Biennial Review

ACA Retirement Income Manifesto

Time to get positive about Workplace Pensions

Pension Trend Survey Results

April 2010

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ABOUT THE ASSOCIATION

The Association is the representative body for UK consulting actuaries and is the largest national grouping of consulting actuaries in the World.

The Association draws its membership from individual actuaries working in the consulting sector. Our members are all qualified actuaries – mainly Fellows of the Faculty or Institute of Actuaries. All actuarial advice given by our members is subject to the Actuaries' Code.

The Association has over 1,750 members working in around 75 firms.

The ACA has as its purpose to provide leadership on issues having a bearing on the actuarial consulting sector and to influence decisions made by the Government, regulators and other bodies within and outside the UK. This is achieved by:

- *promoting* the importance of the work done and services provided by consulting actuaries
- *providing* leadership and guidance to the sector on issues which may affect its public image and reputation
- *researching, analysing* policy and *making representations* to decision makers and other opinion formers to secure improvement in the legal and regulatory framework in areas where consulting actuaries work and are qualified to speak
- *facilitating* the exchange of information and deliberations between ACA Members on matters which concern them and other organisations that work in the same fields as the ACA and its Members
- *working* in liaison with the Actuarial Profession to develop the role and enhance the standing of the consulting actuary.

CHAIRMAN'S INTRODUCTION

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"We cannot rely on NEST and auto-enrolment alone"

"Challenge for new government of whatever colour"

This year's *Biennial Review* not only looks at the activities of the Association over the last two years, but also examines the challenges presented by economic, demographic and regulatory issues, all of which are having a profound impact upon future retirement income provision in the United Kingdom.

Gone are the days when we could be satisfied that the private pension regime we were building was one of the best in the world. Although, by and large, public sector employees enjoy the same quality of pension provision that was available a decade ago, the vast majority of our 'quality' private sector schemes are now closed to new entrants and increasingly to existing employees. Where new pension schemes are being opened, many offer the likelihood of much reduced pension outcomes compared with the schemes they are replacing. They also offer, in all probability, greater volatility in the retirement income that can be expected. Such changes cannot be viewed as anything other than disappointing.

Whilst the Government has seen the need to respond by pursuing reforms to extend pension provision to more private sector employees – a policy objective which we support – considerable doubts remain as to whether the re-named National Employment Savings Trust (NEST) scheme – formerly Personal Accounts – is enough. For those who are enrolled, questions remain as to whether it will provide the level of pensions many members will need in the century ahead and the reasonable certainty of that income. Moreover, there is too much recent evidence, not least from our own *2009 Pension trends survey* and those of other organisations, that the combination of auto-enrolment and NEST present a genuine threat to ongoing 'quality' schemes, where sponsors are disillusioned by rising costs and uncertain forward liabilities and their inability to reduce and cap these under existing legislation.

This picture of declining coverage by 'quality' provision, increasingly affecting younger employees and those who move jobs (both vital to the dynamism of our economy), and uncertainty over the ability of defined contribution arrangements – NEST or otherwise – adequately to fill the gap in terms of the reasonable certainty of income pensioners need, has prompted us to call for legislative changes over the last few years.

As part of our *ACA Retirement Income Manifesto,* published ahead of the forthcoming General Election (see page 3), we want to see the political parties making a commitment to reforms specifically aimed to provide employers with new choices in pension design. These should give employers the ability to offer pension schemes that are more flexible and more certain in costs and forward liabilities than existing defined benefit schemes, whilst offering retirees greater certainty in their retirement income outcome than defined contribution schemes, where 100% of investment and longevity risk is placed with the employee/scheme member. To date, the present Government has been unenthusiastic in its support for these new 'middle way' types of pensions, despite the clear evidence that existing options under current law are not fit for purpose. It is to be hoped that all of the political parties consider supporting the key aspects of our manifesto as they finalise their pension policies for government – we believe the measures in our six point plan offer the opportunity to shake off the downward trend in workplace pensions so evident over recent years.

In this review, we try to move beyond the despair that so permeates pension provision these days. It really is time we 'got positive' about what can be done to deliver good pensions if we set our minds to that purpose.

I hope you find the review both interesting and useful.

