

Are Personal Accounts suitable for all?

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Supporting members event

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This presentation is intended as a contribution to the policy debate on Personal Accounts. Nothing in this presentation should be used by individuals or their advisors as the basis for saving and investment decisions.

Are Personal Accounts suitable for all?



- Methodology
- Findings
- Policy implications

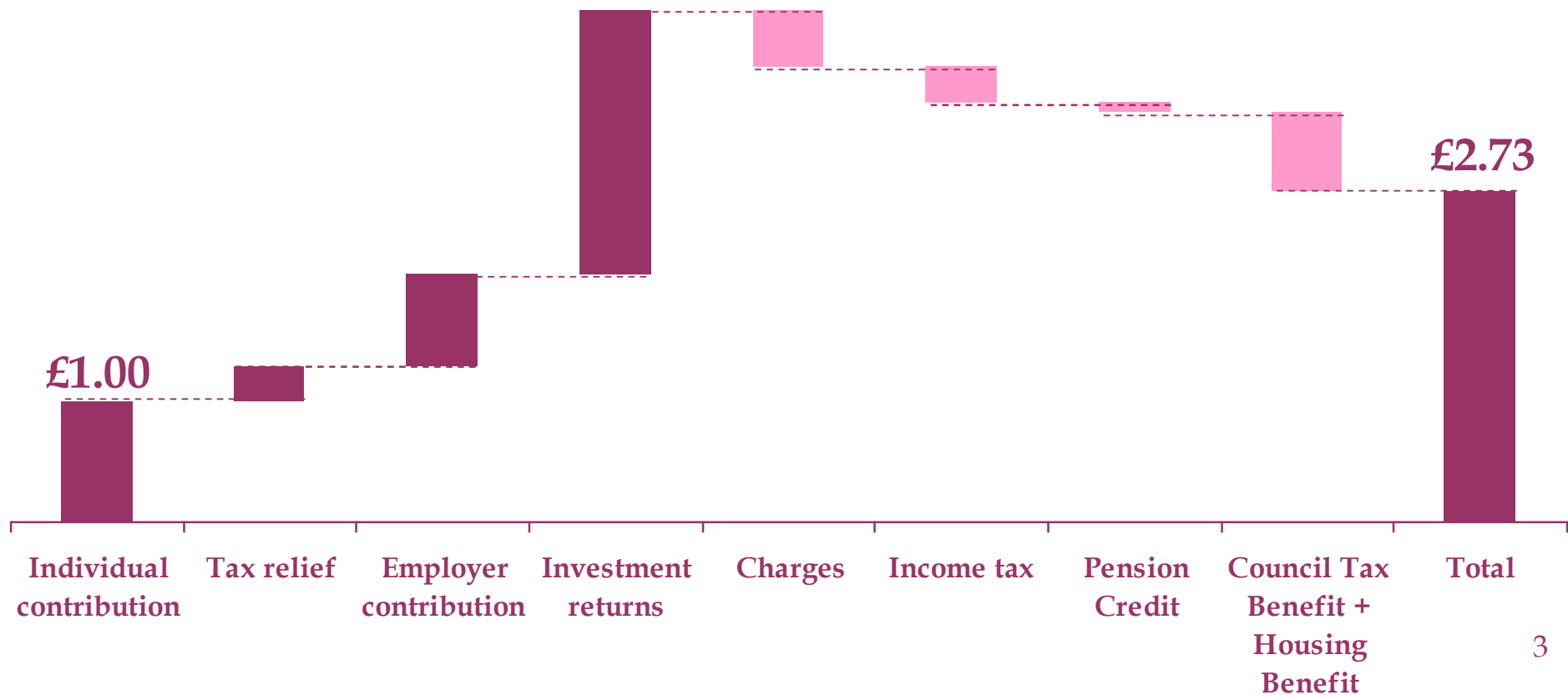
Are Personal Accounts suitable for all?



- Analysed the interaction between Personal Accounts, state pensions, the tax system and means-tested benefits in detail
- To identify groups for whom Personal Accounts may be suitable and those for whom they may not be suitable
- Used the PPI's Individual Model: 210 individuals analysed

