Original Article

Reinvigoration of private occupational pensions in the United Kingdom: What are the chances?

Received (in revised form): 12th December 2011

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ABSTRACT The article considers the promise made by the coalition government when it came into power, to ‘reinvigorate occupational pensions’. It considers the current situation of pension provision in the United Kingdom, identifying the main problems and suggesting focus for possible solutions. Although the article is focused on the government’s pledge to reinvigorate occupational (that is, employment based) provision, it also considers briefly the present State pension provision, which forms the base upon which occupational provision is built. The reinvigoration project is ‘work in progress’ for the coalition government, and the article considers what has been done to date. The ongoing nature of the subject means that new policies are likely to be announced at any time; however, the article focuses on suggested principles behind provisions, rather than on detailed policies resulting from those. Readers will then be able to compare detailed policies with the suggested principles.

Pensions (2012) 17, 8–19. doi:10.1057/pm.2012.3

Keywords: occupational pensions; reinvigoration; State pensions; pension reform

INTRODUCTION

The coalition government, consisting of the Conservative and Liberal Democrat parties, came to power in May 2010, following 13 years of the previous Labour administration. One of their core promises was to ‘reinvigorate occupational pensions’.

This article considers:

- Why it was deemed necessary to make this promise?

- What aspects of the current system are in need of attention?
- Some of the possible solutions that may be available.
- The chances of success.

To date, there have been some policy initiatives towards meeting this promise, but no published long-term ‘master plan’ setting out a clear agenda and against which progress can be measured. In the world of politics, changes can occur rapidly and new policy initiatives are emerging on a regular basis; thus, further progress may have been made by the time of this article’s publication.

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It is clear why politicians are so involved in the subject; the costs involved are very significant, and given both the State's position as welfare provider of the last resort, and the fact that the State benefits are largely paid immediately from tax and National Insurance receipts with very little element of pre-funding, the future strain on the public purse resulting from a failure of the supplementary private system could prove to be unmanageable.

As we will see later, unless the current problems are tackled robustly, that outcome is a possibility. However, the solution may prove to be somewhat elusive and will not be achieved overnight. Certainly, there have been few suggested solutions to date. Underlying the challenge is the problem that political timescales generally revolve around a parliamentary cycle of no more than 5 years, and any solution to this problem is likely to involve consistent and focused efforts for the lifespans of several parliaments.

THE SIZE OF THE PROBLEM

In the course of his statement on 24 June 2010¹ containing this promise, the Secretary of State for Work and Pensions, Ian Duncan Smith, set out a number of reasons why action to improve private funded pensions was necessary. Key points (using statistics from the statement) include:

- Average longevity has increased, and is still doing so. When the first contributory state pension was introduced in 1926, life expectancy for men was only 64 years and 4 months; 34 per cent of men and 40 per cent of women were expected to reach age 65. Now it is 89 years for men and 90 for women, with one in four boys born today expected to live to 100, and one in three girls.
- Household savings rates are among the lowest of the OECD countries, standing at 5.4 per cent, well below that of Germany (11.4 per cent) and France (15.2 per cent), and have a history of being considerably lower in the previous decade, at 1.5 per cent.
- Today, only around one-third of private sector employees are now saving into any form of pension arrangement.

Added to this, the dependency ratio of pensioners to earners – based on current retirement age experience – is predicted to increase from 51 per cent today to 65 per cent by 2050.² This of course is a particularly significant statistic given that State benefits are largely unfunded.

Taken together, the picture is one of a developing crisis of pensioner poverty and the need for action becomes clear.

BACKGROUND – THE UK'S COMPLEX SYSTEM

The UK's system for pension provision involves a complex mix of State and private arrangements. The State provision is at little more than subsistence level, and thus considerable reliance is placed on supplementation by private means. For employees, this is often arranged through the employer.

In order to consider the problems faced by the private pensions system in trying to achieve coverage and value to support the State's welfare efforts, it is necessary first to understand the level of State benefits, illustrating the importance of the role of private occupational pensions in the UK's overall retirement benefits system. The decline of employer provision, which is outlined below, explains the difficulties that the reinvigoration efforts will have to overcome.