Keith Barton
Chairman

ACA RETIREMENT INCOME MANIFESTO: SIX POINT PLAN

Overall philosophy: future UK retirement income policy should focus on the promotion of a wide range of flexible retirement income arrangements, as part of a holistic approach to encouraging lifetime savings. Financial incentives should be greater for longer-term savings over short-term savings, with legislative and regulatory prescription minimised, whilst maintaining the protection of members' pensions in all types of schemes from the impact of employer or provider insolvency or default. In the new Parliament, the Government should legislate to:

1. **Establish a standing Independent Retirement Income Commission** charged with promoting the active extension of private retirement income provision and making recommendations on the future of State and public sector retirement provision (suggested remit - see page 4).

2. **Encourage employers to offer high quality workplace retirement income schemes by making legislative changes to allow greater design freedom for 'middle way' schemes**, where employers' costs and liabilities can be more easily capped whilst providing reduced volatility in retirement income outcomes for members compared to pure defined contribution schemes.

3. **Allow all private and public sector retirement income schemes to automatically link the age at which retirement benefits are paid (without reduction) to improvements in longevity** as recommended by the Independent Retirement Income Commission, but with those individuals within ten years of a scheme's present normal retirement date protected; this to be reviewed triennially.

4. **Provide greater incentives for retirement income savings by allowing early access to (e.g.) the tax-free lump sum currently available only on retirement** to help fund house deposits and/or to meet life's crises.

5. **Reform annuity rules by allowing greater flexibility so annuities can be purchased with variable levels of benefits through term, including allowing full commutation (subject to tax) of pensions in excess of a level clearly sufficient to ensure an individual will not be eligible for means-tested benefits** throughout their retirement.

6. **Allow all retirement income schemes to require either (a) defined contribution deferred members to transfer benefits on leaving an employer to one of a number of centralised schemes** (possibly including NEST) to hold and ultimately pay such benefits, or **(b) that defined benefit member's benefits be bought out in a non-profit deferred annuity in the member's name.**

PROPOSED REMIT OF THE RETIREMENT INCOME COMMISSION

The Commission would review public policy in respect of its success in achieving improvement in retirement incomes from State and/or private retirement income plans and their sustainability, whilst also making policy recommendations to Government after 12 months from establishment and every three years thereafter:

A suggested remit would be as follows:

- reviewing the structure of State pensions and the Government's timetable for raising the State Retirement Age to reflect both improvements in life-spans and overall financial costs to the taxpayer (given the current commitment to index the BSP in line with earnings in the future).

- advising every three years on the need or not for a general increase in retirement age to reflect increases in longevity so as to keep pension funding costs broadly stable in this respect over the long-term where scheme specific information is unavailable.

- recommending policies designed to encourage more employers and employees to invest in retirement income plans, including measures to maximise design flexibilities and choices, advising on financial and tax incentives to encourage wider coverage, whilst taking account of the UK economic, demographic and financial backcloth and life-style changes.

- promoting legislative and regulatory simplification to encourage quality provision, accepting that legislation must continue to protect members' retirement incomes from the impact of employer or provider insolvency or default.

- at the request of Government, reviewing on a periodic basis the structure and rules of the NEST scheme to ensure employees are offered an appropriate fall-back retirement income plan where no better scheme is offered by a sponsoring employer.

- ensuring that over the long-term, the cost of public sector unfunded pensions, and those that are largely funded by the taxpayer, are transparent in cost to the taxpayer and are sustainable.

- reporting (within six months) on matters referred by Government to the Commission on an ad hoc basis and also on European directives that could have an impact on any of the above.

With the Government introducing further legislation in 2007 reforming pensions, we continued to make the case over the last three years that the introduction of NEST (formerly Personal Accounts) was not enough to address the genuine pensions crisis in the private sector, where the closures of good pension schemes has accelerated in recent years.

During 2008/2009, we refined our recommended reforms during the consultation phases associated with the *2007 Pensions Bill* and in particular we concentrated on the promotion of new shared risk pension schemes and reforms that would lighten the burden falling on existing schemes. Our proposals were designed to be easily incorporated in the Bill and existing legislation without undermining the current pension architecture. These were argued for in written responses, press releases and reported speeches of the Chairman. Meetings were held with DWP Officials, MPs and Ministers to further advance the case and additionally with other organisations such as the CBI and fellow pension bodies, such as the NAPF, both of whom were broadly supportive.