Many factors affect the value of saving

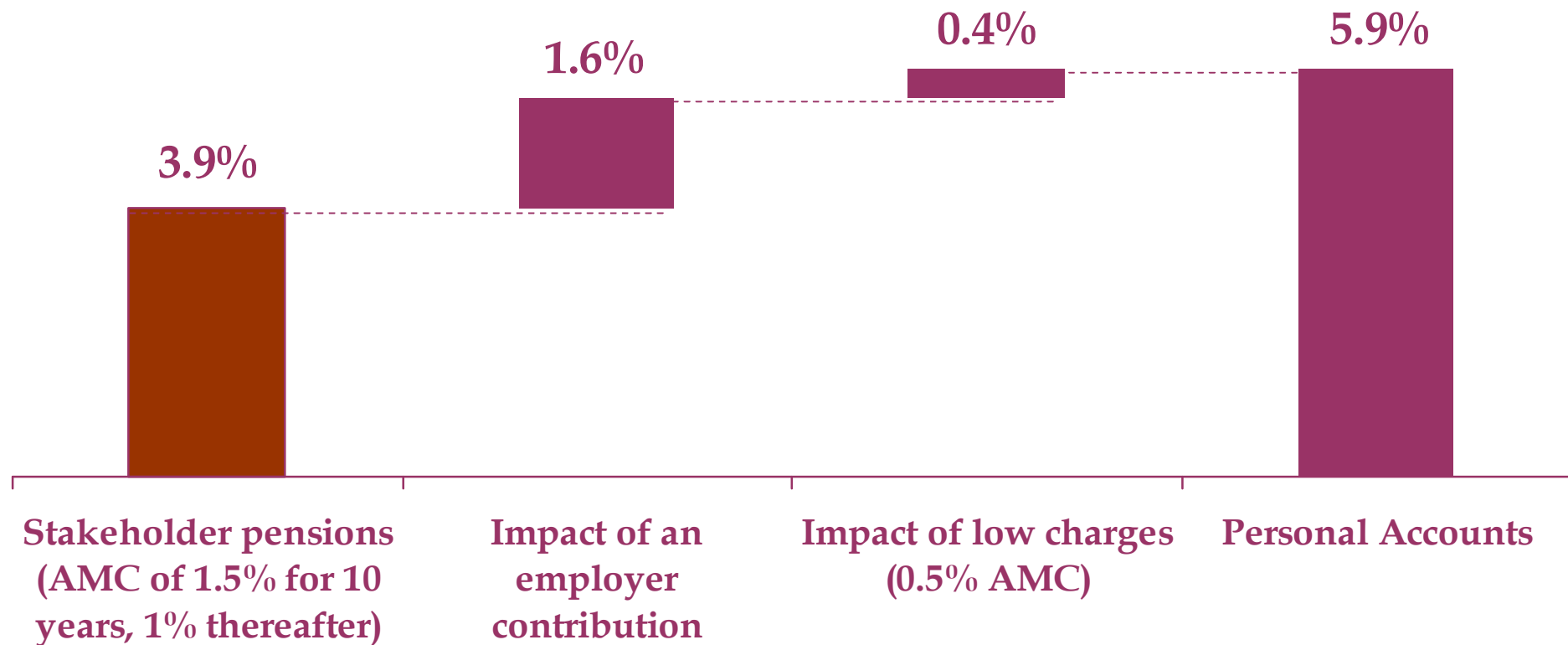
Value of saving in a Personal Account for a median-earning man with a full NI record aged 25 in 2012 for each £1 of contributions



Returns from Personal Accounts could be much higher than from Stakeholder Pensions