State pensions

In stark contrast to many of its European neighbours, the United Kingdom has been positively frugal in the retirement benefits the State provides its citizens, although pension age benefits still cost about £100 billion per annum – nearly as much the State expenditure on public order, defence and transport combined.³

The State pension entitlement is very complex⁴ and it is not necessary for the purposes of this article to acquire more than an idea of the size and type of benefits available. The headline State basic pension, which is payable to most people, is at most £102.15 per week for a single person (2011/2012 figures). In order to receive that amount, the earner would have to have paid full rate National Insurance contributions on earnings of at least £5304 per annum for at least

30 (but in most cases more) years: If the National Insurance contribution record is anything less, then the corresponding pension is reduced.

It is payable from the 65th birthday (although the normal date of commencement of payment for women is currently the 60th birthday; by 2020, it will catch up with that of the men, which by then will itself be age 66). Between 2026 and 2028, the aligned age for both sexes will increase together to the 67th birthday.

The State basic pension is supplemented, for those with earnings between £102 and £770 per week (2011/2012 figures) by a further pension, dependent upon a complex combination of length of service while in that part of the scheme and whichever iteration of the scheme was in force for each of those years, and actual earnings in bands between those two figures in each of the relevant years.⁵ This pension is expected to become a flat rate supplement to the State basic pension from 2030, although, if the reform proposals explained later are introduced, this supplementary State pension is expected to disappear.

This supplementary State pension has changed several times since it was first introduced, as has its name; currently, it is called State Second Pension, or 'S2P'. There is an option for private schemes to take on the responsibility for providing an alternative, in return for a reduction in the level of National Insurance contributions payable to the State; this process is called 'contracting out'.

Underpinning the State retirement pensions is a guarantee that a person's overall income in retirement should not be less than £137.35 per week overall, with any additional State benefits taking income up to this guarantee level being means tested.

The State pension is subject to income tax in receipt as if it were earnings (although with slightly higher personal allowances), in the same way as any private pension would be.

Private supplement

To supplement this meagre State benefit, reliance is placed upon private provision, which (unlike the State pensions) involves a system of,

effectively, funding the liabilities as they accrue. Although the private system allows for individuals (often, but not exclusively, self-employed) to make their own provision through the purchase of an arrangement direct from a provider such as an insurance company, it is common (but at the moment not compulsory) for at least larger employers to make arrangements available to their employees. Where this occurs, employees' own contributions are supplemented by those from their employers, who also generally pay at least some of the set-up and running costs. It is these employer-organised arrangements that are referred to as 'occupational pensions' and which are the main focus of the coalition government's pledge of reinvigoration.

There are many different ways of categorising occupational pension schemes, but the two most prevalent bases for these funded arrangements are known as either 'defined benefit' (DB) or 'defined contribution' (DC). The distinction between these two comes down essentially to the identity of the party accepting responsibility for the amount of benefit payable. There are a few designs that fall between these two extremes, but as yet no variant of such a hybrid has emerged as a clear template for widespread adoption by employers.

In the DB example, benefits are determined according to a formula that is established before the benefit is earned, and to that extent the amount of the ultimate benefit for the member is predictable. However, this means that the cost of providing the benefits is unknown in advance, as factors involved in the calculation of the benefit, such as the member's remuneration, length of service, expected lifespan in retirement and investment return on assets held to fund the benefit, are all variable. Employers usually assume responsibility for the costs posed by these variable factors, whereas the employees pay contributions according to a fixed formula, generally a percentage of their pay.

The most common version of this design is colloquially known as 'final salary' because the benefit formula is related to a calculation of the member's remuneration leading up to retirement or otherwise leaving service. Discussion of

pensions issues is sometimes confused by the use of the term 'final salary' to describe all DB arrangements, but that misleads.

The State pension schemes are also examples of DB arrangements, but are not of the 'final salary' type because the formula used to calculate the benefit is not related to the individual's earnings.

