



What ever happened to good pension plans?

*... and what will they look
like when they come back?*

Adrian Waddingham
BSA Annual Conference May 2010

Good company plans were

- **1/60th final salary per year of service**
- **of salary less 1.5 times basic state pension**
- **NPA 65 (males) 60 (females)**
- **Pension increases at discretion**
- **No preserved benefits for leavers**
- **Probably 50% widows**
(but member had to be married, and
to someone of the opposite sex)
- **And members paid a
tax-deductible 5%**

**and the employer
paid up to 10%
a 2 to 1 subsidy**

...and UK pensions thrived

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☺ The UK boasted
£850+
billion in
pensions

☺ The
envy
of Europe...

☺ ..as were our
capital markets



The pension map of Europe

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What went wrong?

1. Government adding compulsory benefits (e.g. pension increases since 1997)
2. Stock market collapse 2000-2003
3. Low interest rates since 1997
4. Abolition of tax relief on dividends 1997
5. Improving longevity
6. Spending of surplus in the 1990s
7. Debt on the employer in 2003

**So who should we blame
for this "perfect storm"?**



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Overprotection of members? All well-intentioned but over kill

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- £ Preserved deferred pensions for leavers...
- £ ...with “revaluation” to retirement date
- £ “Maxwell” Pensions Act 1995:
- £ “Limited Price Indexation” pension increases
- £ Pension plan dividends taxed (1997)
- £ New accounting standard FRS17
- £ June 11th 2003 bombshell
(e’er fully liable for pension debt)
- £ Pensions Act 2005 introduced the “Pensions Protection Fund” and a new “tough” Regulator

*All this "good stuff" passed
second-division DC plans by*

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Short-termism

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- Secretary of State for Social Security
 - John Moore (July 88 – July 89)
 - Tony Newton (July 89 – April 92)
 - Peter Lilley (April 92 – May 97)
 - Harriet Harman (May 97 – July 98)
 - Alistair Darling (July 98 - June 01)
- Secretary of State for Work and Pensions
 - Alistair Darling (June 01 – May 02)
 - Andrew Smith (May 02 – Sept 04)
 - Alan Johnson (Sept 04 – May 05)
 - David Blunkett (May 05 – Nov 05)
 - John Hutton (Nov 05 – June 07)
 - Peter Hain (June 07 – Jan 08)
 - James Purnell (Jan 08 – Jun 09)
 - Yvette Cooper (present)

*In the
last twelve years a
Secretary of State
has averaged only
14 months.*

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Pensions Act 2004: FUNDING

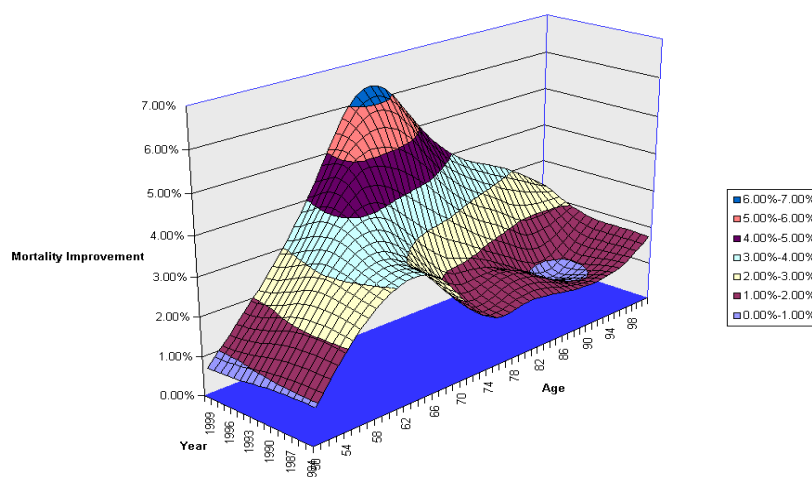
- **The (good) old days**
 - Benefits depended on funds available
 - Significant discretionary element
 - Share of fund on wind-up
- **Now**
 - 1997 Indexation
 - 1997 “Minimum Funding Requirement”
 - 2003 Debt on the employer
 - 2005 new “Pension Protection Fund”
 - And accounting standards FRS17 IAS 19

