keep future costs under control
 - The stabiliser may require scheme members to contribute more to maintain pension, or to take a smaller pension

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- Main Recommendations

- A need for much stronger and more independent governance of all public sector pension schemes

- To ensure government, taxpayers and scheme members are better informed of costs and benefits
 - With minimum standards set for scheme administration (annual reports, benefit statements etc)
 - With improved transparency and clarity of duties, responsibilities etc - and separation of “conflicts of interest” to ensure those benefitting from pension scheme are not also managing them.....
 - Pensions Regulator role ?

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- Hutton Report
 - Convincing
 - Honest
 - Rigorous
 - Faces the issues
 - But also “political” in that it recognises the difficulties of persuading all parties of the need for change, and the necessity for compromise and balance to ensure a “fair deal” for employees, employers and taxpayers....

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- The Isle of Man – Public Sector and the Hymans Robertson Report....equivalent of Hutton
- Hymans Robertson intended to enable consolidation of most manx public sector pensions to a single, unified scheme – but excludes teachers, judiciary and police who remain under UK programmes (and presumably Hutton reforms longer term)...

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- The Isle of Man – Public Sector and the Hymans Robertson Report....
- By comparison
 - Not independent, not given wide remit, and not convincing...
 - Carefully briefed by Government to preserve the status quo – of final salary scheme, with very modest rise in employee contributions
 - Continued opacity in governance arrangements, with no independent oversight....
 - Major cost contribution by taxpayer continues and to grow (alarminglly)

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- Hymans Robertson deeply flawed
 - Continuing final salary scheme justified on basis of comparison with private industry
 - But only 3 (carefully chosen?) private industry comparisons included – who had very generous benefit packages not typical of manx companies...
 - Including gym memberships, company cars, generous pensions etc)

- Reality is that few employees in private sector have significant benefit packages, and only 35% have an employer pension scheme, with average pay below public sector averages

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PRIVATE AND PUBLIC SECTOR COMPARISON - JUNE 2010

	Average weekly earnings (£)			Average weekly hours		
	Private	Public	All	Private	Public	All
Males, manual	430	548	460	42	41	42
Males, non-manual	736	844	762	37	38	38
All males	614	720	640	39	40	39
Females, manual	368	476	403	38	35	37
Females, non-manual	546	614	567	36	34	35
All females	519	591	541	36	34	36
Males and females, manual	415	526	445	41	39	40
Males and females, non-manual	635	703	654	37	36	36
All males and females	572	652	594	38	37	38

Note:- The table includes full-time employees on adult rates of pay whose earnings were not affected by absence for whom basic hours of work were reported.

Manx Government
Earnings Survey 2010

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- Government’s 2010 Annual Report notes the estimated public sector pensions liability at £1.445 billion – only £18,000 for every man, woman and child
- Recent admission that under FRS17 rules, the deficit is actually £2.010 billion in 2012 – but increases to £3.6 billion at current prices by 2030 (when £45,000 per head liability)
- Affordable ? Sustainable ?

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- The independent Hutton Report for UK says “unsustainable, unaffordable and unfair to taxpayer”...
- Hymans Robertson with a very tight brief to produce a continuing final salary scheme, says quite the opposite
 “a fair deal for all”...
 affordable and sustainable
- Which do you believe ?

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- The problems for the Manx Government
 - UK State Pension may change in 2015 to universal basic of £140 – simplifying pension credits and admin
 - but implications for the manx supplement and for the overall balancing of the manx budget?
 - UK Coalition introducing NEST’s from 2012 – workplace pensions with employer contributions – but so far no equivalent manx scheme.... Leaving thousands of company employees dependent on State Pension
 - Hutton Report proposes major, radical reform of public sector pensions – IOM committed to Hymans Robertson... Teachers, police and judiciary on IOM covered by UK arrangements, all others by Hymans.

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- All of which suggests the need for manx government to step back from current proposals, and to re-consider policy options for ALL for the future
 - Public sector and private sector
 - Employees and employers
 - And a proper balancing of costs for a fairer society, and to meet everyone’s expectations for a comfortable old age...

Thank you and the end !

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Appendix 1

- Explanation of Career Average Re-valued Earnings
- Hutton’s graph suggesting possible re-distribution of pension earnings in CARE pension from “high-flyers” to “low – and medium-flyers”

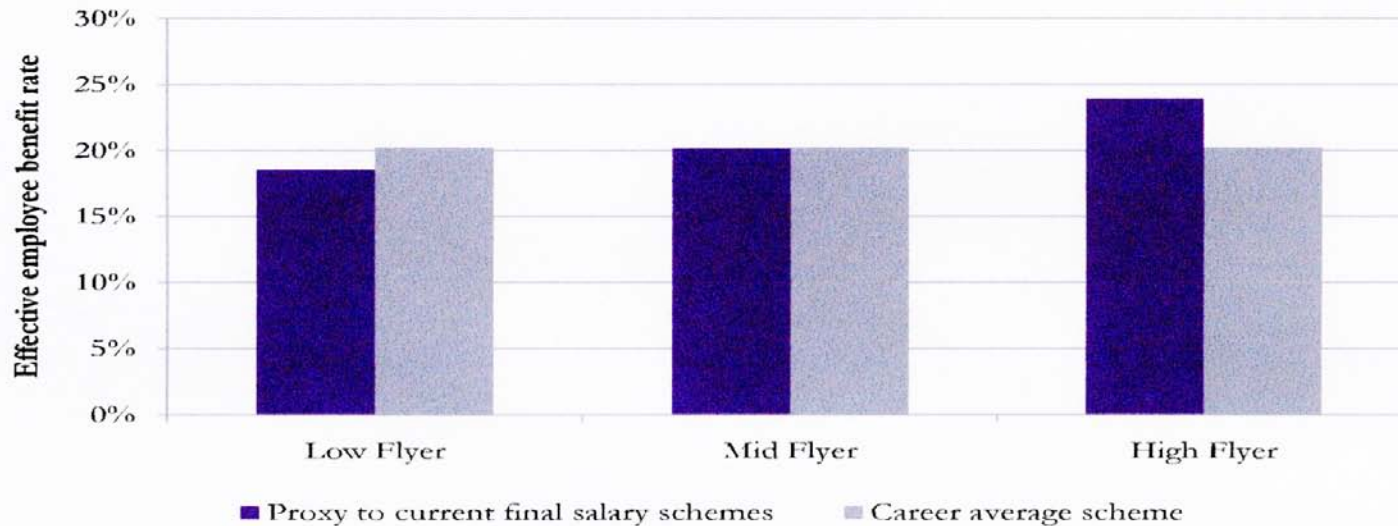
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- Final Salary vs Career Average
 - “final salary” most easily understood form of defined benefits pension.
 - “career average” is “slices” of pension earned each year of employment, each slice up-rated by inflation or agreed indexation factor to produce career average earnings figure which then forms basis of pension. Hutton states that low / medium performers will do well with career averages, high flyers will lose out...

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- Please note – career averaging will involve some re-distribution between “high flyers” and low / moderate flyers” - high flyers will be disadvantaged...

The distributional impact of moving from final salary to CARE



Under the example CARE scheme the EEBR is higher for a low flyer than in the proxy to the current final salary schemes, while for a high flyer it is lower. A CARE scheme therefore redistributes pension benefits from high flyers to low flyers. This redistribution occurs because, for a fixed cost, the savings from the removal of the final salary link for high flyers can be recycled into providing a better level of benefit for other scheme members.