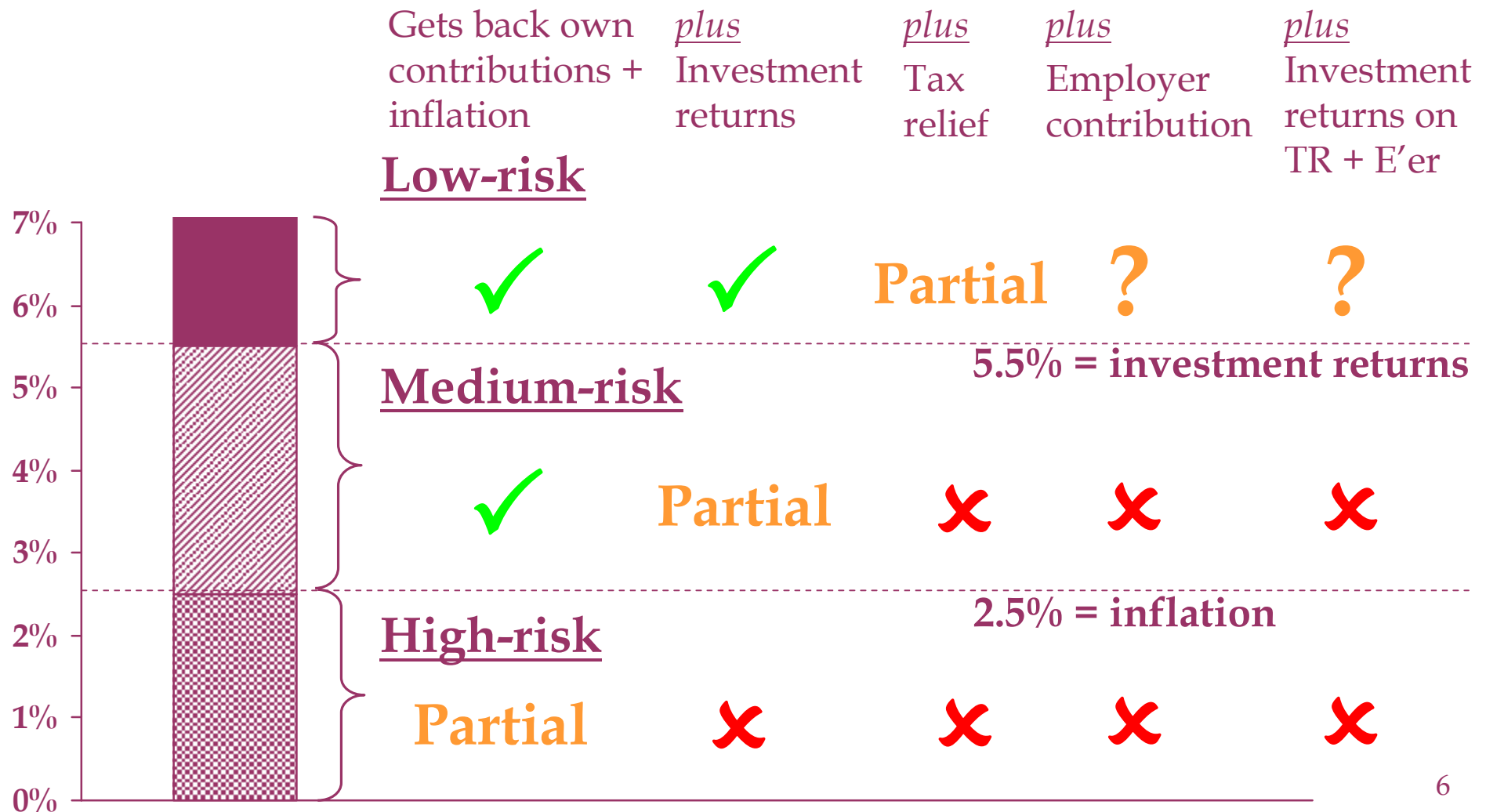
Internal rate of return from saving for a median-earning man with a full NI record aged 25 in 2012



Defining 'Suitability' PPI

- 'Not losing out' as a result of saving
- Less stringent than ensuring saving in Personal Accounts is the right thing for all
- No single definition is appropriate for all, so risk groups used
- Based on an 'Internal Rate of Return' (IRR)
- NOT comparable to interest rates on other products