In contrast, with the DC model, it is the rates or amounts of contributions that are determined at the outset, with the outcome being unpredictable, because of the effect of the same variable factors as described above for DB schemes.

Hybrid designs sit somewhere between these two extremes. There is no single hybrid design type, but generally any such design would contain a mixture of features from DB and DC.

Employer-sponsored arrangements may utilise any of the DB, DC or hybrid variants, according to the employer's choice.

The importance of employer involvement

It is generally accepted that the involvement of employers is a strong positive factor in private provision. Traditionally, under DB schemes – and especially the final salary variety – the employer will pay the set-up and running costs, carry the full liability for the variable costs, and organise the entire scheme, so that the only action the employee has to take (other than eventually selecting the form in which to take their retirement benefits) is whether or not to join. Even with the DC model, the backing of an employer through financial contributions, organisation and administration provides considerable encouragement to employees to participate.

This is especially important, given the generally low levels of understanding and engagement of employees with pensions in the United Kingdom,⁶ which exacerbates the universal tension between competing short- and long-term calls on personal finances.

Consequently, the focus for reinvigoration is firmly on employer-sponsored arrangements.

Employer scheme design issues – DB or DC?

Although the benefits from any pension arrangement are essentially based on the amount of money going into it, in practice the design of the scheme makes a significant difference to the outcome. It used to be the case that DB – in particular, the 'final salary' variant – was the dominant design in pension schemes provided by employers.

Many people look back fondly to the 1980s and 1990s as the golden era of such schemes – 'fondly' because they generally provided more generous benefits for employees than the DC schemes that generally replaced them and because the design meant that the member could look forward to a predictable retirement benefit, which the employer would not only organise and pay the lion's share of the cost of, but would also in the process cover in full the risk of the assets not being sufficient to secure that benefit.

The reality was not quite so straightforward, however, as a consultation document from the Department for Work and Pensions in 2008 noted.⁷ Although some 8 million people were members of DB schemes in the late 1960s, the trend has been downwards since. Between 1979 and 2006, the number of members accruing benefits under DB schemes fell from just under 6 million to 3.4 million.

Therefore, there was a decline in DB provision even through the so-called golden era. However, a significant amount of that decline has occurred since 1997,⁸ and did so in two distinct phases.

Employers involved in the first phase stopped offering membership of the DB scheme to new employees, generally offering a DC alternative instead. The intention was that over time this would naturally reduce – eventually to zero – the number of DB members, and along with it the liabilities associated with running the DB scheme.

However, this process provided only a partial solution and introduced its own problems. It brought forward funding costs for the existing members with 'final salary' promises (the funding process for final salary schemes is arranged so that the employer contributions are calculated as an average of the costs across the membership

base, but are skewed so that the closer a benefit is to payment, the greater its priority over the assets, so with the stock of new members closed off, the funding for existing members' benefits need funding earlier); it also created workforces with different value remuneration packages and, worst of all, failed to stem the increasing costs from the effects of the other variable factors, which remained out of control.

Consequently, there followed a second, more radical, phase of employer retreat from DB provision. This involved stopping accrual of all further benefits under the scheme for existing employee members; again, the alternative was usually to offer membership of the DC arrangement.

The occupational pension sector is today a complex mixture of DB schemes in various states of activity, DC arrangements and a smaller number of designs in between.

Declining employer enthusiasm

These changes are widely seen as evidence of a decline in employers' enthusiasm for pension provision: The DC arrangement is less onerous for employers, to the detriment of employees, and at the same time many employers took the opportunity offered by the change also to reduce the level of their contributions. By 2010, average employer contributions to DB schemes in respect of liabilities for members' future service was 15.8 per cent of their pay, compared with only 6.2 per cent to DC schemes.⁹ Comparing contribution rates between the two types of schemes is a little like comparing apples with pears, but nevertheless the difference in employer contributions is too great to explain away solely by a change in the funding basis of the benefits. Indeed, the point is beyond doubt, from the author's experience, because reduction in cost and its volatility are common reasons cited by employers as the drivers of the exodus to DC.

