Written evidence from Nutmeg (IFG0074)

I. Introduction

In April 2016, Nutmeg worked with the Centre for Economic and Business Research (CEBR) to produce a report on intergenerational fairness, which we called The Generations Report. Drawing on national data sources, YouGov polling, and CEBR analysis, the report argued that:

Intergenerational inequality has increasingly become part of the political agenda since 2010, with the coalition and current Governments choosing to protect pensions and pensioner benefits whilst withdrawing housing benefits for those aged under 25 and increasing university tuition fees. The Intergeneration Foundation produces an index for intergenerational fairness, and found recently that the index has declined by 10% since 2010.

Commenting on the report and the Work and Pension Committee's inquiry, Nutmeg's co-founder Nick Hungerford said:

At long last, with the Work and Pensions Committee's inquiry, intergenerational fairness is getting attention it desperately deserves. We need urgent government action to help generations of people caught in an affordability trap.

Nutmeg warmly welcomes the Committee's interest in intergenerational fairness, and will gladly support the Committee's efforts to raise awareness about the issues involved.

Although we are certainly not economists ourselves, we at Nutmeg are concerned that current policymaking as regards intergenerational fairness is being left behind by a fast-changing demographic, social and economic reality. We believe that urgent change is needed to help adults in the UK to prepare to face a very different financial future in the coming decades.

II. Trends

In Nutmeg's view, in the UK demographic and political change is underway that makes individuals more accountable for their own financial futures than has been the case for many decades – the ageing of the population, the increasing difficulty of securing housing, the weakening and increasingly unsustainable state pension, and more.

In spite of this change, this and recent governments have been neither frank enough in describing this problem, nor forward-thinking or strong enough in trying to address it. Indeed, state pension policy – the strand of policy most obviously related to intergenerational fairness – has not begun to adapt to this new reality nearly fast enough.

The state pension and age-related public expenditure

The OBR has made the following age-related spending projections:

- State pension costs are forecast to increase from 5.1% of GDP in 2019-20 to 7.3% in 2064-65
- Long-term social care costs are expected to rise from 1.2% of GDP in 2019-20 to 2.2% in 2064-65 "reflecting the ageing of the population"
- General health spending is forecast to rise from 6.2% of GDP in 2019-20 to 8% in 2064-65, "rising smoothly as the population ages"

These numbers seem modest, but as a proportion of public spending these figures are very large. Total public spending amounted to 40.8% of GDP in 2014-15, according to the OBR. The state pension alone counted for 11.8% of public spending in 2014-15:

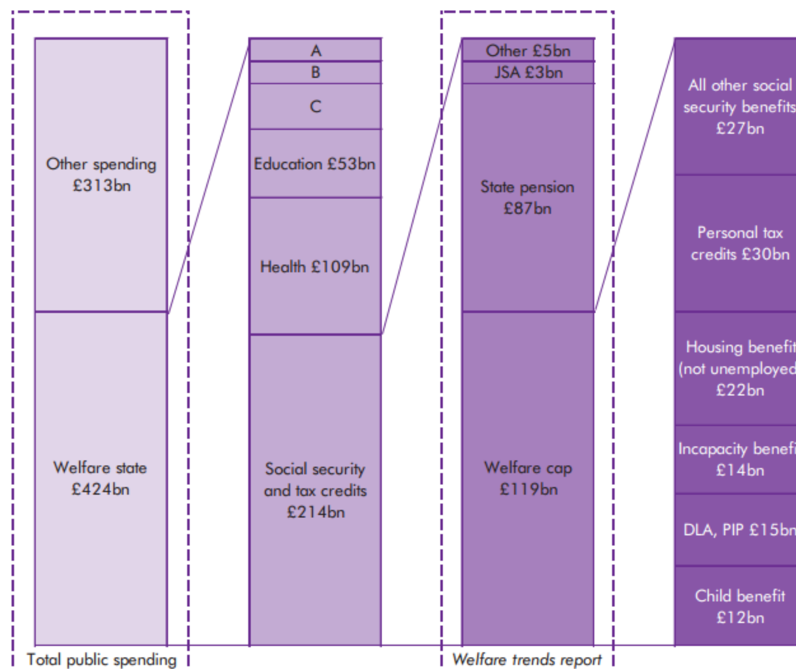

Figure 1 Welfare spending in the UK, 2014-15 (OBR Welfare Trends Report, 2015)

These and other graphics (unless stated) come from 2015 OBR Fiscal Sustainability and Welfare Trends reports.

