'Getting along with less cheese'

At ESOMAR's, 70th anniversary, World Congress from 10-13 September in Amsterdam www.esomar.org/congress we will be presenting a paper on transformational change in the financial services industry, entitled …

Are you insured, Scarlett? *'I can't think about that right now… I'll think about that tomorrow'.* How MetLife imagined a new future for the insurance industry… and is delivering it today

In the run up to this presentation we will be exploring some of the themes touched on in the paper with a weekly blog post. We will also provide a link to the paper and presentation at the end of the Congress.

'It's nice to get out of the rat race, but you have to learn to get along with less cheese' Gene Perret

This third blog … 'Getting along with less cheese' is the first of two that explore the changing nature of retirement

Ernest Hemingway thought "retirement is the ugliest word in the language", but for many the goal of reaching retirement age and spending their golden years gardening, fishing, and/or playing golf etc. is some version of nirvana. But as our population ages and we live longer, and more active, lives … the very nature of retirement has to change, and is changing.

The idea that we reach 65 (with some variations for country and gender) and 'retire' is increasingly an outmoded concept. But where did this idea come from in the first place? Why is 65 the age at which we have historically moved from productive employment into 'old age'? It's something we can thank the Germans for. In response to a rise in Marxist sympathies in the 1880s, Otto Von Bismarck (the original "Iron Chancellor") introduced a social insurance program to contribute to the pensions of older, non-working, Germans. With this stroke he hoped to diffuse public clamour for more radical change but, being a wily old fox, Bismarck settled on the age of 70 (reduced to 65 during WW1) on the basis that it was higher than the average German life expectancy at the time and therefore the policy would be largely (to use a popular phrase) 'cost neutral'. When President Franklin Roosevelt imported the idea to the U.S. in the mid-1930s, and also set 65 as the retirement age, the rationale for this choice probably followed similar lines to Bismarck's - the average life expectancy in America at the time was 61.7 years. While the concept of retirement seemed so simple then, as our life expectancy has moved well beyond the early sixties - it is now in the early 80s for most developed countries, predicted to rise to the late 80s by 2030[1] - supporting ourselves in retirement is a far more challenging issue.

For many the penny still hasn't dropped because they still subscribe to the idea that state social benefits operate like an insurance based or 'lay-away' scheme – this is the "I've paid in all my life" fallacy i.e. that when they retire they are just withdrawing their own money. But as their contributions have paid the

[1] The future of life expectancy and life expectancy inequalities in England and Wales: Bayesian spatiotemporal forecasting. Research funded by the UK Medical Research Council and Public Health England. Published in The Lancet, July 2015

pensions of the generation before, they need to look at who will be working when they reach old age to see who will be supporting them, and the signs are not good. As life expectancy rises, we look at the 'dependency ratio' to get a sense of who will be working to pay the pension of those now retiring. This shows the relationship between those typically not in the labour force (ages 0 to 14 and 65+) and those who typically are (ages 15 to 64), and is used to measure the pressure on the productive population. We have calculated a slightly different ratio below, just looking at those in work (which we have taken to be 15-64) and those 'retired' aged 65+. (Data: OECD Statistics, Historical population data and projections 1950-2050).

In 2016 (in OECD markets) there were 3.9 "productive" individuals supporting each retiree, however OECD population projections suggest this will fall to only 2.3 individuals supporting each retiree by 2050. The table order represents the scale of the drop between 2016 and 2050. China and India see the largest falls – although India will still have over 5 productive individuals for every retiree in 2050. Italy, Germany and Japan will be hardest hit – heading toward a 1:1 ratio.