However, the precipitous decline that has occurred in employer interest in voluntary provision cannot be explained away solely as a simple desire by employers to see their cost base reduced; without at least some understanding of the factors involved, any attempts at

developing policies for reinvigoration are likely to fail to achieve their objectives.

In my experience, the decline was affected by the complex interaction of a number of factors, including:

- increased average member longevity, increasing liabilities;¹⁰
- widespread failure to anticipate the extent of that increase and accurately to predict its future course;
- increasingly severe scheme funding levels required by law (reflecting a reduced trust in the employer's covenant to meet costs in future);
- additional costs from continuation of the well-established trend towards 'social engineering' – imposing new liabilities on existing schemes (for example, the legal requirement to provide increases to pensions in payment¹¹) – and levies raised to fund the Pensions Regulator and particularly the Pensions Protection Fund introduced in April 2005¹²;
- changes to the way in which the pensions liability is recorded in the sponsoring company's accounts (and the effect this has on the increasingly short-term focus of shareholders and finance directors);
- the increased legislative and regulatory burden (starting with the comprehensive new regime introduced under the Pensions Act 1995 by the previous Conservative government, which came into force largely from April 1997);
- legislation driven to some extent by short-term reactions to particular problem cases that arose, rather than according to a consistent long-term strategy (indeed, a long-term strategy would have been difficult to achieve, given the complexity of the pensions Ministerial brief and the fact that it was held by 10 different individuals over the period from 1997 to 2010);
- the abolition from April 1999 of the advance corporation tax concession for pension schemes on the dividends received from their UK equities;
- volatile and declining investment returns, particularly since the global economic downturn began in 2008.

It is not possible to grade these factors in terms of relative importance, nor can we ascertain which factors affected which employers or schemes – all we can say is that they have all been cited frequently over the past 13 years by employers and others as causes of the decline.

One result of this decline in employer engagement is the spillover to employees. There are always short-term challenges to making savings from income, but the support of an employer, through such things as making an arrangement available, encouraging participation, making the joining process as easy as possible, making meaningful contributions itself and encouraging employees to do the same, is a powerful incentive. When employers appear to lose interest themselves, and cut back on the quality of their offering, the message to employees of the importance of private provision is diluted. The success of the government's reinvigoration efforts will therefore depend on policies targeting employees and employers.

The challenges for employees with DC provision do not help the cause. Not only do they have to decide upon the level of contributions to make, they have to select the investment of those contributions, and then convert the resulting fund at retirement to a further arrangement to provide an income for the remainder of their lifetime. When that arrangement is an annuity policy purchased from an insurance company, the cost can be significant, particularly in the current era of low interest rates and falling returns from gilts (the investments the insurance companies use extensively to cover their liabilities). Actual rates differ significantly across the insurance market and change continually, but an indicative rate for a single life annuity increasing annually during payment by 3 per cent that was 23.343 in March 2007 had become 26.042 only 4 years later (meaning that every £1 per annum of pension secured cost nearly £3 more to buy¹³).

For those retiring after 5 April 2011, the requirement to buy an annuity policy with monies from an authorised pension fund has been abolished¹⁴; however, the permitted alternatives

are still subject to restrictions that will mean that in practice most individuals are likely to follow the annuity purchase route.

MOVING FORWARD

Therefore, where must the focus for reinvigoration be directed for the best chance of success? First, know your enemy; progress will not be made without first identifying and agreeing on the issues. Both employers and employees must be targeted.

Employers

At the highest level, employers must be persuaded again of the merits of providing pensions for their employees. Some will be paternalistic, and have social consciences that will lead them down this path. However, many more will base their decision on pure business (financial) issues alone; they will need to be convinced that there is a strong business case – which, given the sentiment from the recent experience with DB arrangements, will not be an easy task. New legislative requirements will require employers to offer at least a minimum auto enrolment arrangement in future (see later), but the minimum requirements will be quite modest; if reinvigoration is to make a real difference to standards of living in retirement, simply providing this minimum will not be enough on its own.