UK public spending on pensioners – chiefly through the state pension, long-term care and age-related health expenditure – is the highest of the Anglophone states, though it is lower than the continential Western European and OECD means:

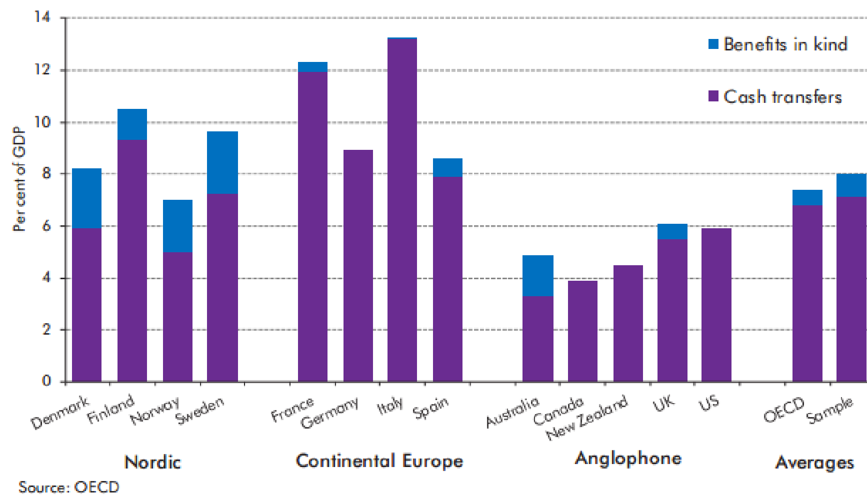

Figure 2 Public spending on pensioners in 2010 (OBR Welfare Trends Report, 2015)

These figures are also exposed to variations in the demographic forecasts. Net debt – which is closely linked to welfare spending given the size of the latter as a component of public spending – is expected to rise or fall within very wide parameters in response to differing demographic realities.

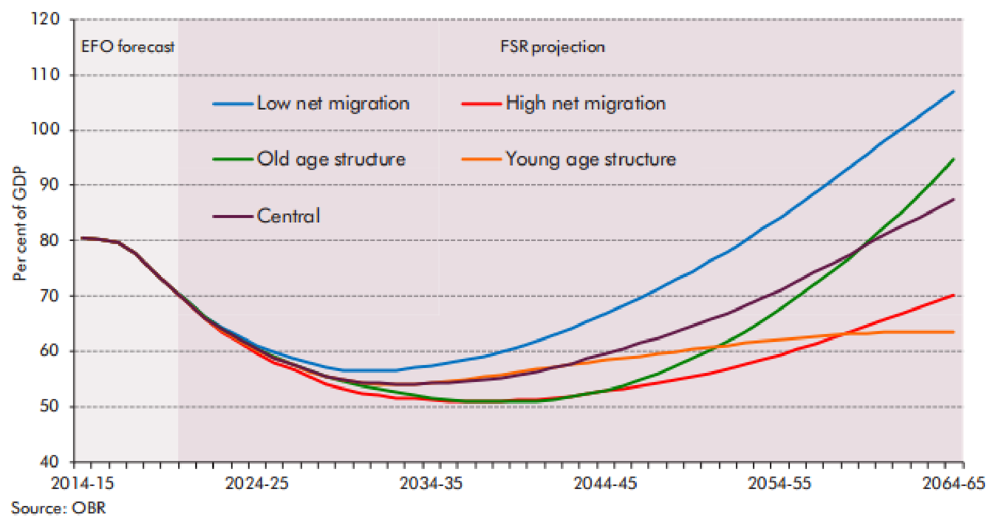

Figure 3 Sensitivity of net debt projections to demographic variants
(OBR Fiscal Sustainability Report, 2015)

The explanation for this variation can be seen clearly in the below chart. Tax revenues are drawn overwhelmingly from the working age population, and public spending is directed overwhelmingly at the non-working age population, in particular the elderly.