Three risk-categories are used, based on the IRR



Low risk

Medium risk

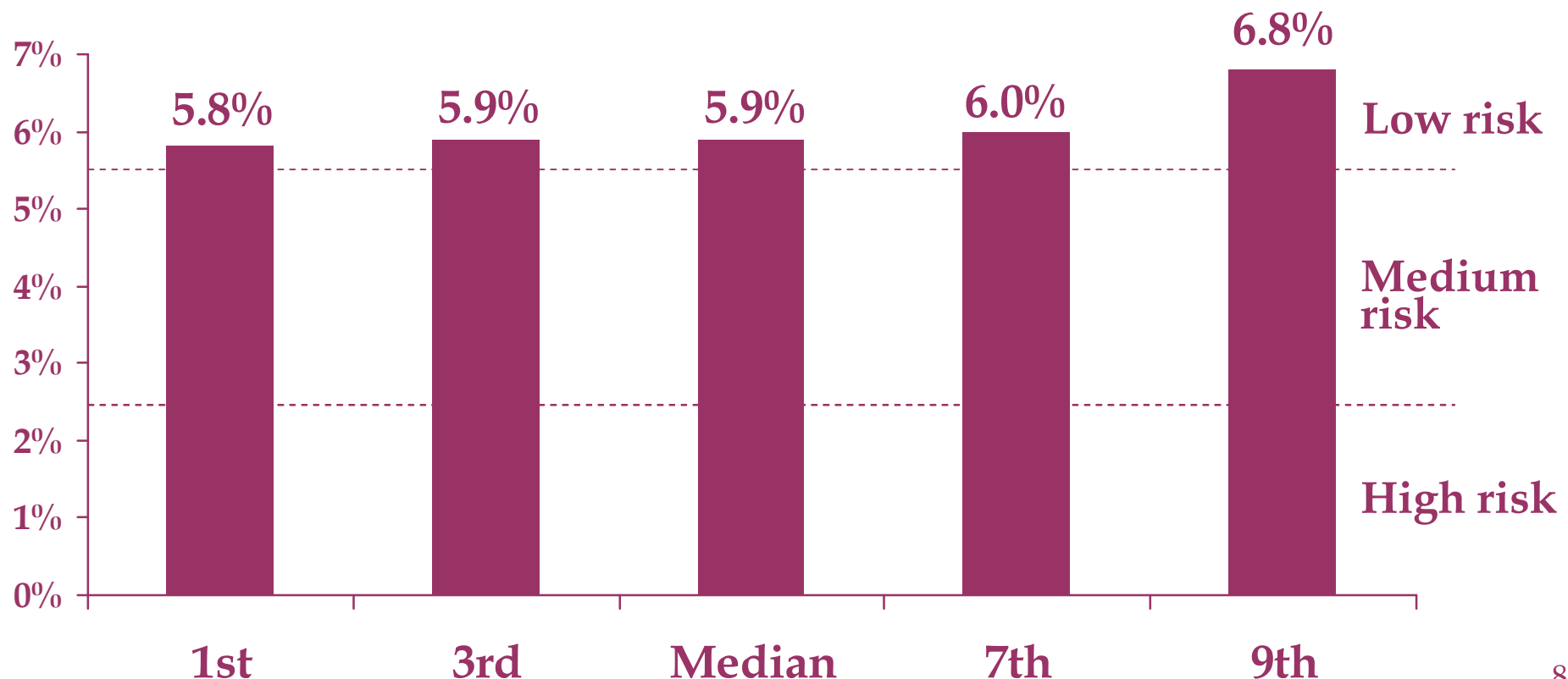
High risk

Individuals in their twenties in 2012 with full working histories could be in the low-risk category

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Estimated IRR for men with full NI records and no retirement saving other than Personal Accounts, aged 25 in 2012, by decile of the male earnings distribution



