JANUARY 2011
PENSIONS BRIEFER

INTRODUCTION

The cold weather of December was witness to a veritable blizzard of outputs relevant to pensions from HM Treasury, the Financial Services Authority (FSA), the Pensions Regulator (tPR), the National Employment Savings Trust (NEST) and many others. This volume of material has taken some while to digest and I don't propose to go through it all on a blow-by-blow basis. We'll take a look at what may be the most significant pronouncements towards the end of 2010 and the start of 2011.

TOWARDS A DECENT, UNIVERSAL, BASIC STATE PENSION

One document which did NOT emerge from the Department for Work and Pensions was the much-anticipated Green Paper outlining how we might move from the current system of Basic State Pension (BSP) and means-tested Guarantee Credit, towards a single BSP paid at a level slightly above a combination of the previous two. In our view, this is an essential step to provide a clear incentive to save for all and a solid platform for further saving. Failure to deliver this will, we think, put a big question mark around the advisability of saving into a pension for modest earners, who would be saving effectively simply to deny themselves the means tested retirement income benefits they would have been entitled to had they done nothing. Various rumours have circulated as to the reasons for delay. There is some suspicion that the Treasury are not happy with the additional forward fixed costs and that those standing to lose out through the abolition of the State Second Pension had put pressure on. The Green Paper might, it seems, be expected towards Easter. We must hope it does so, and shows how we can deliver this policy objective, if the much-needed success of auto-enrolment into pension saving is not to be hobbled at the starting gate.

AUTO-ENROLMENT INTO PENSION SAVING

It was clear from the emails I received after the conclusion of the Government's review of auto-enrolment and NEST in the early Autumn of 2010 that most small employers simply have no idea that they'll be required to comply with the new duties from 2016 at the latest. There is a major communication challenge here, so it is at least encouraging that the first, high level, guide for employers is now on the tPR web site. However, the chances of small employers navigating their way towards it are constrained by the virtual ban on any advertising spend in Whitehall. If ever an awareness campaign were needed, it is here. Furthermore, the details of "phasing" and "staging" are pretty complex for a busy small employer to understand, and I suspect a lot of support will be needed to help them comply. There could even be a business here to help them do so, for a fee! The guidance can be read at www.thepensionsregulator.gov.uk

PENSION REFORM – CONDUCT OF BUSINESS CHANGES – CONSULTATION PAPER 10/26

This little-noticed Consultation emerged in December 2010 but contains some very strange statements which, on the face of it, carry substantial implications for current and future pension provision. Strangely drafted, not in the usual FSA style, it makes a series of unsupported assertions and in other places ties itself in knots. For example, the RU64 rule, whereby reference must be made to the possible suitability of a low-charging "stakeholder" pension I the sale process of, for example, a personal pension, is recognised as being effectively redundant with the effective demise of the former with the advent of NEST. But, the proposal is to keep the rule in being. Why? Further on, the assertion is made that "A Group Personal Pension (does this include a "stakeholder?") with a flat annual charge is unlikely to be appropriate for a group of employees where overall pension pot sizes are expected to be small." So does that include the flat annual 1% charge most modest earners pay in a stakeholder scheme, which was specifically designed by government for this market? Much more continues in this vein, with the assertion later I the paper that a simple Managed Fund is unlikely to be a suitable "default" choice (many stakeholder schemes have this as their default today) and that, broadly, future default fund choices are going to have to comply with DWP guidelines – read across to NEST's likely Target Date Fund approach – on a "comply or explain" basis. The Consultation can be found at www.fsa.gov.uk

NEST

The build of what might well become one of the biggest single pension schemes on the planet continues apace. The latest publication is a collection of words and phrases they are intending to use in their material for members, to try to get away from the jargon and technical phrasing often used, usually not with malice aforethought, in pensions today. So, vesting becomes “opening your retirement pot” and more in a similar vein. Backed by research testing, anything which better enables ordinary consumers to understand what’s going on in a pension has got to be a good thing. The NEST phrasebook is therefore welcome and can be viewed and enjoyed at www.nestpensions.org.uk/plainspeaking

HM TREASURY – CONSULTATION ON EARLY ACCESS TO PENSION SAVING

Keen to make pension saving more attractive to consumers, and hot on the heels of the abolition (for a few) of the requirement to buy an annuity at age 75, this latest consultation considers four possible ways in which consumers might be able to access funds from their pension before retirement. The “lock in” for many years of all pension savings has long been suspected to be a restraining feature, preventing as much money as possible being invested for the long term. Research on this feature, it has to be said, is divided. Some consumers actively want the money to be inaccessible, so they can avoid being tempted to touch it before retirement. Others find the absolute lock-in a major turn-off and this was certainly evident in the research on pensions I undertook with consumers in 2006 and 2007. The jury is also out on how many people would make use of such a facility, if it were available. Section 226A pensions for the self-employed carried a “loan back” facility until they disappeared in 1988, so the concept of early access is not new to the UK. Anecdotal evidence suggests very low levels of take up of this facility. However, in the US, no less than 18% of those able to access a loan from their 401K pensions have done so, with an average loan value of $7,191. This would tend to indicate that we could expect reasonably large numbers of people to use the facility here. However, with the US unemployment and health benefit systems offering much poorer support for those in difficulties compared with the UK, the need for money from any source may be more immediate than here. In general terms, anything which makes pensions as an architecture more attractive to consumers must be a good thing, and this may be the case with early access to pension saving. However, my belief is that much more radical action is needed to design a pension architecture that meets the needs of consumers in the 21st century. The consultation can be accessed at www.hm-treasury.gov.uk

PENSIONS POLICY INSTITUTE – TOWARDS MORE EFFECTIVE SAVINGS INCENTIVES

This latest paper from the widely-respected Pensions Policy Institute (PPI) examines the potential effectiveness of three possible approaches to tax incentivisation of long term savings architectures, including the approach we know as a pension today, with its attendant tax relief on contributions. Using established economic models within PPI, the paper tries to assess the quantum of pension funds we might see in each case. One approach tested would see a pension re-designed to look much more like an ISA, with a Taxed, Exempt, Exempt approach rather than the current Exempt, Exempt, Taxed structure we see in a pension today. As ever with PPI, the paper sets out to be even-handed in its approach, listing the “pro” and “con” features of each with at times almost painful neutrality. Very much worth reading still, it was produced with the involvement and support of Aegon, who themselves have produced a stream if thoughtful work in this area in recent years. However, I recall sitting in on some consumer research a few years ago where the audience were shown five product descriptions, unlabelled, and asked to choose which they would like to save for retirement in. One described how an ISA worked, one the current UK personal pension, with the others being from overseas structures such as the US 401K. The clear winner was our ISA, with varying fortunes for the others. The only description which garnered “nul points” was our very own personal pension. The paper can be accessed at www.pensionspolicyinstitute.org.uk

AND FINALLY

Any “holocaust deniers” out there who still think there is some kind of a future for Defined Benefit (DB) pensions will be shocked by a figure I found in the Treasury’s early access consultation paper. It quoted ONS figures showing that active private sector membership of DB schemes has declined from 5 million in 1995 to 1 million in 2010 and falling. At this rate of decline, there will be just 66,000 active members in 2025. This will further highlight the inequality between public sector and private sector workers, if the former have retained some kind of access to DB pensions.

MALCOLM SMALL
SENIOR ADVISER, PENSIONS POLICY
INSTITUTE OF DIRECTORS