Opinion Piece

No time to waste

Received: 22nd August, 2008

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Abstract With the UK population rapidly ageing and seven million people failing to save into a pension plan for their retirement, the government plans to introduce a new pension's regime in 2012, with automatic enrolment. The question, asks John Jory, deputy chief executive of the UK's most popular provider of stakeholder pensions, is does the UK really need another scheme? With set-up costs for the new Personal Accounts (PAs) estimated to range from £0.5bn to £2bn, wouldn't it be more effective to change the regulatory regime in which stakeholder pensions currently operate? And can the government expect PAs to motivate the British to save for retirement, if pensioners who have saved into pensions are not demonstrably better off in retirement than those who have not?

Pensions (2008) **13**, 251–254. doi:10.1057/pm.2008.21

Keywords: *pensions, stakeholder, PAs, saving, retirement, auto-enrolment*

With just four years to go until the introduction of Personal Accounts (PAs), the lynchpin of the UK's new pensions reform in 2012, it's important to view the new pension's regime in context and look at the drivers behind the introduction of PAs. The key driver, it seems, is demographic. With the population of the UK ageing rapidly, the number of people over 64 in the UK is projected to swell from the current 9.5 million to 15 million in 2040.¹ Yet, despite efforts to push pensions onto the public agenda, the government still estimates that around seven million people in the UK are not saving enough for their retirement.²

Unfortunately, previous attempts to kick-start the UK's working population into saving for retirement have failed. Introduced as part of the government's Welfare Reform in 2001,

stakeholder pensions were designed to encourage those on modest incomes to begin saving, or to save more, for their retirement. The fact that stakeholder pensions failed to fulfil that objective led to the appointment of the Pensions Commission in 2002, the conclusion that something more had to be done, and the plan to encourage widespread saving for retirement with the introduction of the new PAs.

With automatic enrolment and management charges capped at around 0.3–0.5 per cent, PAs are designed to offer a simple, low-cost scheme aimed at encouraging low to moderate earners to save for their retirement. But does that mean PAs are automatically the right answer to the UK's pensions crisis? In my view, the answer is a firm 'No'. I don't believe PAs are necessary.

I firmly believe stakeholder pensions can be a success. The fact that B&CE is the most popular and the largest stakeholder provider, with 500,000 accounts, all containing funds, proves that if you have the right product, with simple investment funds, simple application process, default life-styling and contributions from individuals by

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payroll deductions, a stakeholder pension can be successful.

One thing cannot be over-emphasised, however, and that is the role of the employer. Employers have been absolutely crucial to the success of stakeholder. They provide information about employment and a mechanism for making contributions. So why haven't stakeholder pensions been a wider success? The answer, it seems, is that too few employees are making their own contributions. In fact, most of the contributions coming into our stakeholder pension come solely from employers.

But we should beware of assumptions. The fact that just 15 per cent of members are making their own contributions could lead us to an erroneous conclusion. The perceived wisdom is that 85 per cent of the workforce isn't accruing money into a stakeholder pension pot because inertia is easier than taking a positive decision. Knowing that low to moderate earners have historically looked for reasons *not* to save for their retirement, we have assumed they are not making a conscious decision not to do so now; but we could be wrong. And we won't know whether our assumption was correct until the advent of PAs in 2012.

Too complicated

What we do know, however, is that contributing to a pension has been made far too difficult for many employees in the UK. In some cases providers have to send employees 20 pages of decision trees and numerous other pieces of information before they can accept contributions from them. The process is too complicated. There is too much red tape. Many people don't understand this plethora of information, and as a result they do nothing about it.

It is also easy to understand the low take-up of the stakeholder product by commercial providers. Low charges, small contribution rates and the lack of auto-enrolment can easily translate into low margins and few opportunities to make a profit. For providers, one of the greatest attractions of the PA world would be the opportunity to collect higher premiums, rather than the £20 minimum we have to accept under stakeholder

pensions. It should also be possible for providers to achieve far greater economies of scale in the world of PAs.

So, should there be a role for stakeholder in the future? Well, it may seem obvious, but one point in their favour is that they already exist; they are out in the marketplace, with legislation to support them. Another significant benefit is that there are no set-up costs to using the existing stakeholder market, whereas the Pensions Commission has estimated the cost of setting up PAs to be in the region of £0.5bn,³ although others in the market speculate the costs could be closer to £2bn by the time they are implemented.

Stakeholder, then, is currently in place, with no additional set-up costs and the legislative framework already in position. But if the UK Government is committed to promoting the benefits of saving for retirement, there are a number of key issues it really must address.

Having lobbied long and hard, the pensions industry is delighted with the recent announcement by the Department for Work and Pensions⁴ that auto-enrolment is now going to be allowed into contract-based workplace pensions. But why wait until 2012? Why not begin auto-enrolment immediately? As long as you have a scheme with a matching employer contribution, the opportunity for the individual to opt out, low charges, safeguards in place, and customers provided with all the relevant information they need, why wait another four years? Why waste four years of additional contributions that could be accruing into a pension for their retirement?

