framework financial

latest word

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Pension Shock: The Future is Now .... a perspective

RTE recently aired its 'Pension Shock' programme with George Lee highlighting the pensions crisis in Ireland and how making provisions for retirement has become an increasingly unaffordable task.

So what where the key points in the programme;

Private Pension Funds in Trouble

The majority of private pensions are insolvent i.e. are incapable of meeting future liabilities.

In the case of large company schemes with guaranteed pensions (Defined Benefit), it is estimated that 75% are insolvent. Now any guarantee is only as good as the person or entity giving that guarantee, so an individual would be badly advised to totally rely on that pension liability being met. There are examples like Waterford Wedgewood that when the company went into receivership, the pension fund was only able to meet a fraction of its liabilities, reported at less than 30% of what the employees expected to receive.

A combination of increasing life expectancy and stock market crashes has been the root cause of the problem.

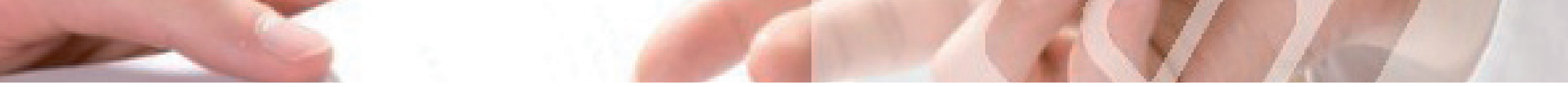
Individuals in company pension schemes in recent years will have a Defined Contribution pension fund, which means that the investment risk rests with the individual. Again, these pension funds are falling way short of what an individual would need to have to live on after retirement. This means that these individuals will need to work until older age and/or live on an income far short of what is required.

People Underestimate True Cost of Retirement

Whether you are self employed, or are employed, individuals have buried their heads in the sand on the issue of providing income after retirement, the matter is simply put on the long finger, as people focus on day to day expenditure, and leave worrying about their pension for another day.

Figures from the "Pension Shock" program estimated that the current cost of a €400 per week pension which was index linked to inflation costs €480,000 for men and €520,000 for women. So you get the idea of the cost of providing a modest income stream after retirement.

In addition, it was estimated that you would need to be setting aside €167 per week if you started providing for your pension from age 35 and cost €292 per week if you left it until age 45 to begin to provide for your income after retirement. So the clear message is to start yesterday!! If you have not begun to provide for the future, then you need assess the seriousness of the situation and act fast. If you believe you can't afford to act, then you need to at least know where you stand and seriously consider your priorities. What is the long term cost of a new car or a beefed up TV package? A key financial planning question is what am I going to live on after retirement?



Difficult To Judge Value, Costs Not Transparent

One reason suggested for the poor take up of private pensions is the complex way the industry talks about pensions with documentation being technical and not user friendly. The costs are not very transparent and can be excessive. There has also been poor advice and poor investment performance.

We would not disagree with any of these assertions. At framework financial, we tell our clients and prospective clients, "the customer always pays". The big problem is when you don't know what you are paying and you don't know what level of service you are getting. It's impossible for the customer to make a value judgement.

Traditionally, payment for service and advice typically is paid in commission with longer term effects on fund performance and a lack of transparency about the cost.

We are in our fourth year pioneering a new way of doing business in this industry. We are interested in long term relationships with the client. We set out clear levels of service. We set out a clear fee structure for the service you receive. You decide how you pay us, but you are very clear what you are paying and what level of service you are receiving, and that's the way it should be. We all expect to pay for a service, but we need to be in a position to decide if it's good or bad value for us.

Regarding poor fund performance, typically equities have been considered the primary asset class o grow your savings and provide for the future. It has always been guided that you must be in a position to take a long term view. When we are in a recession and a financial crisis, the reliance on equities is called into question, and may merit debate but the bigger problem in our view is individuals being in the wrong asset class for their objectives and at the wrong time. For example, you should not take excessive risk if you not need to and you should not be in high risk assets close to retirement.

Regardless of investment advice and fund performance, clients themselves take on excessive risk, not having a clear understanding of their objectives and taking ad hoc decisions without advice. (see our article in last month's newsletter for more on this.)

The bottom line is that the industry must change and the client must demand it.

State Pension Promises not Sustainable

Finally, the program highlighted the cost of public sector pensions. The state guarantees pensions to the public sector employees, it is not dependent on investment performance as it is in the private sector. For the majority of public sector employees the pension entitlement is modest enough but the program highlighted the high cost of pensions in many sectors. For example to purchase the average Garda pension, it would currently cost €1.28m in the market, for the average Teacher pension, it would currently cost €1.29m in the market and for the average TD, it would currently cost €2.3m in the market.

The government does not set aside the funds to meet these pension liabilities but pays them out of the current account (i.e. day to day spending). The problem is the liabilities are stacking up but the government finances are, as we all know, in deep trouble.

If the government has no money, how can it meet its public sector pension liabilities and indeed its state pension liabilities that hundreds of thousands of people rely on.

Conclusion

So what does this all mean?

You are responsible for your money, you are responsible for making sure you have an income after you retire, you cannot rely on the state to provide a solution, if it does, fantastic, if it doesn't then what? You need to know where you stand now, where you are going and you need to know how much it costs and who's paying? Know what you're getting, choose your advice carefully, get interested, it's the ultimate insurance policy. And, act now, most things don't get better by procrastinating over them. As sure as compound interest is compound interest, it pays to act sooner than later.

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