

A change for the better?

Six years ago the UK government began to introduce a series of initiatives aimed at protecting and simplifying pensions, but have they succeeded? **Gill Wadsworth** reports

Historically the UK was seen as providing one of the best pensions systems in the world. However, the early part of the 21st century was marked by a number of cases which brought the security of defined benefit provision into question. When steel company Allied Steel and Wire went into receivership in 2002, hundreds of workers lost their jobs. To make things worse these people were told they would only be receiving a fraction, if anything, of the defined benefit pensions they had spent their careers accumulating. They had fallen victim to a rule prioritising the payment of pensions for those already in retirement with those still in work having to make do with what is left over. This and cases like it, put the spotlight firmly on the security of pension provision in the UK and opened the door to a flood of change over the coming years.

These changes were encapsulated in the Pensions Act 2004 which aimed to simplify and strengthen pension provision. The Act abolished the Occupational Pensions Regulatory Authority and replaced it with the Pensions Regulator, a body with increased powers to intervene in cases where employers were avoiding their pension responsibilities. The Act also brought the Pension Protection Fund into being (PPF) in 2005 – the government lifeboat fund that would bail out defined benefit (DB) pension schemes should their employers become insolvent – a development which secured the financial future for millions of savers. This activity was followed by A-Day in 2006 which sought to streamline the system further and bring more flexibility into how people save into a pension and access their income in retirement. So the pensions landscape in the UK has changed forever but whether the changes have been truly a success is open to debate.

Pension Protection Fund

The introduction of the Pension Protection Fund five years ago was a key part of government plans to secure employees' defined benefit provision.

Ros Altmann, independent pension consultant and former pension adviser to Number 10 Downing Street, said: "[The PPF] has certainly helped provide much needed security for scheme members, who previously could end up with absolutely no pension at all, despite a lifetime of saving and being very close to retirement."

However, given that the PPF is funded via levies paid by every DB scheme in the country, its arrival on the scene has not been without controversy. Notably, the risk-based levy has long been criticised for applying extra pressure to those schemes already teetering on the brink of insolvency, a situation that could, rather perversely, see them pushed into the PPF.

Atkin & Co head of trustee services Richard Bryant said: "Obviously it would seem to make sense to link the PPF levy to the risk of a company going into insolvency, but unfortunately this means an extra burden for the kinds of companies that can least afford it."

The PPF has been sympathetic to pension funds' concerns about equality within the levy system and has initiated numerous consultations about how to proceed. The most recent exercise concluded in March, which resulted in a steering group putting forward its proposals for making the levy fairer and for distributing the burden of payment



more equally across DB funds.

The steering group suggested a levy calculation that is "more proportional to individual scheme risk; better reflects

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the interactions between sponsor covenant, scheme funding and, if appropriate, investment strategy; is benchmarked, where possible, to commercial comparators, to test that charging is fair; and works with the grain of messages on good governance".

The detail of the new levy ideas are now with the wider industry for consideration and further consultation.

Fairness, or otherwise, of the levy system is not the only criticism levelled at the PPF; anxieties are starting to surface about its ability to carry on bailing out beleaguered schemes as the fallout from the global economic turn down forces more companies into administration.

Raj Mody, partner at PricewaterhouseCoopers (PwC), said: "[It] is not completely clear what happens as the level of DB liabilities on which to raise a levy gradually dwindles, and whether that will lead to future strains to the PPF business model."

The PPF recently updated its investment strategy, choosing a slightly more aggressive position and adding a diverse asset mix, although the fund's chief executive Alan Rubenstein said this move was not motivated by an influx of claims. Rather Rubenstein said the PPF, which is now responsible for 120 schemes and 36,800 members, has weathered the financial storm.

"We have reduced our deficit in the past year and we are travelling in the right direction. It's only when people stop questioning our ability to meet our obligations, that I'll start to worry," Rubenstein said.

Irrespective of whether the PPF keeps itself afloat, the chances of it being allowed to fail are remote; with so many members' benefits at stake, responsibility for keeping the fund alive would in all certainty fall to the taxpayer.

Altmann said: "Levy income and investment returns should help mitigate risks but ultimately, if too many companies fail or schemes become too underfunded, the PPF may need to be underwritten by taxpayers. I believe that would be far better than cutting benefits and far more socially equitable, although the decision on that would be political."