Low security
Light regulation



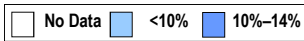
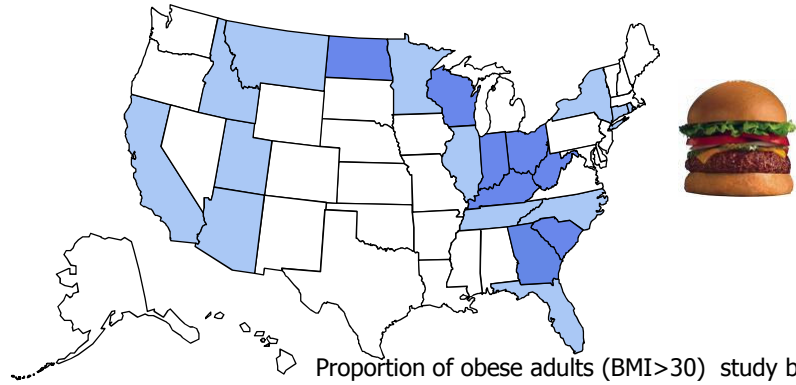
High benefits
High security
High costs
Heavy regulation

Life expectancy improvements



US, 1985

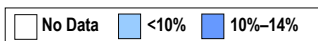
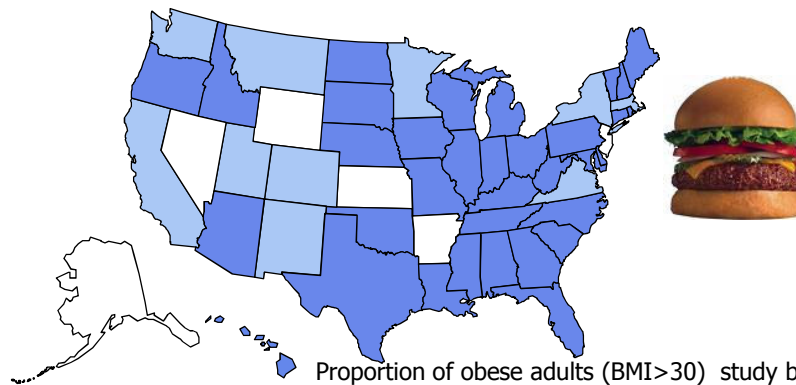
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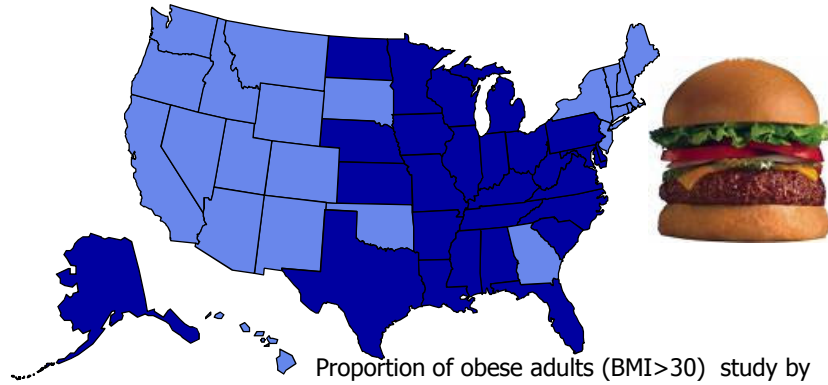
US, 1990

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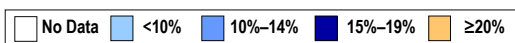
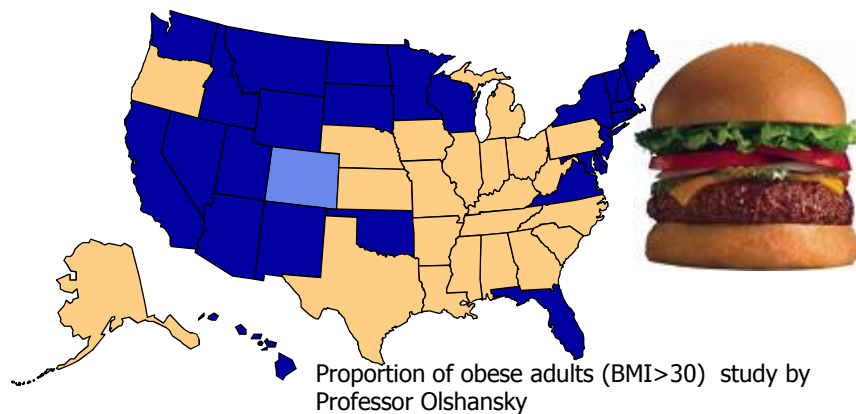


