# Personal Accounts and Pension Reform after the Credit Crunch

A Summary Brief

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ILC-UK

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# About this Brief

This brief summarizes a public debate organised jointly by the ILC-UK and The Actuarial Profession entitled ‘Personal Accounts and Pension Reform after the Credit Crunch’, which took place on March 24th 2009 at the Institute of Actuaries, Staple Inn Hall, High Holborn, London.

The brief summarises the comments of speakers and the audience, firstly on personal accounts, and secondly, on wider UK pension reform.

# Acknowledgements

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Speakers at the debate included:

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| Niki Cleal | Pension Policy Institute |
| Seamus Creedon | Institute of Actuaries |
| Tim Jones | Personal Accounts Delivery Authority |
| James Lloyd | ILC-UK |
| Sir Nicholas Montagu | Xafinity |
| Nigel Waterson MP | Shadow Pensions Minister |

# Personal Accounts after the Credit Crunch

*The future of Personal Accounts*

Speakers remained positive about Personal Accounts, noting that the policy imperatives and rationale of Personal Accounts had not changed, despite instability in the international economy and capital markets. Although some thought that this instability warranted a pause or delay to the reform process, it was pointed out that the risk of not pressing ahead with reform ï that non-savers would not be brought into a savings scheme ï meant the reforms should go ahead as planned. This point was underlined by the fact that some flexibility is built into the launch of Personal Accounts: although October 2012 is the official launch, the duty on employers to provide a Personal Account or reasonable alternative cannot be implemented nationally on the same day, and as a result, the application of this duty will be phased in over at least 18 months.

*Reception to Personal Accounts*

Speakers noted that although some individuals may be more wary of pension saving in light of fluctuations to asset prices, the advantage of inertia is that most people simply do not think about pension saving. So, in response to the credit crunch, it felt was unlikely both that current pensions savers would stop saving, or that individuals automatically enrolled into Personal Accounts would withdraw in higher numbers.

*Replacement rate*

Audience members expressed concern about the proposed income replacement rate made possible by Personal Accounts, arguing that existing proposals failed to match international standards, and that employer contributions should be higher. Speakers noted that the 5+3% contribution rate was effectively a compromise solution between the government and employersô lobby, and that there was perhaps a case for looking again, creatively, at this issue.

*Provider responses*

Speakers acknowledged that some unknowns remained about how employers would respond to Personal Accounts, with the risk of ðlevelling-downô contributions. This was viewed as an ongoing issue for which further work and research could be undertaken.

More generally, the effect of Personal Accounts on pension providers was also seen as an unknown. A positive for the industry may be an increase in the volume of pension saving business. Nevertheless, it was acknowledged that Personal Accounts may lead to downward pressure on management charges.

*Auto-enrolment and recruitment agencies*

Audience members queried how Personal Accounts will address individuals who are highly mobile in the labour market. In particular, what would be the situation with temporary workers employed through recruitment agencies? It was reported that PADA is looking closely at this issue.

*Advantages of Personal Accounts*

Speakers were keen to highlight the advantages of Personal Accounts, noting that some characteristics of Personal Accounts were especially valuable in light of financial market instability. In particular, the simplicity, incentives and ‘plainness’ of Personal Accounts was thought to be advantageous in an environment where distrust of financial services may have increased.

# Pension Reform after the Credit Crunch

*Long-term not short-term*

Speakers were unanimous in believing that recent shocks to the financial system did not warrant ‘panic’ or a complete change of direction in pension reform. Several speakers noted that pensions are inherently a long-term proposition, so it is important not to overreact to short-term events. More generally, the policy imperative behind pension reform ï increasing saving ï was not changed by the credit crunch.

*Attitude to retirement saving*

Speakers noted the possibility that the credit crunch will change attitudes to pension saving. Research of consumer attitudes was cited, which showed that the proportion of individuals who believe that either pensions or property were represented the best way to save for retirement had declined in light of financial instability afflicting the international economy. Instead, more individuals now believed that savings and ISAs were the best way to save for retirement.

*Early withdrawal*

In light of the credit crunch and recession, some speakers floated the idea that under certain conditions ï such as six months of unemployment or identifiable risk of losing a home ï individuals should be able to draw on their accumulated pension savings before the statutory minimum age of 55.

However, speakers remained wary of such an approach, arguing that once the principle of early withdrawal is sanctioned, the conditions under which individuals can withdraw pension saving will become increasingly relaxed, ultimately undermining pension saving. Speakers argued that if saving for retirement is to be incentivised, savings should be protected as such.

*Risk-pooling of investment risk*

Speakers recognised the unfairness confronting individuals whose pension saving was heavily exposed to risky assets, such as equities, and who now confront a much lower annuity income than if they had retired even 2-3 years previously, given declines in equity prices.

Participants noted the absence of investment risk-pooling inherent in the private pension saving model, and some questioned whether, in light of recent stock market falls, money purchase DC schemes are truly ‘fit for purpose’. Some participants argued for schemes to pool investment risk, and suggested overseas examples, such as the Singapore Provident Fund, which enables the pooling of investment risk. However, speakers argued that investment risk-pooling is only really possible in the context of a high level of social solidarity, which is absent in the UK, and that investment risk-pooling necessitates an underlying role for the state in private pension provision. Nevertheless, some speakers argued that collective risk-sharing in relation to DC pension-saving would be highly valuable, and removing the arbitrary ‘confiscation’ of wealth associated with instability would be a step toward cultivating a climate of financial stability.

*Promoting saving*

Audience members noted that outside of the pension industry, there remains a significant lack of awareness about the need to save for retirement. Speakers argued that even in the context of Personal Accounts, a major communications strategy will be required to encourage the public to save. In particular, it was argued that auto-enrolment would not negate the need to encourage individuals to save, not least because individuals will retain the option to withdraw. This need also underscores the role of clear, simple information and generic financial advice.

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