She added: "Those who try to talk down the PPF are doing no favours to anyone and cannot be sure of their forecasts. What would they like to see instead? A return to the old days when members could be left high and dry and employers could just walk away?"

Pension simplification

While the dust still whirled around the aftermath of the 2004 Pensions Act, the government embarked on another major reform: pensions simplification.

After several lengthy delays and widespread uncertainty, on April 6, 2006, A-Day came into force with the main aim of reducing the UK's eight tax regimes into one, simplified system.

The legislation also removed the forced purchase of annuities on retirement, allowing savers to wait until age 75, and introduced tax-free lump sums and alternatively secured pensions.

In spite of greater flexibility in retirement and the removal of tax complexities, the pensions industry remains hugely sceptical that the government succeeded in making life easier.

Alex Thurley-Ratcliff, head of multimedia at pensions communication firm Shilling, said: "You need to distinguish between political rhetoric and the real world. A-Day was never about simplification, it was more to do with creating headlines to detract from the pension shambles. If the government really wanted to simplify pensions it would talk to the end-user rather than aged political mandarins and bankers in ivory towers."

Recent changes to the tax rules governing those with an income above £150,000 (US\$226,000) have done little to help perception of the government's treatment of pensions. From April 2011 individuals earning £150,000 or more will only receive basic rate tax relief (20%) on their pension contributions. Prior to this, tax relief for these high earners had been at the higher rate of 40%. The move was an attempt to redistribute wealth away from the highest earners, creating a fairer system for all. Instead the government stands accused of undermining pensions entirely by removing the incentive for higher earners to save into a pension at all.

Mody said: "The clear consequence of the high earner proposals is that for most high earners it will not make sense from a tax-efficiency perspective to continue to participate in a company pension scheme. The way the proposed rules would work mean that many employees who would not normally expect to get caught by these rules might find themselves on an occasional or one-off basis falling into the affected group."

Mody noted that in a recent PwC survey of 157 large employers, more than three-quarters (77%) of respondents said the pensions tax proposals had further reduced their

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motivation to provide workplace pensions.

Altmann believed that A-Day never truly simplified the UK pension system and adds that because the recent Budget changes for high earners have since undone many of the benefits of pension simplification, the system is back to square one.

"We have by far the most complex pension system in the world and it desperately needs to be radically overhauled," she said.

Future pension reform

Not to be deterred by a less than warm reception to earlier pensions reform, the government is continuing in its efforts to create a healthy, equitable and adequate retirement system for UK citizens. The latest endeavour involves auto-enrolling every employee over the age of 22, earning above £5,035 into a company pension scheme into which the employer will eventually contribute 3%, the employee 4% while 1% comes from tax relief.

The UK's largest employers will be expected to comply with reform first, meeting an October 2012 deadline, the rest of the country will gradually follow suit until the whole country is involved by 2016.

At the same time government has created the National Employment Savings Trust (NEST), which will be the default scheme and represents the minimum standard for employers' qualifying schemes. (See related feature on page 16)

The idea is to get as many as 10 million non-savers contributing to a private pension, thereby easing the burden on the state and securing their financial future.

Pitman Trustees director David Archer said auto-enrolment is "not at all likely" to create adequate retirement savings for the majority, adding: "In these difficult economic times the cost [of auto-enrolment] will reflect into lower pay rises for the next few years."

Ultimately, the government's seemingly endless efforts to overhaul the pensions system have been left wanting, industry watchers said. Every success, such as the PPF, is accompanied by failures or at the very least a set of unintended consequences which undermine its more positive endeavours.

As we await the outcome of May's general election, the precise direction for current pension reform is uncertain, but whichever political party finds itself in power they can be sure that successfully tackling the UK's retirement system will prove one of its biggest challenges. ■

KEYSTATS

- GDP (PPP): US\$2,165trn (2009 est.)
- GDP Per capita (PPP): US\$35,400 (2009 est.)
- Investment (gross fixed): 15% of GDP (2009 est.)
- Labour force: 31.25 million (2009 est.)
- Public debt: 68.5% of GDP (2009 est.)

Source: CIA World Factbook