Original Article

The future of pensions policy in Europe

Received (in revised form): 22nd July 2010

Peter Askins

has responsibility for a range of trustee appointments as a director of Independent Trustee Services Limited. These include sole trustee appointments, as Chair of several trustee boards and as a co-trustee. He has appointments with a number of schemes with international sponsors, and in addition to ongoing trustee responsibilities has been involved in a number of complex corporate transactions. He joined ITS following over 30 years at the UK Department of Work and Pensions where he led the Defined Benefit Pensions Policy team. He played a significant role in shaping the pensions legislative framework for over 10 years.

ABSTRACT Peter Askins, former head of Defined Benefits Pensions Policy at the UK Department of Work and Pensions, examines the prospects for future pensions policy in the European Community. Focussing on the effects of increasing longevity, the baby boom generation, regulation and globalisation, he looks at the challenges facing policymakers and pension providers in terms of sustainability, risk and communicating the need for change in Europe with an ageing population and falling birth rates.

Pensions (2010) 15, 245–248. doi:10.1057/pm.2010.24

Keywords: globalisation; regulation; risk; policy; Europe; sustainable

It is not my intention in this article to look at the pension arrangements of individual European states; rather it is an attempt to understand the issues faced across Europe as a whole in making financial provision for an increasingly ageing population. The four major influences affecting financial provision that I want to consider are Longevity, the Baby Boom generation, Regulation and Supervision and the continuing effects of Globalisation.

Ever since the actuarial profession had its Eureka moment and woke up to the fact that previous estimates of life expectancy had been significantly underestimated, there has been growing pressure on both state and private pension provision to take account of this very significant financial factor. When considered in the context of the Baby Boom generation, those born between 1945 and 1965, the effect on national economies is dramatic. By 2020, the

majority of this generation, which compared to other generations is disproportionately large, will distort the financial landscape to a degree that could have devastating consequences.

The regulation and supervision of non-state pension provision has also had an increasing effect on the level and sustainability of private provision. Beginning with changes to accounting standards in 2000, there has been a consistent drive by both supervisors and regulators to a position that the funding of private pension arrangements should be risk free. Many would argue that this has been a significant factor in the decline of private pension provision and saving, paradoxically at a time when the European Commission is calling for greater elements of funded provision in member states.

The last significant factor is that of Globalisation. Without exception, pension policies across Europe have been developed during an extended period of unparalleled growth, with Western economies expanding at the expense of those outside that sphere of influence. More recently, that situation has changed; expansion comes from China, India,

Correspondence: Peter Askins
Independent Trustee Services Ltd, 2 Seething Lane London EC3N 4AT, UK
E-mail: peter_askins@itslimited.org.uk;
Website: <http://www.itslimited.co.uk>

Brazil and the Pacific Rim, while in Europe our ageing populations become, in terms of proportion, an ever greater burden on what is in relative terms a shrinking working population, this at a time when birth rates in Europe as a whole are falling. Future financial provision for those beyond working age in Europe will have to take account of these factors. It seems increasingly unlikely that we can look for a return to growth in our economies as a way of sustaining existing levels of pension provision.

The speed of changing economic and other financial factors has left us all, governments, finance professionals and Regulators, gasping. The problem here is that while financial and economic factors are changing very quickly, the necessary corresponding policy change has barely got underway. The deficit crisis facing European economies has brought this into sharp focus; but apart from knee-jerk reactions to increase national pension ages by a couple of years, little thought has been given by governments to establishing coherent long-term policies to meet the challenges faced in Europe.

Hemmed in by increasing regulation, pensions providers have begun to apply thought and effort to the problem that to date has resulted in action at the margins of policy and regulation. This model of small incremental change seems to be aimed at enabling existing models of state and private provision to be maintained. Looking forward this seems increasingly unlikely. The current reality is that we are moving rapidly to a world containing only two effective models of provision: the State, with a guaranteed element of provision underpinned by tax revenues if necessary, and personal savings vehicles either as individuals or as part of a group arrangement, where all the risk is borne by the citizen.

Given the factors affecting state and individual provision, it is difficult to see how the existing models can be sustained in forms that are recognisable today. Here then is the dichotomy. Citizens have an increasing expectation that pensions should be guaranteed, and Regulators that pension scheme assets should be risk free. Given the prospects for national defaults on debt, it becomes increasingly difficult to determine

what constitutes risk free, and emphasises the fact that there is no such thing as a risk-free investment. Alongside the clamour for the issue for ever-longer-dated gilts must be a concern at just how much risk can be transferred to nation states, and ultimately tax payers, to underpin private pension savings.

Rather than taking what some see as an oversimplistic view of relying on risk-free asset classes, regardless of what they are, many take the view that the emphasis should be on encouraging greater diversity in investment strategies as a way of mitigating risk.

The problems facing policymakers are huge. As the issue is so big and the time scales so long, there is little political will across Europe to deal with these issues other than when forced to do so by immediate financial pressures. For instance, the recently published European Green Paper on pensions demonstrates a lack of intellectual rigour concentrating, as it does, on outdated dogma-driven issues. The emphasis on revisiting Solvency II, the internal market, pension mobility issues and aspirations for a single regulatory model spectacularly misses the point that current models are not sustainable.

The recent economic situation has thrown up any number of examples. On the state side, the generosity of many European state schemes is, in terms of sustainability, quite staggering.