Over the period, briefing papers were forwarded to DWP Officials and interested MPs on a regular basis to keep them appraised of developments. And a submission was produced to the DWP's consultation on *Risk Sharing* which was announced during the Committee stage of the 2007 Bill in response to a formal amendment to the Bill, drafted by the ACA with technical support from the Association of Pension Lawyers, and proposed by HM Opposition.

Over the period there were meetings with the then Pensions Reform Minister, Mike O' Brien (and later Angela Eagle), Lord McKenzie and members of his DWP team, the Shadow Secretary of State for Work & Pensions (Chris Grayling, then Theresa May), the Shadow Pensions Minister (Nigel Waterson) and their Lords' Shadow Minister, Baroness Noakes and the Liberal Democrat spokespersons, at which we pressed the case for reform.

In the end, the *2008 Pensions Act* was a missed opportunity with the Government enacting very few reforms that would either help existing quality schemes to be kept open or to promote new pension designs other than NEST, which is intended to fill gaps where no current pension provision is available, rather than be the design of choice for all employers. Unfortunately, as we predicted at the time, closures of quality schemes have accelerated still further since the passage of the *2008 Pensions Act*.

Undeterred, we have continued to argue the case for legislative reforms for employers to be given greater freedom to offer new 'middle way' pension designs. This has involved continued contact with the Government, the Official Opposition, business and pension trade bodies. As we move towards the General Election, we hope that all the political parties recognise that some greater freedom in design, offering a greater ability for employers to choose 'middle way' approaches, is essential if we are not to have a position where more and more private sector employees are exposed to a restrictive choice and volatile and inadequate pension outcomes.

Missed legislative opportunity

Association continues to prosper

Aside from this campaigning work, the ACA continues to offer a wide range of other activities for our 1,750 members – a figure that continues to rise from year to year.

Monthly sessional meetings in London have continued to attract attendances of up to 270 members and have been supported by two series of regional meetings in Scotland, the Midlands and the North each year. The 2009 annual dinner was held at Claridge's and was addressed by Sir Nicholas Montagu, former Head of the Inland Revenue and the ACA Charity Golf Day again raised funds for the sports charity for disabled children, *Get Kids Going!*

Over 380 members attended the most recent Members' Conference at Gatwick which included over 20 technical seminars, together with a separate half-day seminar on international aspects. In 2009, this included a session on US pension trends, run in association with the Conference of Consulting Actuaries (CCA) and the International Association of Consulting Actuaries (IACA). Later in the year, ACA speakers addressed the CCA's conference in Tucson, Arizona.

The ACA in Committee

No summary of the ACA's activities would be complete without including a review of the work undertaken – all on a voluntary basis – by ACA members through our various specialist Committees.

Accounting Committee

The **Accounting Committee** met in November 2009 to discuss the Accounts TAS (Technical Actuarial Standard) consultation paper as issued by BAS. We see ACA members as being key users of any such TAS that is issued and thus it is key that we respond to ensure we influence the outcome.

Also, in the relatively near future the Committee expects the IASB to issue an Exposure Draft setting out amendments to IAS 19 which will significantly change the presentation of pension numbers in company accounts. It seems likely that those proposals will be unpopular with preparers of accounts and hardly more helpful to users of accounts than the current IAS 19. Based on the deliberations by the IASB it will be important that responses to the Exposure Draft provide clear and well reasoned objections and alternatives. The greater the extent of agreement in responses by a variety of respondents (preparers, users, accountants and actuaries being the main classes) the greater the prospects of successfully influencing the future changes.

The IASB has also indicated that as part of its preparatory work for the next phase they will ask for input from actuarial bodies regarding the appropriate measurement basis for pension liabilities. This request could turn into a very politically sensitive issue as whatever answer might be reached it is not going to please everyone. At the least it could be seen as "sharing the blame", if a consensus is reached on a measurement approach. At the worst it could be "if the actuaries cannot agree on the appropriate measurement approach then just picking the one that is most consistent with other accounting provisions cannot be unreasonable".

We note that the IASB's recent Exposure Draft attempting to amend the discount rate derivation under IAS 19 was shelved in light of feedback so we hope that the IASB will listen similarly to any concerns raised by responses to its anticipated Exposure Draft making wider changes to IAS 19.

General Insurance Committee

The main concern for the **General Insurance Committee** is that the position and role of consulting actuaries in the sector is furthered, working closely with the Actuarial Profession.