Low risk

Medium risk

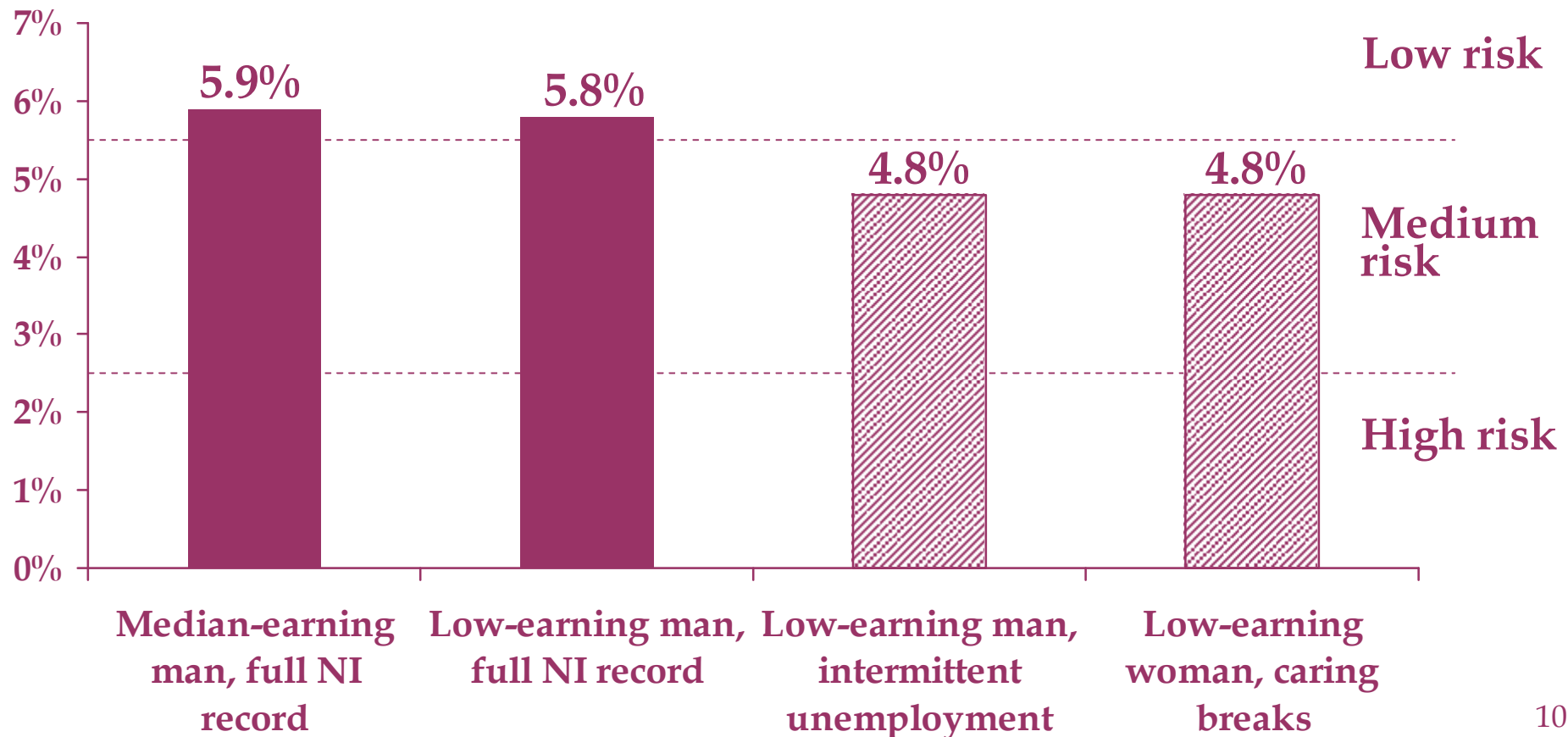
High risk

Returns can be lower for people with lower earnings and career breaks

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Estimated IRR for men and women aged 25 in 2012, for different levels of earnings and work histories

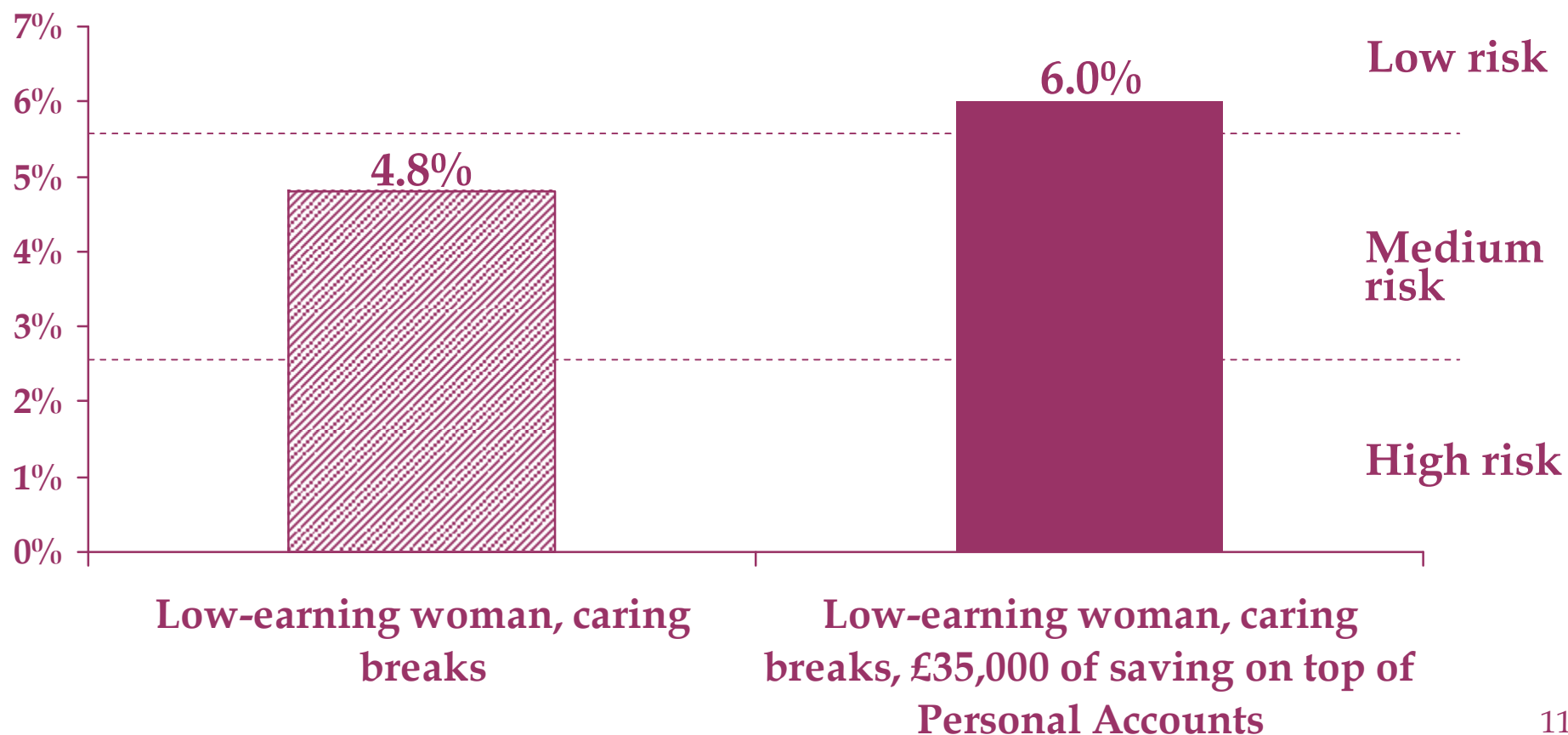


Personal Account returns can be higher for people who have other forms of saving

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Estimated IRR for men and women aged 25 in 2012, for different levels of saving on top of Personal Accounts

