

# Crisis, what crisis?

## The failing UK pension system

By Mark Penston

For some years the pensions industry and associated professional bodies have warned us that future retirement incomes for individuals are at a dangerously low level. The UK pension issue has been a bit of a political hot potato for some time now - something that should be dealt with, but which is such a long term issue that one might suspect it doesn't feature in the relatively short term political agenda. Facing up to these matters now, with all the other financial issues that the UK is facing, seems unlikely to say the least.

The government have broadcast the relatively minor changes they are making to pensions that will improve matters, e.g. returning indexation of the State Pension to that of earnings rather than RPI, but they tell us little about extending the State Pension age or capping additional pension benefits.

In a recent survey by the Association of Consulting Actuaries (ACA) they found that only 6% of firms believe that the Government's promise to encourage quality pension schemes is working. This compares with a figure of 32% two years earlier.

In broad terms the problem falls into three areas:-

### Company Pension Schemes

The ACA survey concludes that pension scheme policy is in a 'real crisis' and needs 'radical' change. It claims:-

- 87% of all final salary schemes are now closed to new entrants with 18% of these closed to further accrual.
- One third of these schemes is under review to save costs by changing criteria such as extending retirement date or changing the definition of final salary.



- 91% of schemes surveyed were in deficit with over 20% of these schemes reporting recovery plans of over 10 years.
- In consideration of the proposed auto-enrolment schemes in 2012 nearly a quarter of all employers expect to reduce costs now in order to prepare for the higher costs.
- Many employers have, and are continuing, to move away from the responsibility to offer the guaranteed benefits of a final salary pension in favour of 'defined contribution' pension schemes. These schemes place all the investment risk and return in the hands of the employee by effectively giving them their own invested retirement fund.
- Including employer and employee contributions, the average payment into a defined contribution scheme is 11% of salary, which is well under half of the cost of running a final salary pension scheme.

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#### Personal Pension Schemes

The uptake of personal pensions has increased significantly over the last 10 to 15 years prompted by changes in legislation to simplify uptake, coverage in the media and advertising. Yet with average fund sizes at retirement of a little over £40,000 it would seem that many are misguided about necessary funding levels to provide a meaningful income in retirement.

'Moneyfacts' reveals that pension incomes have fallen by almost 75% over the last 10 years due to disappointing stock market returns and plunging annuity rates. The size of the average pension pot has fallen by 60% over the last decade with events such as the dot com crash and credit crisis all taking their toll. This position would have been even worse if it had not been for the recent stock market revival which saw average pension fund values increase by 22%. Falling gilt rates and improving mortality rates have combined to leave annuity rates 28% lower than they were ten years earlier. To achieve the same pension income as someone who retired a decade ago and had been contributing £100 per month to a pension, those retiring now would need to have saved around £355 per month instead.

#### State Pension

Those with expectations of a 'reasonable' standard of living cannot rely on the State Pension alone. This is notwithstanding the fact that state pension age is now moving to age 68 and that pension increases are currently not keeping up with the increases in costs that pensioners face. Many actuarial bodies have commented that moving retirement age to 68 is not enough and with increasing longevity the Government will face financial difficulties in funding State Pensions at earlier ages.

#### Summary

Our experience shows that individuals place less and less reliance on the Government to provide an income for them in retirement. Government Pension policy changes and latterly economic instability has made many of our clients realise that the responsibility for providing an income in retirement is theirs and anything the State provides will be viewed as a bonus. As ever, independent financial planning and advice is key to establishing what actions should be taken to ensure that the required funds are available in retirement.

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