The emerging savings crisis

Government failing the savings test

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There was plenty of analysis on pensions and saving in the run-up to the Budget. The Government u-turn on "taxed-exempt-exempt" (TEE) pensions happened so quickly that if you blinked you would have missed it. But much of this talk sidestepped the basic problem: people simply aren't saving enough and no policy currently being discussed is likely to address this.

This is not a savings gap. It is a savings crisis:

- ONS data shows the savings ratio has fallen to 3.8% – the lowest in 53 years of measurement.
- DWP data shows that seven in ten households have savings of less than £10,000; just under half have less than £1,000.
- DWP says 2012 was 'peak DB' – with future retirees progressively less likely to be securing income from defined benefit schemes. Defined contribution (DC) pensions now dominate, but are attracting half the level of contributions.
- Home ownership has reduced from 73.3% in 2007 to 64.8% in 2014, according to Eurostat, reversing a trend that had seen ownership increase every year since the First World War. Over time this will mean more pensioners needing to pay rent in retirement and being unable to draw down on home equity to supplement income.

It gets worse. Low investment returns are hurting annuities. Increased longevity continues to throw out actuarial assumptions. And to believe that unfunded public sector DB schemes and the triple-lock state pension are affordable in the long term requires Alice in Wonderland accounting. Against that backdrop, inadequate saving will lead to a progressive deterioration in the retirement people can look forward to.

The Budget could have given us a significant step towards a stable policy framework to encourage saving – which KPMG called for last year in our report, Paradise Postponed. "We had been hoping to see a long-term model with clarity and direction to show how the government will incentivise saving in the future." says Andy Masters, Partner, Savings and Wealth.

Instead, the new lifetime ISA (LISA) is being introduced into an already complex environment. Complexity simply encourages end consumers to disengage even further from the savings market – and increases the risk ordinary savers will make poor decisions. Phase one of auto enrolment doesn't finish for two years yet, and there is widespread concern that LISA will detract from the early success of this key building-block of the future savings landscape.

And given the Government did not touch the current tax incentives regime for pensions, it seems inevitable that more change is round the corner.

"The word until shortly before the Budget was that the Chancellor would introduce pension ISAs."

> "I don't believe that he's abandoned that idea completely – the new LISA looks like a stealth move from an EET system towards TEE. The question is when and how the transition happens."

This would continue the government's theme of liberating individuals' personal savings plans by offering them more choice. But to what end?

"Flexibility" and "freedom" are leading us to lose sight of the purpose of pensions and why tax incentives underpin them. Society needs individuals to create a secure income in retirement so they do not become dependent on the state.

So how do we get Britain to save for its retirement? We need to decide:

- Whether soft compulsion on auto enrolment becomes hard compulsion, with either a limited or no opt out.
- How we extend auto enrolment to the growing army of self-employed.
- When and how to increase minimum auto-enrolment contribution levels.
- When and how we reform public sector DB to reduce the burden on taxpayers.
- The long term future for the state pension. When will it pay out, and how much?
- What incentives will be offered in the future to those saving for retirement.

These are extremely urgent questions. The longer we leave them unanswered, the harder they will get.

The Government must intervene to address the cultural shift that's led a nation of savers to become a nation of consumers. It must lay out an honest contract between the individual and the state as to each side's responsibilities.

Are clearer pension incentives going to be enough to address this shift? "No, but they would be a start," says Masters. "We need genuinely long-term policy from government, based on open dialogue with key stakeholders across industry, employers and consumer groups."

If you'd like to discuss further, please get in touch.

Andy Masters
Partner, Savings and Wealth
T: +44 (0)131 5276749
E: andy.masters@kpmg.co.uk

kpmg.com/uk