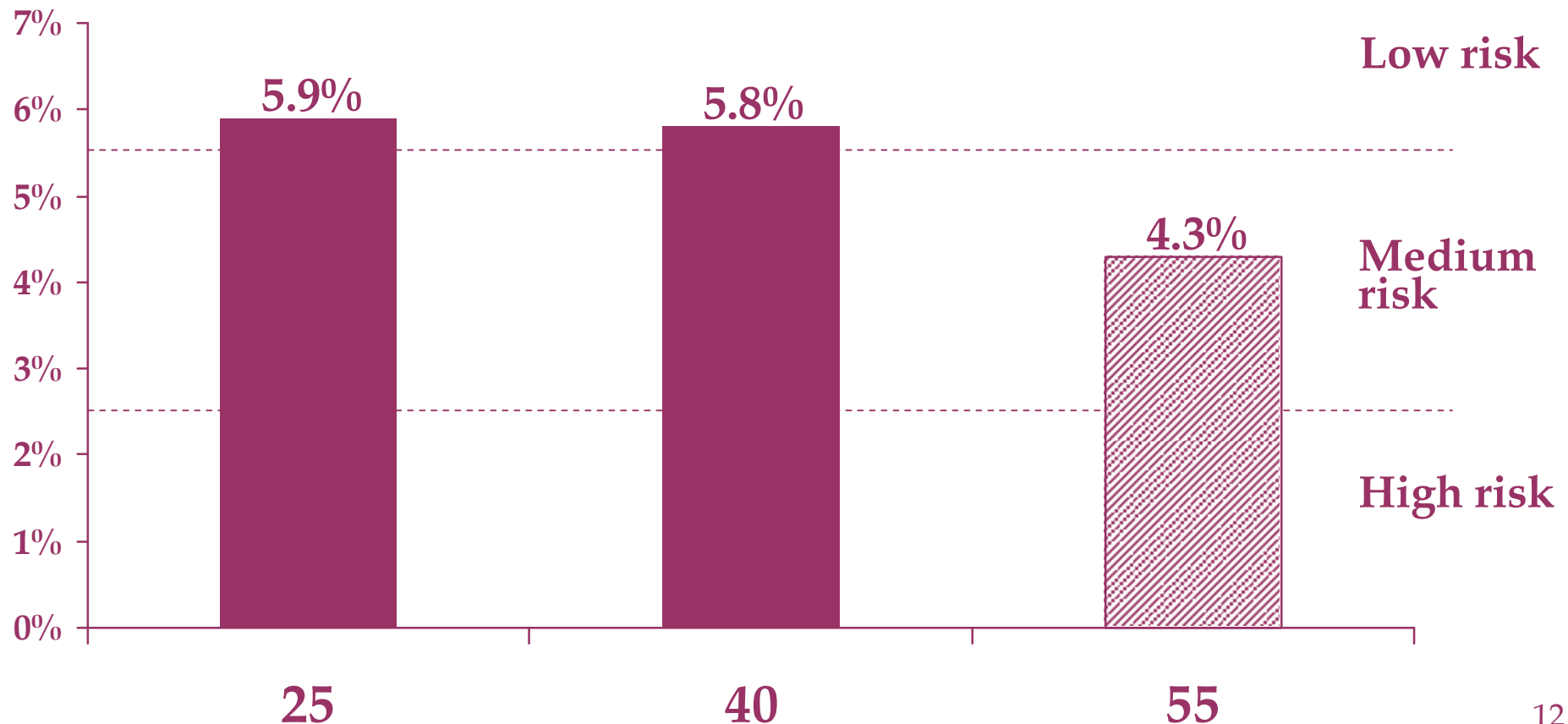


Returns from Personal Accounts can be lower for today's older workers

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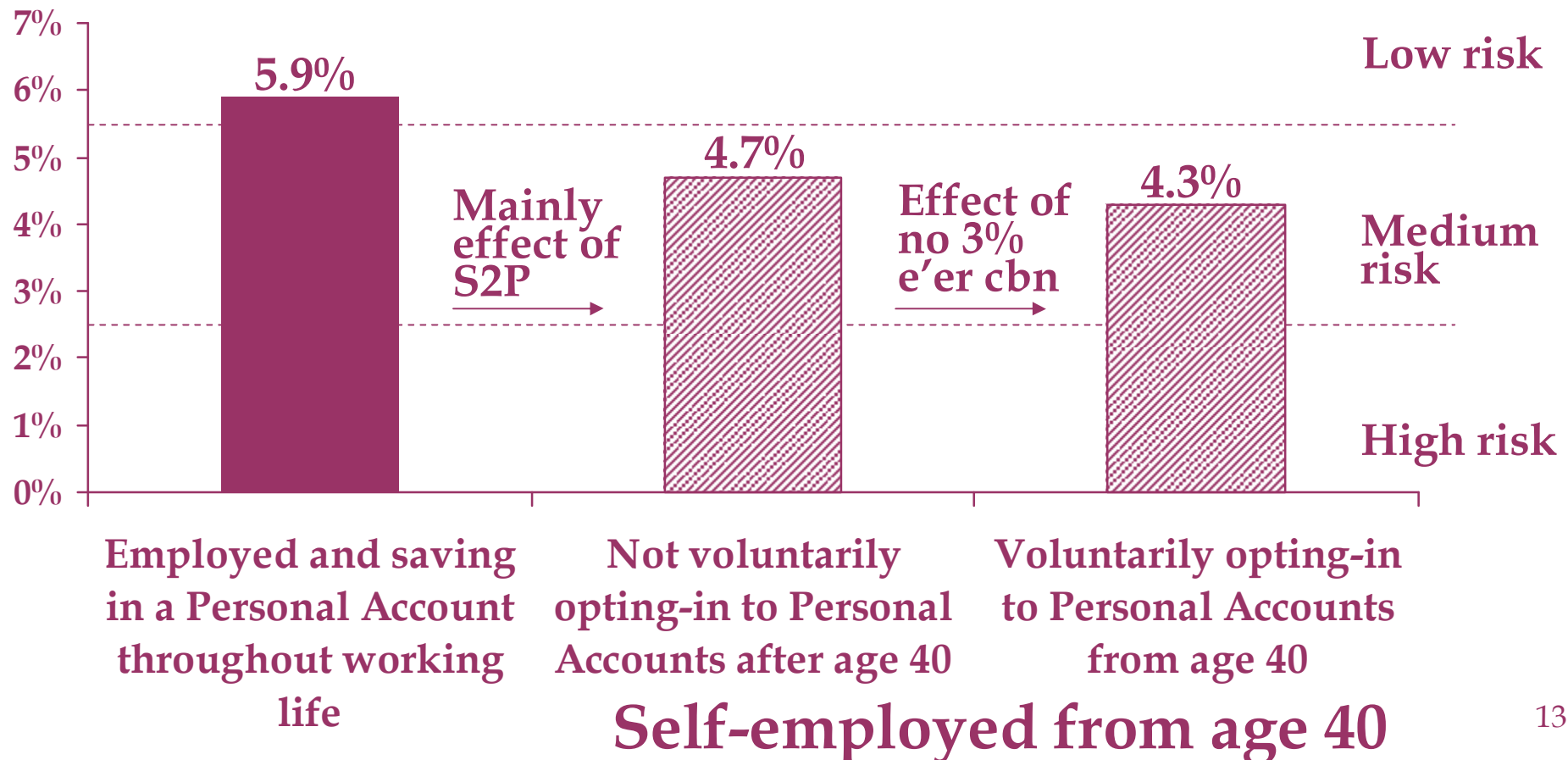
PPI

Estimated IRR for median-earning men with full NI records of different ages in 2012, with no retirement saving other than Personal Accounts



Self-employment can lead to lower returns

Estimated IRR for median-earning men with full NI records and aged 25 in 2012, with no retirement saving other than Personal Accounts