From October 2011, the default retirement age provisions, which allowed an employer to terminate an employee's employment on the grounds of retirement at a predetermined contractual date, were removed.¹⁵ This makes it more difficult to retire an employee against their will – and resistance is surely more likely if the employee will have at best a poor level of retirement income to look forward to. Consequently, it is now difficult to terminate the employment of an employee whose effectiveness has simply declined, whether relative to changing employer requirements and/or because of the effects of age.

This can be expected to provide some incentive for employers to provide more generous pension arrangements than the legal minimum, although given the long-term nature of pension savings,

some may still feel that they can avoid problems in practice by only employing a 'young' and transient workforce whose members will not still be with them at retirement age.

The results of a survey published in summer 2011 by the Association of Consulting Actuaries¹⁶ found that the employers surveyed (and who already provide pension arrangements for their employees, suggesting some level of conscious commitment to the cause) were looking to reduce their current financial commitment to pensions, running contrary to their likely long-term needs; this hints at the size of the task facing the government.

Employees

It will also be necessary to encourage employees to participate in the arrangements that are made available to them. The forthcoming introduction of auto enrolment (see later) will ensure that every employee is offered membership of at least a basic-level arrangement. Individuals will need to take decisions about the level of their involvement in the arrangement, and will need to understand the level of benefits that are likely to result from those decisions.

It is possible that the minimum contributions required by the auto enrolment requirements will be increased at some point in the future, as has happened with, for example, the Australian (fully compulsory) Superannuation system (Australian Super).¹⁷ At the end of the day, the solution to the nation's retirement crisis will depend heavily on the amount of money committed to savings (although of course pension may only be one of a number of methods utilised).

Currently, there is a poor level of understanding about the pensions system, including items such as the monthly income that will be necessary to provide a reasonable standard of living, the capital cost of securing that income and the likely contribution from the State (and the political uncertainties that may cause the State parts of the equation to change significantly in amount and/or shape, possibly several times, before an employee comes to retire).

Is there a 'silver bullet' – Or failing that, a bronze one, perhaps?

No. In the same way that there were a number of factors that drove the decline, reinvigoration will require actions in a number of different areas.

Given the current level of negative sentiment around private pension provision, the starting point must be a high-level government vision, incorporating the relationship between State and 'private' provision, and the extent to which it is desirable or possible for the State to provide help to 'private' arrangements. From such a vision, detailed policies can then be developed.

Areas for possible policy or legislation changes include:

- Making employee tax concessions more visible and more effectively targeted; tax reliefs can be an extremely powerful incentive – but only if they are understood. There is a debate over whether the cost of income tax relief would be more effective if it were concentrated on lower earners. At the moment relief for pension contributions is available against income assessable to both basic and higher rate income tax, and the 50 per cent 'additional rate' for assessable income above £150 000 per annum.¹⁸ This results in allegedly about 80 per cent of the tax relief for pensions going to the top 20 per cent of earners.
- The question is whether overall engagement with pensions is more likely to result from spending the amount given in income tax relief on those who are only basic rate taxpayers, for whom the increased amounts received would form a higher proportion of their income, or to leave it as it is. An argument in favour of the current system is that it acts as an important incentive to those who are more likely to be the decision makers in employers and who would be less likely to provide pensions for employees if they themselves gain little benefit from their provision.
The answer to this will probably never be known definitively – it will just be down to politicians to make the call. What is clear is that tax reliefs will have no incentive effect

unless the benefit they confer is understood; however, there is evidence that currently levels of understanding are poor. An obvious starting point therefore is to boost understanding; if that cannot be achieved, then perhaps that points to the better use of reliefs as being to continue to give them to the higher rate taxpayers, encouraging them to make provision for their employees.

