Pensions in the Headlines Again

Long time British expatriates may be forgiven if they have lost sight of some of the issues that now haunt their former peers in their home country. Whilst headlines in Jakarta may focus on political matters, corruption cases or the threat to remove the petrol subsidy on private cars, fears about the economy and the future dominate the newspapers in the UK.

This was certainly my impression when I took a break in the UK over Christmas and the New Year. Here are examples of the headlines:

Financial Times, 31 December: ***$6.3 trillion wiped off markets in 2011.***

Financial Times, 3 January: ***Economics experts foresee a bleak 2012.***

Daily Express, 3 January (full spread on page 1): ***PENSIONS IN CRISIS AS FUNDS COLLAPSE – Hard time ahead for millions. – Britain's private pension system has suffered a "seismic collapse" to leave millions of savers facing a bleak retirement, new figures show today.***

WHAT IS THE PROBLEM?

Basically the traditional company pension has become unsustainable. A reported 90% of firms' final salary schemes have been closed with experts declaring the "golden age" of pensions over. The fact is that the old model where companies guaranteed a final pension related to years of service and final salary is no longer workable. Pension funds built on this principal have been decimated by increased life expectancy on the one hand and the poor performance of stock and bond markets on the other. Even 'safe' UK government bonds are now paying less than 2% per annum, which is less than inflation. The burden of funding a pension scheme has even affected the bottom line of many large companies. Hence the reason why many have closed the schemes to new entrants and have reduced the benefits to existing employees – that is, if the unions will let them! The new model for pensions is one where employees bear the risks of the markets. They make their contributions as usual but what they will receive is no longer guaranteed; their pensions will depend entirely on how their fund performs, just as for anyone who invests in a private plan. It is still better than not having a plan but it means that income in retirement will now be much less certain than was previously the case.

WHAT ABOUT THE PUBLIC SECTOR?

Here we have a different situation because pensions are paid out of the public purse as opposed to a fund that has been painstakingly constructed. Many public servants are now enjoying retirement benefits superior to those in the private sector. But the pressure on national and local budgets has also become unsustainable, hence the moves by the government to substantially reduce the value of pensions and increase the retirement age. If you have been following international news reports over the past year you will have seen the many strikes taking place as teachers and other public servants protest the attack on their long-enjoyed benefits. This is not going to go away; on the one hand the country just cannot afford to maintain the status quo and on the other hand workers are not going to give up their benefits easily.

WHAT IS HAPPENING IN OTHER WESTERN COUNTRIES?

The same situation is true of just about every western country. People are living longer and governments and companies can no longer sustain previous levels of benefits. Workers have been protesting austerity measures on the streets in France, Italy and especially Greece, which could become the first country to default on its debts and leave the Eurozone this year. Should that occur it will be very painful for its citizens as the country picks up the pieces and tries to rebuild with its old currency. Should contagion occur in Europe, resulting in the collapse of the Euro, the consequences would be felt worldwide and global markets could face a very volatile time. Economists generally believe this will not happen but the possibility is certainly there.

The US has the same basic problem of changing demographics and dwindling returns from investments. To illustrate the effects of the latter it is of interest to note that in the 15 years from the end of 1984 to the end of 1999 the total return from the S&P 500 stock index was more than 740%. This amounted to an annual compound return of more than 15 per cent. By contrast, since the end of 1999 the stock market has not even kept pace with inflation, thus resulting in a negative real return. It is little wonder investors are frustrated and that pension schemes are in the red. Having said this, Americans are more pragmatic; they generally do not go out on the street to protest and have a better understanding of how the markets work. They do not expect European-type employment protection. Consequently it is easier for them to find jobs since employers are not faced with the same liabilities as their counterparts in Europe. This is one reason perhaps why the first signs of recovery are emerging in the US, looking at the latest employment figures. Those responsible for formulating labor laws in Indonesia might wish to take note. Forcing obligations on employers may be of benefit to existing employees but it discourages companies from hiring new ones.

SHOULD EXPATRIATES BE CONCERNED?

They should be, but I generally find they are not! Many are in denial or are convinced that the assets they have accumulated are sufficient to see them through retirement. Some have no pension plan at all! The problem with living overseas is that it is no longer possible to maintain a home-based pension and few companies overseas offer a replacement. Expatriates are left to their own devices or are sold a typical life company offshore savings / pension plan. There is nothing wrong with the latter provided that the structure is fully understood. The plans allow you to accumulate units in a variety of funds that in normal times should produce a decent return after 15 or 20 years. But stopping contributions or cashing in early can result in heavy losses so such a plan should be undertaken only if you are confident of seeing it through its full term.

Having just one plan is not enough, especially if the plan is focused on stock market funds. Plan values today have been considerably depressed by the crash of 2008 and the further falls in 2011. It is important to have several strings to your retirement bow. These can include a variety of assets beyond stocks and bonds such as gold and other commodities, selected hedge funds, property, asset-backed lending and other alternative investments. In all cases, professional advice should be sought.

If you are British and have a frozen plan of significant value in the UK you should take advantage of the new QROPS facility which will allow you to transfer it offshore and have more control over it. Moreover the plan will remain part of your estate whereas the UK plan is likely to disappear when you do! Caution must be exercised however when transferring the plan as there are potentially costly pitfalls.

WHAT IS THE PERFECT RETIREMENT PLAN?

This would be a plan which allows you to live life to the full during retirement to the point where the funds run out on the day you die and your cheque to the undertaker bounces! However, unless you can plan what day that is likely to be or if you have family you would like to provide for, then maybe you need to take some time out to do a little retirement planning. Protecting against death is easy; you just take out a life policy. Protecting against long life requires much more effort! ■

Colin Bloodworth

Director of PPI Indonesia, has worked as a financial adviser in Indonesia since 1992. He is a Director of PPI Indonesia and can be contacted at **colin.bloodworth@ppi-advisory.com** or **+62 21 3004 8024.**