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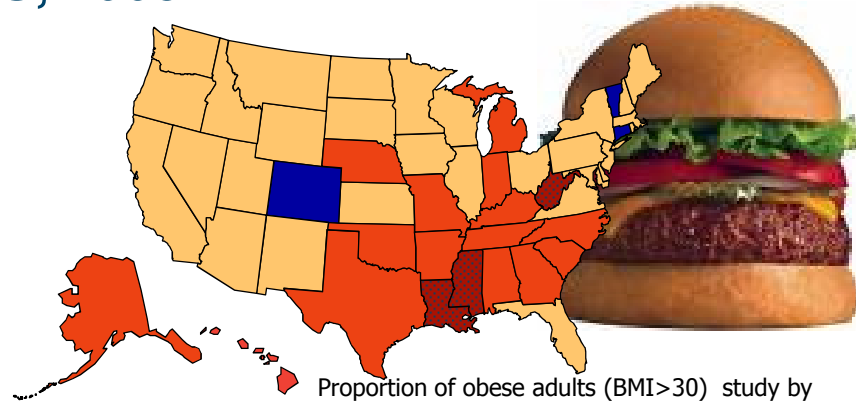
US, 1995



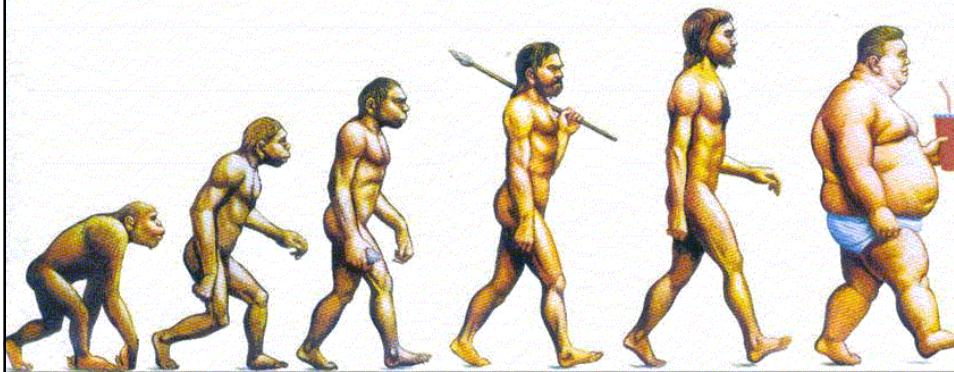
US, 2000



US, 2005



The evolution of man?



The “Turner” Pensions Commission

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Lord Turner concluded that society and individuals must choose between 4 options:

1. Pensioners will become poorer relative to the rest of society; or
2. Taxes devoted to pensions must rise; or
3. Savings must rise; or
4. Average retirement ages must rise

(a pity he wasn't allowed to say what went wrong)

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The latest Pensions Act

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- ***Reductions to the rate of revaluation for deferred pensions from 5% Limited Price Indexation (LPI) to 2.5% LPI.***
- ***Simplification to certain requirements relating to pension sharing on divorce.***
- ***Provision for Pension Protection Fund (PPF) compensation to be shared on divorce.***
- ***Provision of more detail in relation to personal accounts***

And what was not in the Act

**Even the slightest encouragement for good employers to offer good pensions
And continued refusal to help fill the very wide space between DB and DC**

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Déjà vu?

- Stakeholder is pretty much dead in the water
- Why will “NEST” be any different?
- And NEST more than likely to be delayed after the election
- *Remember – it is the lower paid who most need good pensions*



The unreported DC crisis!