Chart 3.6: Representative profiles for tax, public services and welfare spending

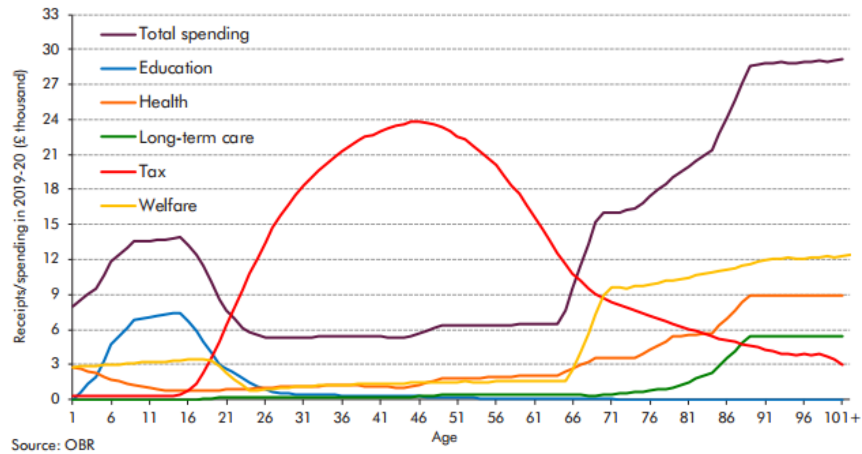

Figure 4 Representative profiles for tax, public services and welfare spending (OBR Fiscal Sustainability Report, 2015)

Speaking about his 2015 Centre for Policy Studies (CPS) paper, *Who will care for generation Y?*, Michael Johnson argued that (emphasis added):

Baby boomers have become masters at perpetrating inter-generational injustice, by making vast unfunded promises to themselves, notably in respect of pensions. Indeed, such is their scale that if the UK were accounted for as a public company, it would be bust. In any event, Generation Y will have to foot the bill.

The gap between the nation's assets and liabilities grew by an unsustainable 51% in the five years to end-March 2014, to £1,852 billion. At 111% of GDP, this is equivalent to£70,000 per household – ***if the State Pension, the largest of all unfunded liabilities (roughly £4,000 billion) is included the burden per household rises to £221,000.***

Reining back on unfunded promises means either stop making them, or fund them now, which would require higher taxation (or additional cuts in public spending).

Nutmeg agrees, including with Mr Johnson's assessment that these promises must either be reined in, or funded – one of the two – as a matter of urgency.

Private pensions

The state pension is not the only national pension scheme that is underfunded and misunderstood. The BHS pension scheme is a topical example of a pension scheme in trouble, but as the Wall Street Journal reported in April 2016, BHS' problems are partly indicative of a wider problem among UK pension schemes. As the paper reported:

Data from the Pension Protection Fund, a U.K. government organisation designed to protect employee pensions when companies go bust, shows the impact of falling yields. At the end of March 2015 the aggregate deficit of funds on the PPF 7800, an index of 7,800 defined benefit pension schemes in the U.K, ran to £285.3 billion.

The causes include the difficulty of finding returns or yield in a near-zero interest rate policy environment, as well as inadequate contribution rates in relation to payments out:

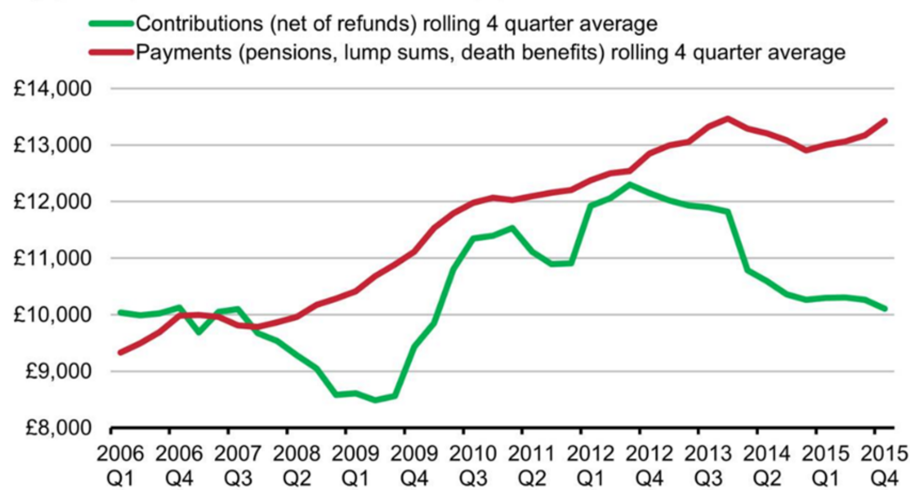

Figure 5 WSJ graphic
(*The Collapse of BHS is a Warning for the U.K's Faltering Pension Schemes,* 25 April 2016)