- Policies aimed at encouraging employees to participate in occupational provision. Research should help identify issues that are perceived by members as disincentives (whether or not they actually deter participation) requiring appropriate changes. One possible example may be the issue of allowing access to pension funds in emergency situations at a date before retirement. A perception exists (although there does not appear to be reliable evidence to support it – a fact confirmed by responses to a HM Treasury consultation exercise held on the issue¹⁹) that members are dissuaded from saving towards their pension through the medium of a dedicated pension arrangement, because of a fear that they would not be able to access those savings in the event of a prior emergency that would assume priority over a pension. This is in contrast to more short-term savings arrangements, such as an Individual Savings Account. Whether or not such an option would actually be used much in practice (and its usefulness may be reduced if the amounts potentially available are capped to ensure that the pension fund cannot be exhausted before retirement) if the perception is that it would, then failure to offer it may clearly provide support for an individual's decision not to save in a dedicated pension scheme.
- For employees in particular, simplification should assist understanding, but this will need to be complemented by improved knowledge, but crucially also ready availability of advice. Given the poor levels of member engagement with schemes, as demonstrated by the proportion of members who leave their contributions to be invested in their scheme's default investment fund,²⁰ it seems likely that many will never engage fully, and thus they will need assistance;

particularly challenged are likely to be those who were formerly in DB arrangements, where arrangements were run on their behalf, and thus have not gained expertise to take their own decisions when they lost that membership for future service.

- Reducing the number and complexity of regulations. Regulation should only exist where it is clearly necessary to address a clear problem; it should also not be introduced unless its effect on other legislation is understood and accepted. This has been publically acknowledged by the Pensions Minister, Steve Webb, for example, at the Liberal Democrat conference 2011 when he said 'We have a fiendishly complex system that no-one understands that doesn't deliver enough either for today's pensioners or tomorrow's'.²¹ I suggest that there should be a group of civil servants, supplemented by private sector pensions experts, tasked with looking for and dismantling regulations that are not deemed strictly necessary.
- Review of the basis for accounting for DB pension liabilities in company accounts. The principle should be that the disclosures should recognise the fact that the liabilities fall to be met over a long period in the future. Arguably, the current system produces unclear outcomes by taking the unfunded part of the liabilities in full each year, and putting them on the balance sheet (unless the scheme buys out the liabilities, or buys in a specific asset to match all or part of the liability in full, in which case that would rightly be a transaction in a particular year). In addition, logic suggests that the basis upon which the liabilities are valued in the company's accounts should be aligned with the basis upon which the scheme values them and should reflect the asset basis used in the scheme's actuarial valuation (a valuation that is generally only revisited on a 3-yearly cycle, which would contribute to a reduction in volatility). For as long as the scheme and company figures remain out of synch, scheme liabilities will continue to generate volatile and significant figures in sponsoring companies' balance sheets,

undermining shareholders' willingness to continue to provide pensions for employees.

- Assistance to employers with managing legacy DB liabilities. Given that, as we have seen above, many employers have now ceased all accrual of new benefits under their DB schemes, those schemes have ceased to be of any use to the business; the benefits they provide relate solely to service that their members have already provided in the past to the employer, and thus will not be a recruitment, retention and motivation tool – traditionally, a key justification for offering a pension arrangement to employees. Instead, the schemes have become simply a cost to the business – a cost that continues to be affected by many of the variables mentioned earlier, such as increasing member longevity and volatile investment returns.

Help could be provided directly through the taxation system. Opponents might complain that these employers took a business decision to offer DB pensions and thus the taxpayer should not help them financially when the cost becomes a problem; however, a not insignificant part of the unpredicted costs arises from the impact of State-imposed requirements on what was a voluntary act by those employers, which ultimately benefits the State in terms of a reduction in the likelihood of benefit claims.

- Alternatively, funding-level requirements on schemes could be eased, with the State providing a degree of underwriting of the underfunding risk, should that be required in practice. Currently, the Pension Protection Fund (PPF) provides cover for member benefits below a cap following the failure of an employer, which leaves a DB scheme with a funding deficit above a prescribed threshold.²² However, the PPF is funded by a levy on all other DB schemes, and thus does nothing to address the overall funding strain on UK businesses. The State could provide an interim support system, which would be activated in any case when something less than a total failure of the sponsoring employer occurs, but where the scheme's funding level is insufficient to cover benefit payments due immediately. This contingent cover would allow some slack to be introduced into the current

funding regulatory system, enabling schemes to function with lower funding levels than are presently required, thereby reducing the strain on their sponsoring employers.