Low risk

Medium risk

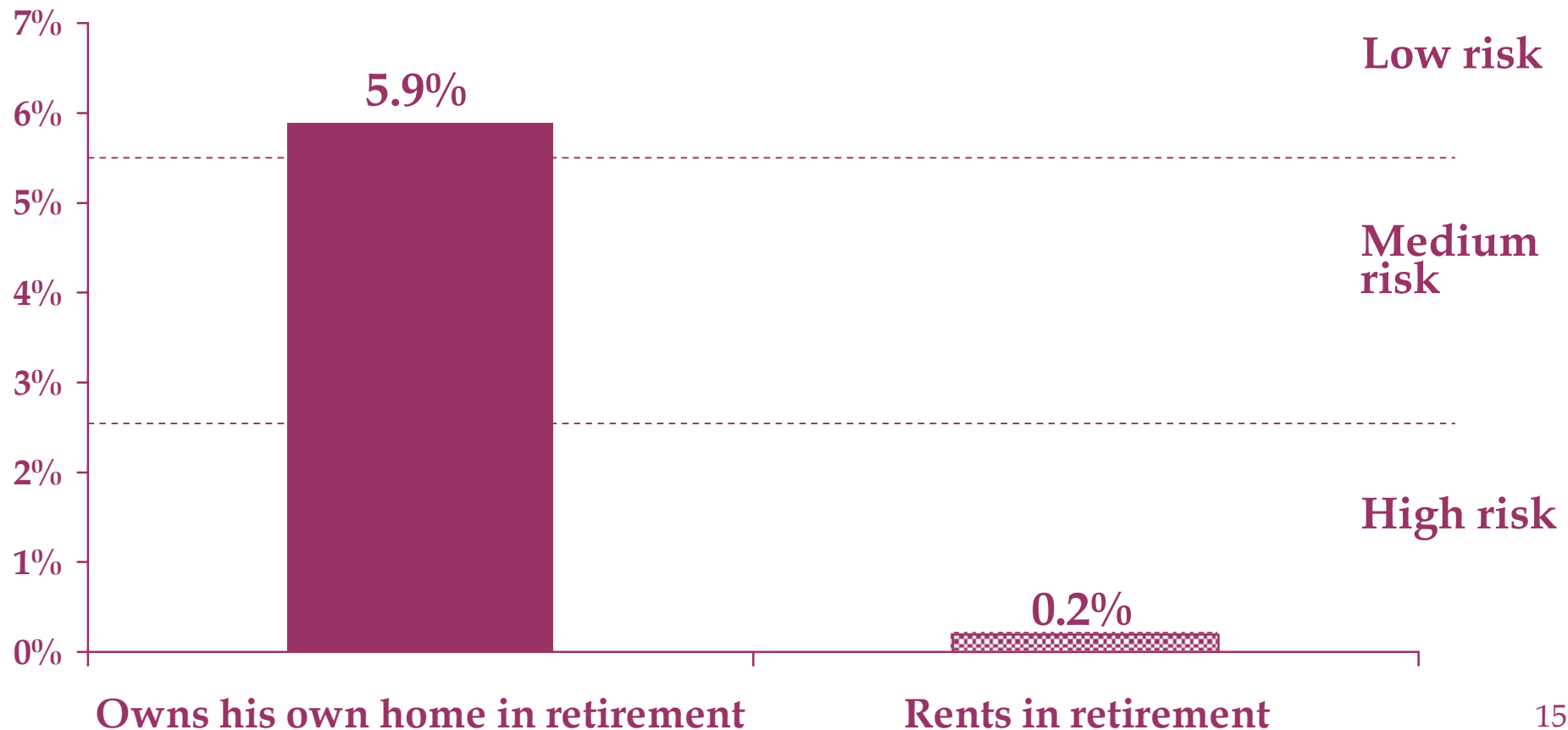
High risk

Renting in retirement can lead to very low returns

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Estimated IRR for median-earning men with full NI records and aged 25 in 2012, with no retirement saving other than Personal Accounts



Who is at risk of finding PAs unsuitable?

- Low-risk: Single people in their 20s in 2012 with full working histories
- Medium-risk:
 - Single people in their 20s in 2012 with low earnings and broken working histories (whether because of caring breaks or unemployment) – unless they have other savings
 - Single people in their 40s and 50s in 2012 with low earnings and full working histories
 - Single people in their 20s in 2012 who stay opted-in to Personal Accounts while employed, and then later become self-employed
- High-risk: Those who are likely to rent in retirement

What other factors could affect suitability?

- Risk is lower for people who are likely to be married in retirement
- Consumption smoothing – individuals might otherwise face low retirement incomes
- Debt – levels of secured and unsecured debt are historically high
- Affordability – will depend on individual preferences on current expenditure and saving

What does this mean for policy?

- Even if Personal Accounts are not suitable for all, it does not necessarily mean that individuals should not be auto-enrolled
- But should help inform the type of information supplied to help decision making
- Some factors may be more problematic than others:
 - Current age, earnings and debt
 - Future marital or housing status
 - Affordability
- The design of information may need to change over time

Next steps?

- Can generic advice cover everything sufficiently?
- Is there a need for more radical solutions (e.g. not auto-enrolling some groups)?
- Should trivial commutation levels be changed?