	2016	2020	2030	2040	2050
World	7.8	7.0	5.6	4.6	4.0
OECD - Total	3.9	3.6	2.9	2.5	2.3
China	7.3	6.0	4.2	2.9	2.6
India	11.8	10.7	8.3	6.7	5.3
Italy	3.0	2.8	2.3	1.8	1.6
Germany	3.1	2.9	2.2	1.9	1.8
Japan	2.2	2.0	1.8	1.5	1.3
France	3.3	3.0	2.5	2.2	2.2
United States	4.3	3.8	3.0	2.9	2.9
Australia	4.4	4.0	3.4	3.1	3.0
United Kingdom	3.5	3.3	2.8	2.5	2.5
Finland	3.0	2.7	2.3	2.2	2.1
Denmark	3.4	3.2	2.7	2.4	2.5
Latvia	3.5	3.4	3.0	2.9	2.6
Sweden	3.2	3.0	2.7	2.5	2.5

These low ratios will have a major impact on these economies and as a result we have seen governments trying to bridge the gap of affording longevity by gradually increasing the eligibility age for state pensions and introducing initiatives to encourage individuals to be more accountable … prepared to fund their own retirement. Australia introduced the first national compulsory saving scheme some twenty years ago, which has generally been hailed as a success in encouraging universal adoption of long term saving: the UK followed suit in 2012 with a top-down roll out of a National auto enrolment pension scheme.

Time will tell whether or not auto enrolment is a big enough nudge to bridge the affordability gap. Aegon statistics[2] show that more than 7 million new savers auto-enrolled into more than 340,000 employer's schemes since 2012, along with a remarkably low opt-out rate of 9%. But setting up a scheme is only half the battle. In and of itself the auto enrolment pension, as it currently

"The greatest problem about old age is the fear that it may go on too long"

AJP Taylor, British Historian

2 https://www.aegon.co.uk/news/is_the_success_ofauto-enrolmentinyourhands.html

https://capitalandmain.com/

stands, is not going to solve the pension deficit if paying in at minimum contribution levels – predictions as to what someone joining such a scheme now (aged 22) may get at retirement (aged 67) vary widely. Standard Life predicted a tax-free lump sum of £21,500 and a weekly pension of £75. Nest (National Employment Savings Trust), which is the government's workplace pension scheme, estimates £4,500 and £14. This would be over and above any state pension that might be available – paid for by the decreasing numbers of "productive" individuals in the workplace. But the actual amount of the 'pot' may be less important than the attitudinal and behavioural changes enrolment may bring about – fostering more of an interest in your own future provision and maybe encouraging saving and investment behavior beyond the auto-enrolment pension product itself. Steve Webb, the former pensions minister who oversaw the introduction of automatic enrolment, said it was "encouraging" that pension membership has risen among those not covered by the scheme, such as those earning less than £10,000 a year but that "the challenge now is to build on this encouraging growth in membership and to get people saving at more realistic levels" – but is a realistic level so high that it will choke off interest? A key inhibitor, especially for low earners, is that once invested, it is not possible to access ones money in case of emergency. This is something which Nest is currently looking into, aiming to trial a scheme which splits contributions between a pension pot and a more accessible rainy day savings fund which is kept topped up to a certain level, after which monies are diverted to the pension.

And whilst at the moment, self-employed workers - who find it the hardest to save long term for their retirement with no company umbrella pension infrastructure around them – are outside the auto-enrolment arena, government plans are afoot to bring them into the fold. This is likely to be fraught with logistical difficulties but the intention to do so demonstrates a recognition that gig workers/self-employed are equally (if not more) vulnerable in this respect.

To make a long term success of auto-enrolment, industry, corporate and regulatory agencies need to have vision to work together. Employees need motivation, incentive, opportunity and support to increase their level of savings year on year (paying/receiving minimum contribution levels of the average salary will not generate a meaningful retirement income). Small employers may feel under pressure to contribute more than the minimum 3% but can implement creative compensation packages embracing salary sacrifice to help their staff save in keeping with the old adage '*if you've never had it, you won't miss it'*. But crucially, industry and regulators need to structurally re-think the portability of auto-enrolled pensions. Interestingly

Master Trusts probably hold the solution: as schemes with independent governance (rather than individual contract schemes) it surely is feasible to envisage a future where employees can leave one employer and move to another whilst remaining within the same scheme for life?

The great unknown is whether auto-enrolment will come- of- age and realise the ambition to be the effective long-term savings channel of choice, addressing the "I've paid in all my life" fallacy and acting as an enabler of adequate retirement income? Or are we simply setting the stage for a mountain of orphaned token pension pots in the future - a massively expensive, but ultimately ineffective, social experiment?