The search for consistency

Whatever the solutions package eventually decided upon, the changes to legislation and regulation will require that politicians of all parties understand the nature, importance and size of the problems. They must be committed to making decisions that may at times not be popular with the electorate in the short term, to rebuild confidence that appropriate policies to address the problems will be forthcoming, and that a clearly defined path will be consistently followed, regardless of the party in government.

This could be done by an all-party agreement to implement policies that are consistent with the agreed long-term principles, while recognising that the principles may need to change over time to reflect changes to social, economic and other conditions; any such changes will also require all-party agreement. Unfortunately, experience to date has been that the few consensus agreements that have been reached have not lasted the course (one example is the State scheme introduced in 1978 by the Labour government, which enjoyed all-party support, but which was cut back 10 years later by the then Conservative administration). Politicians will always disagree over issues, and given the complexity and importance of pensions it is unlikely that the future will produce anything different.

One solution would be to create an independent pensions body, staffed by individuals who have relevant qualifications and experience across all the areas affecting pensions, and following a high-level remit set and reviewed by politicians. Although the exact detail of the remit, including its scope, would be subject to political discussion and agreement at the time of its creation, the body would be most effective if it was at least responsible for producing detailed policies, where necessary proposing legislation, and ensuring that the detailed provisions are put into place. Although working to a much narrower remit, the Bank of England Monetary

Policy Committee provides an example in principle of how such a body might function.

Whatever the solution adopted, perception is all-important; strong, positive, encouraging and consistent messages will be required throughout the long process of reform – and continuing beyond. When a negative message has to be given, such as ‘your predicted pension assets by the date of your retirement will only provide a pension of a fraction of the amount you will need’, the message should also indicate that the problem is soluble – in this case by a potentially achievable increase in contributions.

WHAT HAS BEEN DONE SO FAR?

Given the stated intention of the coalition government to reinvigorate occupational pension provision in particular, and the passage of time since that June 2010 announcement, what new policies have been formulated, and have they followed a path that is to any extent consistent with the principles outlined above?

A number of legislative and regulatory changes have been introduced, but arguably there are three policies with the greatest potential to effect change.

Auto enrolment

Building upon the recommendations of the Turner Commission,²³ which published its main report on 30 November 2005, the Pensions Act 2008 set the framework for the introduction of a system whereby all employers will be required to provide a pension arrangement, meeting the requirements for authorisation under the Finance Act 2004, and to compel their employees between age 22 and State pension age to become members. Both the employer and their employee will be required to contribute. The arrangement may be on a DB, DC or hybrid basis; however, in the current climate, those employers who will be starting pension provision for the first time are unlikely to introduce a DB arrangement.

Although the new requirements were formulated under the previous Labour administration, following an independent review conducted in the autumn of 2010²⁴ to

assess whether the proposals were still appropriate in the current economic circumstances, the coalition government decided to continue with the programme, with only detail changes.

The requirements to provide access to an arrangement will be phased in, with each employer being allocated a ‘staging date’ from which their obligations will commence. Staging dates will range across a 4-year period from 1 October 2012 to 1 October 2016, with broadly larger employers having the earlier staging dates, and working down through employer size towards 2016. Once a staging date has been passed, the employer must put each qualifying employee into the arrangement and commence deducting the employee’s minimum contributions from their pay, adding the minimum employer contribution before remitting the total to the arrangement.

However, on 28 November 2011,²⁵ a decision was announced that the staging dates for employers with fewer than 50 employees would be deferred by a year, in response to the impact of difficult economic conditions.

The amount of the minimum contributions will be phased in over the staging date period, but the levels that will apply when the system is fully in force will be 3 per cent of the employee’s gross earnings between £5035 and £33540 per annum (2006/2007 figures) from the employer, 4 per cent from the employee, with a further 1 per cent coming from tax relief. The gross earnings figures for this purpose will be reviewed annually in line with increases in average earnings.

