

Speech to Tax Incentivised Saving Association conference

18th November 2009

Thank you to TISA and everybody involved in hosting this event. I am delighted to be here to give you some insight into where the Conservative Party stands on pensions and savings.

Recently, the FT ran a headline that said, 'End game near for final salary pensions'. The report, based on an EEF survey, went on to comment that a third of businesses that retain a final salary scheme are planning to close it to new entrants or to further contributions from existing employees. Over the last few years we have increasingly read similar headlines and similar reports. But the crisis in pensions is not just one of Defined Benefit provision – in fact, I would argue that the crisis is not just one of pensions but of saving overall. Over the last 12 years we have seen not just the decline of our occupational pensions system from being one of the best in Europe to one of the weakest, but we have also seen a decline in levels of saving and in our culture of responsible saving for the future.

These two issues – our pensions system and our culture of saving – are obviously linked. We need a pensions system that rewards people who do the right thing by saving for the future and encourages them to do so. And we need a wider culture that ensures that people know how much they need to be saving and are putting that money aside in a pension fund. The role of financial advisers is hugely important in this. Good financial advice will be crucial to ensuring that as many people as possible are saving enough and are getting the information they need to make the right decisions for their future. So we need to extend the availability of good quality financial advice.

Pensions

But if we are serious about renewing savings then we must be serious about renewing our pensions regime. Firstly we need to acknowledge the damage that has been done over recent years. In 1991 the number of active employee members of private sector pension schemes reached a 30 year high of six and a half million. By 2007 this had fallen to 3.6 million – a 45% decline in just 16 years. Nearly 13 million jobs have no pension provision, an increase since 1997 of two and a half million. These are deeply damaging trends that must be reversed if we are to avoid calamitous retirement outcomes in the future.

This is a particular concern for women. Last week HSBC reported that women's over-reliance on their male partners to save for retirement is fuelling a growing gender gap in pension provision. They found that men are more likely to take sole responsibility for pensions saving and more likely to engage with financial advice and financial planning.¹ It is no coincidence that women's savings are worth on average 33% less than men's.

¹ Pensions Week, 2nd November 2009

But this is a problem that is affecting everyone. Far too few people are saving enough in a pension to give them security in retirement. 13 million working people save either too little or absolutely nothing in a pension – around half the working population. This is shown by the pension pots that are being used to buy annuities – the vast majority are worth less than £40,000 and the average size is around £25,000. These are not sufficient amounts to give most people the security that they expect in retirement. The sad truth is that millions of people are reaching retirement and finding that their pension is not worth what they thought it was.

There are many causes and many manifestations of the crisis that has hit our pensions system. Gordon Brown's unforgivable tax raid has undoubtedly been a major factor. As George Osborne has said, it will be the ambition of the next Conservative government to reverse the effects of that raid, but we are clear that it might take more than one Parliament to achieve this.

But there are wider issues as well. We must confront the reasons that people don't save enough in a pension. Sadly too many people see saving as a restriction on their financial freedom rather than a tool of financial liberation. We need to fundamentally change this perception and all of us – government, opposition and those working in the industry – need to get better at explaining the value of saving and the options that are available to people. There are many people for whom putting aside money in a pension that they will not see for 40 years is not at all attractive – low-earners and graduates paying off debts come to mind.

So we need better awareness of the benefits of saving for the future. But we also need to look at practical measures to ensure that pensions are working for people. Not being able to access your own money, even in an emergency, is hugely off putting. That is why we are looking at models of early access to pension funds, such as those implemented in New Zealand and the USA. Any such system in the UK would need to ensure that proper safeguards were in place so that the scheme remained worthwhile. But it is clear that offering people greater flexibility could be an important means of reinvigorating long-term saving.

And while we're talking about flexibility, we also need to address the issue of annuities. If we want more flexibility before retirement then we must also give people more flexibility once they have retired. Conservatives naturally believe that individuals are best placed to make decisions about their life and it is right to give people more control over their incomes in retirement, so we will end the effective obligation to buy an annuity at 75.

Defined benefit

As we look to the future of pensions, I of course appreciate that the most important factor is not the type of schemes available but the value of the pensions that they will provide. However, it is unavoidable that the decline in DB provision will for many contribute to worsening retirement outcomes. We have all heard the reports of those schemes closing to new members or future accrual and recently the OECD reported

that the UK is one of the only developed countries in which the DB pensions deficit is growing, whereas countries such as the US and Japan have seen their deficits shrink.²

In the face of such evidence it would be tempting to simply give up on DB schemes and assume that they are a thing of the past. But this would be short-sighted. It is clear that the pensions landscape is going to continue to change, and it may be impossible to save DB schemes as we know them. But I do not believe we should just give up on the concept. Instead we need to look at alternatives to schemes where all the risk is passed to the employee. Unsurprisingly, surveys have shown that the vast majority of employers do not think that their employees are comfortable in taking on the risk associated with defined contribution schemes, nor do employers believe that the current legislative framework allows them to adequately share risks with their employees.

That is why we are looking both at what action can be taken to make it easier for companies who want to retain their DB schemes and to find ways of salvaging some element of DB provision, perhaps through a different model which involves risk-sharing. So we must look seriously at hybrid solutions that combine elements of DB and DC and how the regulatory system can enable and encourage them. We are studying several pieces of regulation that are potentially making it harder for companies to retain their schemes and it is clear that any measures that increase volatility on a balance sheet or restrict a company's ability to adapt to changing circumstances need to be reviewed very closely.

