A Perspective from the UK

Steve Webb
Director of Policy, Royal London
UK Pensions Minister 2010-15

Beware of these…

The background to UK reforms

- Historically, public sector workers and workers for big private firms in Defined Benefit schemes
- Long term (50 years) decline in workplace pension membership
- DB schemes generally well funded into 1990s
  - Employer contribution ‘holidays’
  - From 1997 mandatory inflation protection etc
- Main issue: coverage rather than adequacy

Things start to go wrong

- Longevity increases faster than expected
  - Cost of statutory protections increases
- Interest rates / rates of return start to fall
- Economic pressure on employers
- Accrued rights 100% protected: *rigid* system
- Employer insolvencies with schemes in deficit leave workers with heavy losses
- Employer concerns as company accounts show big swings owing to deficit re-valuations

The new world:
1. Automatic enrolment

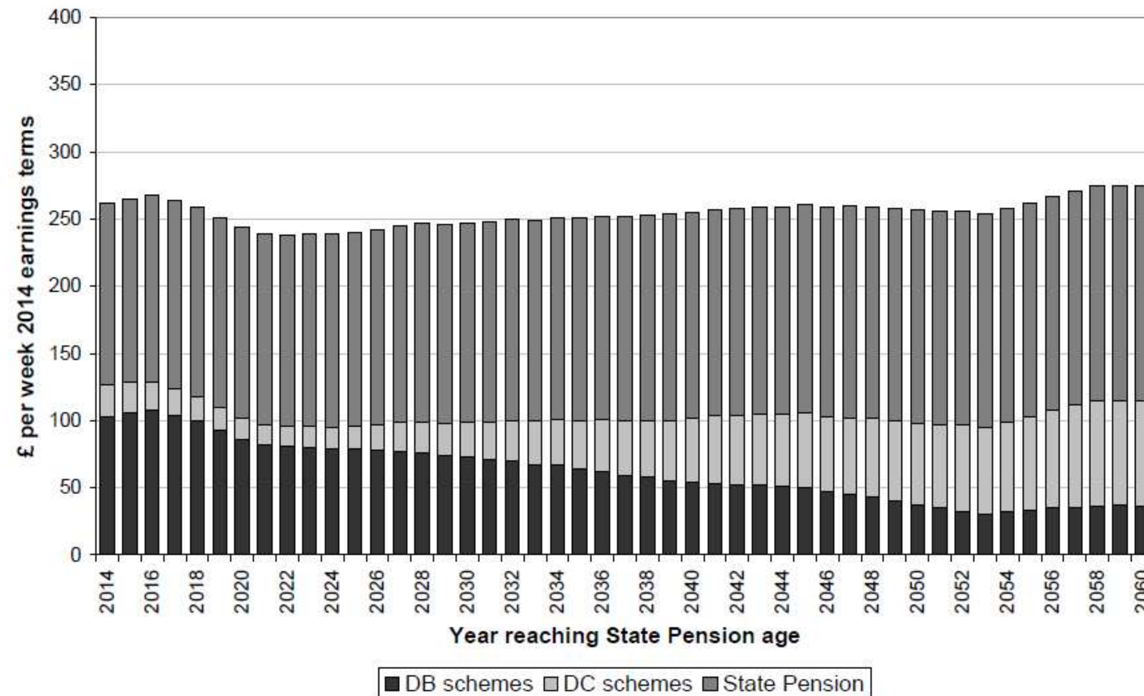
- All employers have to enrol workers into a pension and make a contribution
- Started with big employers in 2012, complete by 2017
- Minimum contributions at very low level – initially 2% (1 worker +1 firm), rising to 8% (5 worker + 3 firm) in 2019
- Vast majority enrolled into individual DC;

The new world:
1. Automatic enrolment (cont)

- Hugely successful in terms of coverage:
  - 6 million enrolled so far
  - Approx 90% staying enrolled
  - Eventually 10 million will have been enrolled
- BUT
  - contribution rates far too low (no plan for beyond 8%);
  - Exclusions – self-employed (4m), low earners

What do you do with your pot?

- Big switch from DB to DC



The “annuity problem”

- Very small DC pots could be taken as cash, large pots could be invested and limited income ‘drawn down’ but..
- Majority of pots had to be converted to an annuity – but, increasingly unpopular
  - Falling annuity rates – demographics, int. rates;
  - Limited ‘shopping around’ -> poor value;
  - Under-developed market for ‘enhanced’ annuities

“Freedom and Choice” (2015 Reforms)

- 2014 Budget announced that from 2015 “you don’t have to buy an annuity”
- Complete move away from assumption that pension policy is about generating an income for life
- Made possible by:
  - Simpler ‘flat-rate’ state pension set at subsistence level
  - Less ‘paternalistic’ political outlook by govt.
- Note: DC pot might only be part of pension rights

Initial response?

- Initial public and media response hugely positive
- Main concern was what happened if someone spent their pension on one of these…

What happened next?

- System went live in April 2015, big pent up 'surge' of people cashing in pension pots; annuity sales slumped;
- Generally pots cashed in were relatively small and part of multiple pension rights
- Many used money for clearing debts, home imrovements, holidays, family weddings etc
- Annuity sales starting to recover; more people using 'flexible drawdown'

Where will the debate go?

- Concerns about advice / guidance – ability of individuals to make complex choices, especially in later retirement
- Concerns about people:
  - Spending too quickly and 'running out'; esp. as people under-estimate their own longevity;
  - Spending too cautiously and depriving themselves
- Possible pressure for new defaults (eg annuity at 75?)

Possible implications for the Dutch debate?

- Value what you have? Many features of existing Dutch system admired, including:
  - Collective provision / risk pooling;
  - ‘Safety Valves’ when schemes are under-funded [v. very rigid UK system];
- A move to individual pots (even with ‘smoothing’) still likely to increase complexity and reduce certainty for individuals? Are consumers equipped to make good decisions?
- Wholesale reform makes it harder to reverse if it doesn’t work; may be a case for incremental change?