Editorial: Public policy and pensions — Pension reform vs. pension adequacy

Over the last 30 years, governments have engaged in a seemingly endless series of attempts at 'pension reform'. These legislative initiatives have focused, at various times, on pension coverage, protection of members' rights and entitlements, limits on 'tax expenditure', mandating provision and coverage, and fiduciary responsibilities. The results have been mixed, at best.

In the United States, the sheer complexity of compliance makes little sense and clearly discourages many small employers from sponsoring any form of pension arrangement for employees. Fortunately, the immense popularity of tax approved '401(k) plans' creates a labour market climate where failure to sponsor a scheme is a recruiting and retention disadvantage. However, the bottom line is that, since the enactment, in 1974, of the Employee Retirement Income Security Act, retirement income security of American workers has declined measurably.

In the UK, regulatory complexity has increased exponentially over the last 20 years, most recently with the enactment of the Pensions Act 1995. Each attempt at 'reform' results in significant additional administration burdens on employers with little perceptible benefit inuring to employees. The Personal Pensions mis-selling debacle was, in this author's opinion, a direct result of misguided public policy and faulty regulation. At the time, knowledgeable observers predicted the disastrous eventual

outcome. Significant compliance burdens are encouraging employers to move to Group Personal Pension provision, a quasi-retail arrangement whereby employers are relieved of compliance burdens and employees receive smaller ultimate benefits in relation to amounts contributed. Most recently, the current UK Government is busy introducing 'Stakeholder Pensions' legislation.

Although the motive is expansion of pension coverage among the UK workforce, some of the decisions being taken seem to indicate a complete lack of understanding of economic realities.

In Australia, Chile and Hong Kong, mandatory defined contribution systems have been introduced. Employees in Australia must have individual choice over investments and investment management providers. In Hong Kong, employees must be given the right to opt out of an employer's more generous scheme, in favour of participating in an essentially retail Mandatory Provident Fund (MPF) arrangement. In all cases, these mandated arrangements are based on quasi-retail investment management regimes.

It is time that governments and legislatures focused on coherent public policy with respect to retirement income systems. The foundation elements of public pension policy should address:

- retirement income adequacy;
- security of entitlements;
- fiduciary responsibility and accountability; and

— meaningful incentives for occupational provision.

Adequacy is the first priority. If, in retirement, individuals are unable to maintain their accustomed pre-retirement standard of living, further burdens inevitably fall on society and working taxpayers. The health of the elderly population, already a huge public policy issue in its own right, is adversely affected. Older people are forced to dispose of assets, including homes, in order to finance day-to-day necessities. As rental and care costs accelerate, income adequacy declines further. In our more affluent societies, financial independence and dignity for older citizens who have worked an entire career should not be a luxury.

Regulatory complexity should be minimised and well intentioned but wrong-headed imposition of broad panacea solutions should be eliminated. Unduly complex regulation is a clear disincentive for employers.

This is not a question of defined benefit vs. defined contribution provision. Money is fungible. The major

issue with defined contribution provision is not the form but rather the adequacy of funding.

The efficacy of occupational provision over individual provision has been conclusively proven. The administrative cost of individual, retail-based systems is vastly greater than that of employer-sponsored arrangements, absent the burdens of unduly complex regulation and compliance requirements.

Of course, coverage under a relatively modest scheme is preferable to no coverage. However, if governments mandate modest schemes while regulating more generous occupational arrangements out of existence, the certain result will be an aggregate reduction in retirement income security for the working population. Legislation favouring retail individual provision over more economically efficient occupational provision will only serve to reduce ultimate levels of pension adequacy further.

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