I do not want to join the bandwagon for knocking Greece, but a system where it was possible to retire between the ages of 58 and 61 years, depending on circumstances, on a state pension set at between 75 and 90 per cent of average wages, is not made sustainable by increasing the pension age from 61 to 63 years. It is not just Greece, France has also increased its pension age marginally. Like the United Kingdom, France also has problems with the disparity between occupational pension provision in the state and private sector. In both countries, state sector provision outstrips that available in the private sector, and funding arrangements, or rather the lack of them, are building up huge liabilities for future generations.

The common policy response across Europe to the growing awareness that pensions arrangements

in the community are not sustainable is to raise the pension age and encourage people to work longer. It is extremely doubtful that such measures will be enough to maintain existing models of provision. We are at a tipping point where a number of economic and demographic factors are set to collide with potentially catastrophic effects.

As change has come so quickly, there has been no time for policy to evolve organically in response. We are left facing a daunting and, from a political perspective, deadly set of circumstances. There is a growing democratic deficit where those who provide resources, the economically active population, are being outstripped by an ageing army of the economically inactive.

If those are the problems we face, what are the possible solutions to those problems? Unlike some commentators, I do not purport to have the answer to the problem. However, I do think that there are a number of factors that could be addressed across Europe in a way that fits the needs of individual nation states.

There is a need for serious and substantial debate on the factors that have led to this issue becoming so fraught. It serves little purpose to blame it all on the 'Bankers'. The shock caused to the world's financial systems by the impecunious behaviour of the 'Masters Of the Universe' has nothing to do with the deep-seated problems associated with future pension provision. Most European governments were and continue to live beyond their means. Deficit reduction programmes are just that, a matter of reducing debt, not eliminating it, and not running a surplus. Regardless of a banking crisis, we would still face these problems.

Not only is there a need for greater debate, but there is also a need for a wider social responsibility when looking at this problem. It is worrying that the representatives of labour across Europe describe the current situation as an attack on the working class and the poor. It is arguable that it is irresponsible to suggest that existing pensions policies across Europe are sustainable in the short, medium or long term. Such simplistic reactions are symptomatic that it

is not just politicians who are failing to grasp the scale of the problems we face.

There is a need to educate Europe's citizens about the scale of demographic change that has taken place over the last 50 years or so. Taking the United Kingdom as an example when the State scheme was reformed shortly after the Second World War and the pension age for men was set at 65 years, the average life expectancy for a man was 61 years. Averages can never tell the whole story, but set against current trends of survival rates for men of around 15–17 years beyond the age of 65 years, and women's survival rates in excess of 20 years past the age of 65 years, the scale of the change is enormous. The UK experience is replicated with some degree of variation across Europe.

The message surely must be that the world has changed, and peoples' expectations have to be engineered in a way that reflects that change.

If change is on the agenda for the citizen, then it has to be the same for governments. There has been little appetite for reform of national pensions policies because, where even the most modest efforts at reform have been made in the past, the result has usually been an electoral disaster.

So great is the fear of the electoral power of Europe's older generation that, in the midst of the financial retrenchment across Europe, little or nothing has been done to address the pensions issue. At a time when Government departmental budgets in the United Kingdom are being slashed by 25–33 per cent, the rate of future increases in the State Pension has been enhanced. This would be fine if coupled with a coherent wider pensions reform programme going forward, but there is no evidence of that at the moment.

If governments loathe to act, other than to increase the regulatory burden on private pension provision, it is little wonder that those in the professions associated with private pension provision are limited in their response to the crisis, driven as they are to embrace the orthodoxy that current models can be sustained by diluting them. This is undermined by the fact that such policies have failed to keep pace with the speed and volume of economic change, and

are little more than palliatives that may allow some arrangements to continue for a little longer.

Thus far the development of pensions policy has been in the context of the Western Economic Model that has prevailed for the last 50 years, and it has to be said that is now, to a great degree, defunct. Increasing globalisation means that it is unlikely that the Western Economic Model will ever return to a position of supremacy in global economic terms, and it is important that we recognise this as fact because already some voices are being raised in favour of the cyclical argument. In particular, some political and labour-representative voices are saying that the pensions problem is a cyclical issue and as such everything will turn out right in the end. Such siren voices can only delay the inevitable, making it more difficult to effect necessary change.

The issue for both Government and the private sector, which neither has yet grasped, is that our current pensions models, for the great majority of people, are neither sustainable nor capable of delivering the financial outcomes that the citizen has come to expect. Change is inevitable and we need to embrace it rather than resist it.

We need to look for new ways for the citizen to save for their post-work life. This means developing new savings and investment vehicles, altering both the citizens and regulators understanding and attitude to risk, and finding different ways of providing tax and other incentives to individual savers and those employers who remain willing to sponsor savings

vehicles. We need to respect the different expectations and traditions of nation states while balancing that with a broad regulatory overview built on transparency and reasonableness.

It may be that we need to reappraise the very concepts of retirement and a pension. With increasing longevity and much longer periods of active old age, we need to develop strategies for managing the transition from a financially active state to a financially inactive state over much longer periods of time than is currently the case. We need to refocus our efforts on providing incentives for people to stay financially active for as long as is practically possible that are both realistic and sustainable.

The recent financial crisis has thrown the pensions issue into sharp relief. The policy response has been limited to increasing pension ages and little else.

The citizens' prevailing view is that what was good for their forebears should be good for them. This view has to be addressed. Responsible people, regardless of their constituency, need to engage with the huge communications challenge involved in explaining that the world and our perceptions of it have changed forever. This is not a spin off from the recession; this is what the future looks like.

The massive economic benefits accruing to populations in the growth economies outside Europe and their increasing expectations come at a cost, and it is a cost that will be borne across Europe for decades to come as we adjust to the new economic world order.