Although employees will be automatically placed into their employer’s arrangement, they will have the option of withdrawing (opting out). The process for this should deter many from exercising the option, supporting the underlying objective behind the ‘soft compulsion’ process of capitalising on employees’ inertia, which is expected to lead to many simply taking no action and thereby remaining in the arrangement by default. Those that do opt out will be re-enrolled in the employer’s arrangement every 3 years, and will have to opt out again each time if they still wish not to participate.

Only time will tell the extent to which this new system will increase occupational pension provision. A Department for Work and Pensions impact assessment in 2009 suggested that between 4 and 8 million more pensions savers will be created.²⁶ Whatever the actual figure, it seems likely that there will be a significant increase in the number of employees with private pensions.

State pension reform

The other large-scale initiative on the horizon is the coalition government's proposals to simplify the current State pension system. A consultation paper issued in April 2011²⁷ proposed moving to a single State pension system, with reduced contribution requirements to qualify for the full amount, which was suggested as being around £140 per person, per week in 2010 figures. The State supplementary scheme would disappear, as also would the option for contracting out. The government is intending to publish the next stage of its thinking in the spring of 2012.

If reform to simplify radically the State pension system goes ahead, it should help the cause of reinvigoration by making it easier for individuals to anticipate the pension they will receive from the State – and thereby to decide what level of supplement they should seek from their private arrangements. However, State scheme simplification will not be an easy task, not least because of the complexity of the current scheme and the need to protect at least the value of the benefits already promised, and thus reform is unlikely to boost levels of engagement in the short term.

Abolition of the default retirement age

The provisions allowing an employer to terminate an employee's employment on the grounds solely of attainment of a specified age were abolished with effect from October 2011.²⁸ The intended effect of this is that more employees will remain in employment after the age that they would otherwise have retired, both because employers will have to find another performance-related reason to retire them against their will, and because over time retirement ages will drift upwards, reflecting to some extent

increased longevity and complementing rising State pension ages. Deferred retirement should give longer periods for retirement saving resulting in, all things being equal, increased pension amounts.

MEASURING SUCCESS

How should the success or otherwise of the programme of 'reinvigoration' be measured? This is a political question, as there can be no objective measurement, only an opinion of where it is reasonable to fix the bar, relative to the needs of individuals, their employers, and of the State generally. Nevertheless, without a clear goal, any programme will lack focus and success may be compromised.

Given the high-level imperative of increasing the level of monies available for UK citizens' retirement and to avoid creating unaffordable liabilities on the future unfunded State arrangements, a sensible approach would be a simple measure of increasing the total number of people with privately provided retirement benefits, combined with some measure of the increase in the average size of benefits. This latter arm will be necessary, as auto enrolment is likely to increase the number of members, but the new influx may drag down the average level of monies in schemes where contributions are at the minimum statutory level for auto enrolment; if that were to be the result, then the experiment will have failed and the UK's impending pensions crisis will still be on course.

So: Realistically, what are the chances of success?

This is the US\$64 000 question, of course. From the current perspective, the task looks very daunting indeed. However, there is a growing, although somewhat late, recognition among politicians of the scale of the problem, and a desire to address it. The difficulties they face, however, are to produce effective policies, particularly in an environment where the true extent of the problem and the money that will be required to solve it does not seem to be recognised by the majority of the population – as evidenced by the current widespread opposition among public sector employees to proposals for

amendments to their pensions aimed at reducing the future cost burden on the State.

That presents politicians with a dilemma, given their need to maintain public support if they are to be re-elected so that they can continue to pursue policies to address the problem. This suggests that they need as a matter of urgency to outline a collection of policies based on principles as outlined above, and to pass the responsibilities for the details to experts.

At the same time, an ongoing public awareness programme will be needed to educate the public and gain their understanding and support, especially of any short-term unpopular decisions. Steps are being taken, in the form of a publicity campaign conducted by the Department of Work and Pensions, based on the forthcoming auto enrolment programme.

It is to be hoped that together these measures will create a new savings culture in the United Kingdom; if that can be achieved, reinvigoration might yet be achievable.

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