As well as a funding problem, private pensions are widely misunderstood. Pensionsworld reported on Ipsos Mori research in March 2016 showing that 42% of pension scheme members do not know whether they are paying into a defined contribution or defined benefit scheme. Many are therefore unaware whether they are paying into a personal 'pot' or a collective scheme.

Furthermore, 47% of defined contribution scheme members say they did not understand their scheme's fees "very well" or "at all". Research by Opinium for Nutmeg in 2015 found similar levels of ignorance about pension scheme charges, which are themselves complicated by additional charges, including underlying product charges and exit charges.

Housing, wages, and costs

Nutmeg's Generations Report highlighted further concerns that we have as regards the living costs faced by young people, and the difficulties they face in trying to save. Key findings included:

- The savings ratio is forecast to fall to its lowest level in 50 years in 2017 – 3.8%. This ratio stood at over 10% during the height of the financial crisis and during much of the 1990s.

- 25% of 18-34s "cannot afford to save money at the moment, but want to"
- More than twice the proportion of over-55s (40%) compared to 18-34s (20%) say they are "content with both [their] short-term and long-term finances"
- 31% aged 35-44 who do not already own a house think they will never be able to afford a deposit
- The 'unaffordability ratio' – the ratio of property prices vs income – nearly doubled in the 30

Figure 6 Property prices vs income, first-time buyer, UK (Nutmeg Generations Report, 2016)

years between 1984 and 2014 (2.3 to 4.2) across the UK, and has been wider in London:

III. Policy

Narrating the change – and advising savers better

We agree with Michael Johnson's argument in his CPS paper that:

Ideally, all pensions and other age-related services should be pre-funded... But there is little evidence to suggest that the baby boomers are willing to halt the torrent of unfunded promises that they are making to themselves. Consequently, it is down to Generation Y to raise the issue, including encouraging politicians to think beyond the horizon of the next general election.

We are not optimistic about the readiness of this or any government to fund the state pension and other unfunded commitments through increased spending or borrowing. It also seems unlikely that this government will break its "triple lock" commitment on the state pension, or that it will raise the state pension age substantially in May 2017, the scheduled time for the next review.

This being the case, we encourage the government to be at least more honest with UK adults about what the current policy decisions and demographic and social changes mean for them. If the state is likely, at some point, to reduce its support to the elderly, and if the challenges of buying a house are set to continue growing, how should individuals make personal provision for old age, or for large purchases?

Financial Advice Market Review

We strongly support the recent Financial Advice Market Review (FAMR) and urge the government to continue in the positive direction taken in the 2016 Budget. We continue to call for:

- the expansion of the pension dashboard concept to a wider pensions and savings dashboard;
- a simplified definition of advice in line with MiFID II;
- greater scope to give less-regulated generic financial advice (e.g. people in x position tend to do y), as opposed to fully-regulated personalised advice (as recommended in FAMR);
- higher standards of transparency on pricing of financial advice and investment products (including unilateral UK implementation of transparency measures delayed in the MiFID II package);
- greater regulatory flexibility in the investment space, to allow firms to communicate with and report to customers in ways that suit the customer (i.e. in language they understand, and in electronic not paper formats);
- and more active official promotion of financial advice.

Giving more support to financial technology (FinTech) companies

We view FinTech as one of the leading organic market responses to a rising demand for accessible, low-cost, straightforward investment solutions. We welcome the government and the regulator's support for FinTech, but strongly encourage the government to offer more active and vocal support

to the projects of many FinTech firms in the investment and pensions space – to reduce costs and fees, to widen access, to increase competition, and to deliver transparency.

Making the state pension sustainable

Nutmeg calls for the long-term state pension costs to be made more transparently visible to the voting public (cf Michael Johnson's CPS paper *Who will care for Generation Y?*) and for the state pension age to be raised more rapidly than planned in the current schedule.

June 2016