Maturity date	Fund	Annuity rate	Pension
Jan 1996	£287,413	79.14	£22,706
Jan 1998	£263,716	66.16	£17,407
Jan 2000	£242,842	59.47	£14,404
Jan 2002	£206,501	56.7	£11,669
Jan 2004	£148,725	44.6	£6,593
Jan 2006	£121,452	41.2	£4,964

(A man saving £200 per month up to age 65)

NPSS: Turner's 2003 view! **Barnett Waddingham**

"Is (a switch) to DC inevitable? Some say yes...but we can't be so sanguine. Above a certain level of income and wealth it is reasonable..for people to be exposed to significant risk, there are real issues about increasing numbers of low income people being exposed to high return volatility as state provision becomes more basic and private DB provision retreats. Employers are concluding that (DB) risks are too high and are switching to DC. But we do not need to take the either/or approach. The big problem with DC is the irrational volatility of return. (We can construct part DB part DC contracts which remove (investment) risk from the individual to the corporate...assure workers a proportion of average salary rather than final salary and which promise it at a retirement age not fixed in advance. We should be encouraging employers to think of these intermediate approaches. If we do not the ..the alternative is almost bound to be a shift to DC pure and simple....opposition to retirement age flexibility in DB schemes could kill DB schemes entirely."

(Lord Turner: Staple Inn
2nd September 2003)

HEAR HEAR!

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Why don't employees value pensions?

- retirement is "too far off"
- lack of understanding
- "saving is boring"
- Competing needs (housing)
- "the State will provide"
- Reports of plans in trouble
- Equitable / Rock collapses
- Poor stock markets

**The solution has to involve
workplace pension plans**

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And for employers...

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- Reasonable excuses
 - Existing compliance costs are high
 - The economic conditions are tough
- Less reasonable excuses
 - “Employees don’t value pensions!”
 - “Sort the public sector out first”
 - “Employees are too mobile these days”
 - “It’s the market rate of contribution to DC”
- ...some flexibility is needed to help companies, however



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A new UK model plan?

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- ✓ 1% CARE (*i.e. career-average earnings*)
- ✓ NRD 68 in 2030
(*increase thereafter with longevity*)
- ✓ Lump sum accrual on top (eg 5 x pension)
(*payable at, say, 65*)
- ✓ Conditional pension indexation
- ✓ Dependants’ pensions?
- ✓ In PPF but lower premiums?



***Might cost 15% of earnings, split 10% e'er
and 5% e'ee. Just as it used to be!***

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More imagination

- Employees under 40 unsure where they should commit savings
- Offer the chance of cash ISAs in the early years
- Still get tax relief on roll-up...
- ...but with access to cash for specific needs (eg first house deposit)
- Or transfer into the pension fund with tax relief at a later stage

Higher Earners

- **Let down by the 2006 “A Day” tax reforms**
- **New rules are over-complicated and unfair**
- **Puts decision makers off pensions**
- Restriction of tax relief on high earners’ pension accrual/ contributions from April 2011
- Small increase in income could have big tax consequences

EFRBS could help

- **Employer-Financed Retirement Benefits Scheme**
- **Unaffected by new charges or the LTA**
- **No income tax or NIC on contributions**
- **No Investment restrictions**
- **Flexible benefits**

But...

- *Corporation Tax is deferred*
- *Investment returns are taxed at trust rates*
- *...unless the EFRBS is offshore*

Tories:

“Providing for Pensions”

- **To restore the health of occupational pensions**
 - **Ensure adequate security**
 - **Encourage savings through rewards not penalties**
 - **The 2012 reforms will be addressed (?)**
 - **Auto enrolment may be brought forward**
 - **Hybrid schemes will be “explored”**
 - **The age 75 annuity obligation will be reviewed**
 - **Link state pensions to earnings, paid for by raising ret. age to 66 (2016 for men; 2020 for women)**
 - **Raise the default retirement age**
 - **Consider early access to pensions savings**
- (Theresa May – “Politeia 23 Feb 2010)

Default Retirement Age

- Currently age 65
- Criticised by the European Court
- The next government very likely to remove it or increase it
- *A new incentive for better pensions?*
- **Employers will have a business reason to help employees afford retirement**

First “easy” steps

1. Commit to an independent pensions commission to vet all regulation
2. Legalise “risk-sharing” pensions
3. Raise state pension age further and improve the benefit
4. Link pension age automatically to longevity
5. Amend the “no worse off” rule on pension changes to value rather than amount
6. Abolish future compulsory pension increases (private and public)
7. Simplify tax rules, and link them with “anti-discrimination”

**Good pensions?
or
*Guaranteed pensions?***

**Be in no doubt.
It was regulation that killed the British
pension scheme.**

And only government can mend the damage