Means testing

With auto-enrolment, however, means testing becomes a major issue, and this is an area the government urgently needs to address. We certainly do not advocate the abolition of means testing, which has a valuable role in ensuring that the less well off in our society are not neglected. But we do need to address the fact that means testing can present a powerful disincentive to save, if someone with a small pension fund, or income in retirement, can find they have disqualified

themselves from benefits they would otherwise have received, or even find that those benefits might have been worth more than their small pension.

Our concern is that if people believe they will be worse off with a small pension pot under means testing, those looking for reasons not to save will view it as an opportunity to opt out. For those people, the danger is that means testing is liable to change, and an individual won't know what they should have been doing until the date they retire.

But, does stakeholder offer any advantages over PAs in encouraging that saving culture? Well, stakeholder is better designed than PAs to meet the needs of employers, who have a key role to play in promoting pensions. With stakeholder, employers don't have to accept a 'one size fits all' solution. Which is important, because their role makes it imperative that we do business in a way that suits them. We have to make administration as simple as possible, because we need employers to encourage their workforces to save. Employers also look to organisations such as B&CE to add value by providing guidance, which helps them comply with pensions legislation — something that may not be achievable with PAs. Most importantly, however, we need to communicate the message to employers that pension schemes have a long shelf life, and stakeholder pensions have an important role to play — not only in the run-up to PAs — but in 2012 and beyond.

Stakeholder can also be geared to the needs of individual members. It can be communicated in a manner that suits them, and accommodates their preferences for the way they contribute, their fund choices and their choices at retirement. As a provider under the stakeholder scheme we can go into construction companies and make presentations directly in their workplace, which has far more impact than other methods. In a market where there is a level of uncertainty and there has been some mis-trust in the past, it is particularly important that stakeholder enables providers to offer a personal service, and human interaction with an individual who handles a query until it is resolved.

Level playing field

Throughout the debate over PAs, we have always championed the importance of a level playing field between stakeholder and PAs. Auto-enrolment has been vital to achieving that level playing field. Another key feature is that the charging structure of PAs must be fair. Commercial providers make a significant and long-term investment in developing pension products, sometimes taking 10–20 years to achieve a return. For the government-sponsored scheme to effectively receive a state subsidy by writing off set-up costs would simply be unfair.

Small pots

Small pension pots, or stranded funds, are another significant issue that needs to be addressed. In an industry such as construction, where the workforce is transient, many employees who have had inactive pensions will be left with a small pot at retirement, when they may notify their provider they also have another pension. This means the small pot cannot then be paid as a trivial sum. This leaves a few hundred pounds, which the provider can do little with, as it is not a suitable amount on which to base an annuity. One possibility — already suggested to Her Majesty's Revenue and Customs — is that a small pot of a few hundred pounds, for which there has been no activity for some years, could be refunded to the individual minus the standard rate of tax.

In a world with a highly mobile workforce, however, tracing pension holders when it comes to retirement will be a major problem for PAs, and an area where we need to see a far more flexible approach. Under the current rules, should migrant workers be auto-enrolled for a short period of time, then disappear leaving a small pot, the provider would not currently be allowed to do anything without the consent of their customer — surely a no-win situation for all concerned?

Benefits of saving

The challenge for both PAs and approved alternative schemes such as stakeholder is that they must reward people who save for retirement.

To achieve that, anyone who saves for retirement, however little, must be demonstrably better off at retirement than non-savers. The government has an important role to play in conveying the message about the need to save for retirement, and it is important for people to understand that in a country with an ageing population, the State will only be able to afford a basic level of subsistence.

The possibility that people may find themselves worse off for having saved for their retirement is also counterproductive, and the UK Government has a major role to play in making it clear that the State will only be able to provide pensioners with a basic level of subsistence. Those who want 'luxuries' such as holidays, meals out and trips with their grandchildren will have to save to meet their aspirations. Those who do save for their retirement also need to be sure that they will be demonstrably better off than if they had not done so.

I do not believe PAs are really necessary. On the contrary, I believe that with some small changes such as auto-enrolment, the existing

structure of stakeholder pensions could achieve the same results as PAs, without the associated set-up costs.

The reality, however, is that in four years' time PAs will have come to fruition. For the sake of those who want to save for their retirement, we have to take a pragmatic stance, move forward, work with PAs and work alongside them. The key issue we have to address now is to remove the unnecessary barriers that stop people saving for retirement. After all, why shouldn't they have the opportunity to look forward to retirement and being able to do the things we all hope to do when we reach retirement? But unless we take action, they won't have that future to look forward to.

Notes

- 1 BBC/Catalyst Report.
- 2 PAs: a new way to save. Department for Work and Pensions, December 2006.
- 3 Pensions Bill — Impact Assessment. Department for Work and Pensions, April 2008.
- 4 News Release 'Millions of savers to benefit from auto-enrolment into workplace schemes'. Department for Work and Pensions, 16 May 2008.