2012 reforms

Turning to the Government's planned 2012 reforms, it is important to separate auto-enrolment and Personal Accounts as we consider this. The Conservative Party has been a long-standing advocate of auto-enrolment and we believe that there is no reason why it should not be brought forward before 2012 on a voluntary basis for companies. We must do all that we can to ensure that auto-enrolment is introduced smoothly. Early, voluntary auto-enrolment could help prevent any implementation problems that might arise in 2012, would allow employers to properly plan for implementation within their own financial cycles, and of course will boost pension saving in the long run. So it is disappointing that the Government do not appear to have investigated this with any real vigour.

Auto-enrolment has been somewhat overshadowed by the discussion around Personal Accounts. The motives behind Personal Accounts are the right ones: ensuring that low and middle earners are saving for the future with contributions from their employer. But we have concerns about several aspects of the scheme, including the likelihood of levelling down, the administrative costs and the ability of government to deliver another large-scale IT project.

The DWP's latest implementation regulations have only added to these concerns. We now find out that we will not reach 3% employer contributions until 2016, six years after Lord Turner's initial target date for Personal Accounts to begin. Far from

² Pensions Week, 2nd November 2009

boosting saving, we could see employers level down their contributions to 1% for a few years, a considerable reduction on average DC contribution levels. Clearly there needs to be some degree of phasing-in but I do not think anybody expected to see contribution levels of 1% as late as 2015. Such a slow start could undermine the credibility of the whole project and leave millions of people facing a gap in contributions that they might never make up. Not only will this not lead to improved levels of savings it could actually reduce saving rates at the very time we need them to be increasing.

There is a clear need for the Government to address this concern. Should we win the next election we will review the Personal Accounts project as a matter of urgency.

Savings

As well as the problems in our pensions system, there are wider issues to address. As a nation we are not saving enough for the future. This is not just an issue of schemes and structures, it is also an issue of attitude and culture. The household savings ratio gives us an insight into what is going on. It was 10% in 1997; last year it went into negative territory. Despite a recent welcome rise, it has been lower in every year under Labour than it was in even the lowest year of John Major's government.

There are many factors that have contributed to this situation. But a key aspect has been the actions and attitude of the Government over the last 12 years. At the centre of the economic downturn has been debt – government debt, corporate debt and personal debt. The Government turned a blind eye as all three rocketed. This cavalier approach to debt, not least public sector debt, has damaged our economy, but almost as seriously the message of unlimited spending without consequence has undermined Britain's culture of sensible saving, prudent budgeting and sound finance. You cannot blame people for getting into debt when their government takes such a casual attitude towards its own debt. A government under David Cameron will be one guided by a belief in responsible finance and the value of saving. Britain's savers should be rewarded not punished for their prudence.

Financial advice

An important step will be to improve the quality and availability of financial advice. Studies have demonstrated worryingly high levels of financial illiteracy in the UK and while tackling this at a young age would be beneficial, we need to accept that people need good quality, reliable financial advice as they make major decisions throughout their lives. The truth is that most people grossly underestimate the amount of money they will need to save to secure a comfortable retirement. Research has demonstrated the direct link between the availability of advice and the level of savings. Nearly half of lower earning households who currently save would not have done so in the absence of financial advice.

This is particularly relevant for people on lower incomes who need encouragement to save. For many families, rather than saving, it is too easy to fall into debt, and debt is a key driver of poverty. One report published before the recession found that up to 9 million people had a serious debt problem. The report described personal debt as 'the

most serious social problem facing the UK'.³ We need to recognise that it is far easier for people to get into debt than to save for the future.

Following the work of Otto Thoresen's review, we have set out plans for a Conservative government to launch Britain's first ever free national financial advice service to provide impartial advice online, over the telephone and in face-to-face meetings. And we've been honest about how we will pay for it. It will cost £50 million a year, to be paid for through a new social responsibility levy on the financial services sector. I am pleased that the Government appears to have accepted this need and has now announced similar plans of their own.

Consumer protection

We also need to address a wider issue: for some time the Conservative Party has had concerns about poor consumer protection in the financial services sector. We have seen aggressive marketing of unsuitable products and unfair bank charges contributing to crippling personal debt and undermining the ability to save. Instead of splitting responsibility for protecting consumers between the FSA and the Office of Fair Trading we will create a strong new Consumer Protection Agency taking responsibility for consumer protection and consumer credit regulation. We will expect this new agency to name firms in breach of consumer protection regulations and to ensure that firms publish more information about the complaints they receive.

But reforming the regulator won't be enough. We also need to address the root causes of personal debt and in particular issues around credit and interest rates. Firstly we will introduce new legislation requiring all credit card statements and advertisements to contain standardised information about borrowing costs, including how much the credit will cost if only minimum repayments are made and how long it will take to repay. Along with improved financial advice this will help to ensure that people are better informed than ever before about the financial decisions they are making. We also need to do more to prevent families from being forced into selling their homes so we are calling for new rules to prevent lenders from requiring people to sell their home to pay off credit card bills or other unsecured debts of less than £25,000.

Conclusion

Our pensions regime has taken a battering over the past 12 years: Gordon Brown's stealth tax raid; regulations that have hindered flexibility and stability; and of course the stock market fluctuations. Our ambition is for a savers society. If we are to achieve this then we must encourage and reward saving, not punish those who do the right thing. We must make sure that individuals themselves understand the value of saving and the dangers of debt.

I want all people to have the financial security in old age and throughout life that currently eludes too many people. As we come out of recession we must make sure that economic recovery helps foster a new sense of financial responsibility and a new culture of saving. The Government must set the right example by getting its own house in order. But all of us must do more to explain the value of saving in a pension.

³ Centre for Social Justice, *Breakthrough Britain*, 2007

If we succeed and we see more people saving in better schemes then we will improve not only our nation's finances but the lives of millions of our citizens.