Opinion Piece

The future of retirement

Received (in revised form): 20th April 2012

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is an independent pension consultant who is widely recognised for his efforts and achievements in the pension's field. For over 13 years between January 1997 and April 2010, he was Chief Executive of The Pensions Advisory Service (TPAS), a role which considerably enhanced his reputation as one of the country's leading pension experts. His earlier career was largely as a civil servant involved in the development of pensions policy and as a senior operational manager responsible for the processing and payment of social security benefits. Since 19 April 2010, he has been working alongside key Barnett Waddingham personnel to help cement the firm's profile. He has long been seen as a champion for the pension consumer and his experience and high personal profile within the pensions industry are enabling factors in helping Barnett Waddingham's key messages and research reach a wider audience. He continues to be a popular speaker at pension conferences and other industry events. He also makes regular guest appearances on both television and radio, notably the BBC's News Channel Business Reports and Radio 4's Moneybox Live programme. In recent years, he has received a number of prestigious industry awards for his work, including a unique award for 'The Greatest Individual Contribution to Occupational Pensions of the Decade' at the UK Pensions 10th Anniversary Awards in 2007 and most recently the Pension Management Institute's inaugural award for 'Outstanding Contribution to the Pensions Industry 2011'.

ABSTRACT To consider the impact for pension planning of an ageing population and later retirement ages and the need for individuals to accept more responsibility for their own financial security in later life.

Pensions (2012) 17, 134–136. doi:10.1057/pm.2012.14

Keywords: retirement; state pension age; longevity; cost; planning; well-being

For most people retirement used to be a fairly straightforward process.

You finished work and took home your final pay packet. You started to receive any company or other private pension you had subscribed to over your working life and you claimed the state pension.

If you had planned your future properly and had been a diligent saver the bulk of your replacement income in retirement would come from your private arrangements – in respect of a pension ideally the proceeds of a final salary scheme. For you the state pension was a bit of a bonus – a top-up to your main income.

For others, the reverse was probably true with the state element providing the whole or the biggest part of your income.

In either situation, however, the chances are that the retirement took place at or close to state pension age, which for a man was and still currently is 65 and for a woman somewhere between 60 and 65 depending on age.

The concept of the state pension age being synonymous with the retirement age has held good for a number of years but is now starting to be eroded to a greater or lesser degree. The significance of 65 as representing normal retirement age was materially altered by the abolition of the default retirement age giving workers the right to stay on at work past 65 if they chose to do so and preventing employers from dismissing staff purely on age grounds.

The signs that attitudes to work and retirement had to change had been apparent for some time before this. Hard evidence was now available that as a nation we were all now on average living longer and with it came the realisation that pensions would have to be paid for longer and would cost more in consequence.

The private sector was the first to feel the impact as employers sought to contain costs by

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closing down final salary schemes, which had previously been available to their workforce and replacing them with much less generous and (to the workers) often much more risky alternatives normally of the defined contribution type. In some instances this has had a double whammy effect as the end product of defined contribution pension arrangements are annuities which themselves have been falling and represent much less value for money than previously.

The public sector too has now had to face up to the reality of the situation with schemes there being forced to give up final salary arrangements for ones based on an average salary and for workers having to face the prospect in the future of 'paying more, working longer and possibly getting less'.

So what of the future overall? Where are we as a society heading for in terms of a work/life balance and what will be the impact as far as retirement planning is concerned?

The main drivers for change are undoubtedly ones relating to longevity and cost and as we live for longer the balance between time in work and time in retirement will almost certainly have to be further adjusted.

There is every likelihood that the state pension age will continue to be pushed back continuing the process that has already begun. It could conceivably reach 70 within the next 20 years and who knows how much further after that. You have to think there must be a limit somewhere but with the ability of medical science to counteract and treat what were once life-threatening illnesses and prolong life it is difficult to say what that will be.

For those for whom the bulk of their income in retirement comes from private saving and for whom the state pension is simply a top-up, the ability to retire at an age of their own choosing will still be there. But there will probably be less of those around in the future once the baby boomer generation has worked through and workplace and other private pension schemes become less substantial. Indeed, the days of the final salary scheme are almost certainly numbered and we may well find in a few years' time there will be none left with closure to new

entrants being followed through with full closure to all accrual at an escalating rate of knots.

For others – the majority – who are depending on the state pension to provide them with, say, half or more of their income it will inevitably mean a longer working life and less years in retirement as the state pension age gets further and further away from their desired age for finishing work. There will also be within this category people who are simply incapable of working on to these later ages – not simply as a matter of choice but because the physical or mental strains in their everyday working lives are just too demanding for them to do so.

As ever, the answer, if there is a satisfactory answer, to this problem lies in effective pre-planning at the earliest possible stage. If you know you will be incapable of carrying out your job right through until 70 then a career change into lighter or otherwise less onerous work might be possible in say your mid to late fifties. The other option is to look to set up a sort of bridging income arrangement in the form of a limited term annuity to provide a substitute for your not receiving your state pension between the date you would ideally like to retire at and the date when the state pension actually comes in.

The term annuity plan need not be too expensive if you start early enough and commit yourself to doing it. Take as an example that of someone in their early twenties currently earning around £500 a week and facing a state pension age of 70 or later. For that person to retire like his/her parents and grandparents did at age 65 he/she would need to start committing an extra 3 per cent or so of earnings into a pension plan. This would then facilitate the purchase of a 5-year term annuity at age 65 matching the level of the state pension (based on a current assumed level of £140 a week at today's price levels) and be paid up to age 70 when the state pension itself would come in and replace it. For workers with higher earnings the percentage required would, of course, be less but could be the same or even higher with a later starting age. To retire on this basis on a full retirement income even earlier at age 60 it would be necessary to commit

an extra 7 per cent of earnings to replicate the state pension and plug the 10 year gap up to age 70.

So it will be possible to retire at an age earlier than the state pension age for some but not all. It will obviously be a hard sell to persuade young people to commit extra money into a pension plan from which they might not benefit for 40 years or more. And, of course, in the current economic climate the first priority is to get and hold down a job and if possible pay off any debts they might have build up previously. But if they and others who come after them are going to retire in comfort and at an age that suits them there will have to be an acceptance of the need to plan ahead for the long term.

With the certainty of much later state provision it may be necessary for everyone to think in terms of a two-tier plan under which their private pension comes in first followed by the state pension later and it will be on that basis and on the actions they have taken in anticipation of it that their ability to retire early will depend.

We face many challenges in this country but in social and economic terms the impact of a rapidly ageing population is high on the list of issues that any responsible government has to face up to and neglects to deal with at its peril. Our present government to its credit is taking some steps in anticipation of what many would see as a ticking time bomb by introducing in the Autumn a form of automatic enrolment of all eligible employees into a workplace pension arrangement. But there are those who say that even this is too little too late and a system that allows an employee opt-out will have to be replaced eventually by one based on full compulsion for both the employee and the employer.

So there are many uncertainties around how all of this is going to work out but one thing it seems to me to be crystal clear. Individuals can only be led by the nose so far and they will all have to take responsibility to a greater or lesser extent than many have seen fit to do in the past for their own financial well-being in old age.

Their retirement may be in the future but the future of that retirement lies largely within their own hands.