The main areas of activity for general insurance actuaries in the past year have included:

- Impact of the Global Financial Crisis and the emergence of claims against advisers in the wake of Madoff, Stanford and other financial scandals.
- Impact of the turmoil in global markets and effects of movements in rates of exchange and credit default risks.
- Impact of Solvency II and its effect on distribution, pricing, product design and capital requirements for general insurers.
- Pricing and Reserving for liability business with significant changes in frequency and severity of losses.

Investment Committee

The **Investment Committee** organised a seminar at the Members' Conference entitled *The Outlook for pension scheme investment* hosted by Emma Dowell, Andrew Wilson and Antony Osborn-Barker. This focused on what the main priorities for trustees might be over the forthcoming year. In the seminar the evolution of new governance models was explored given the increasingly complex investment background that trustees face. It also covered the increasing focus that trustees are giving to sponsor covenant and risk controls given the uncertain economic outlook. As part of the debate the seminar considered how far the current market environment should drive the timetable for the de-risking strategies that many trustee boards are currently contemplating.

At an ACA evening seminar held in February 2009 Brian St John Hall and Alvar Chambers considered the good performance of liability driven investment strategies over 2008 compared to more traditional investment arrangements. The seminar examined whether the dislocations in the swap and bond markets presented any opportunities for pensions schemes and went on to discuss a variety of possible transactions that could help pension schemes achieve their LDI objectives more efficiently in the current investment climate.

The Committee also contributed to the investment consultation paper in respect of NEST issued by the Personal Accounts Delivery Authority.

Life Insurance Committee

The **Life Insurance Committee** drafted the ACA's response to the ABI consultation paper on the use of external actuaries to review the work of in-house actuaries in certain circumstances. Generally, the Committee was supportive of the ABI's proposals, provided the external reviewer had the appropriate experience and access to other expertise if he needed it to undertake the review.

In the second half of 2009 the Committee organised an evening seminar with a Solvency II presentation from the ABI on the implications of Solvency II for both insurance and pension annuitants. The Committee also responded to BAS consultation papers, most recently on the proposed Insurance TAS. Whilst generally supportive of the aims of the Insurance TAS, the response called for this to be flexible and recognise the commercial environment consulting actuaries work in and not to place unnecessary restrictions on them.

Local Government Committee

This has been a busy period for **the Local Government Committee** as a result of ongoing activity regarding changes to the Local Government Pension Scheme (LGPS).

The main focus has been input to Communities and Local Government (CLG) in respect of development of a cost sharing mechanism for the LGPS. Input by Committee members has been achieved by representation on the Policy Review Group as 'impartial experts'. The Committee also provided some input to the Cipfa Pensions Panel.

The Committee has also been represented on the Officer Advisory Group and the Local Government Pensions Committee. In addition, meetings have been held directly with Government and the Government Actuary's Department (GAD) in respect of cost sharing and issues in relation to the forthcoming round of valuations in England and Wales as at March 2010.

The Committee has facilitated the supply of data by represented firms to the Government Actuary's Department to enable development of a Dummy Model Fund as a precursor to establishment of a National Model Fund to guide the cost sharing process. The Committee has also considered various data specifications issued by GAD and fed back comments to CLG.

Pension Schemes Committee

The **Pension Schemes Committee** has been exceptionally busy and has responded to over 40 consultation papers in the last year alone. Each year, the number of bodies consulting seems to expand, with PADA and the DWP Select Committee being added to the list this year. The Committee has endeavoured to provide straightforward constructive feedback on consultation documents, spelling out our alternative proposals where the Committee believes that the proposed direction needs changing.

This year, the Committee has been asked to be represented at a larger number of meetings than in the past, including:

- a number of meetings with DWP on their deregulatory work and on the terms for pension schemes which exempt employers from contributing to NEST
- PPF on the future development of the PPF levy
- BAS on TM1 and the Pensions TAS
- The Joint Working Group

It is not expected that the workload will reduce in the period ahead and it should be noted that the outputs achieved are only possible due to the tireless support of a very active committee.

Pensions Taxation Committee

The **Pensions Taxation Committee** has also experienced a particularly heavy workload thanks to the 2009 Budget announcing major changes to the tax reliefs for pensions for "high earners" from April 2011, with immediate "anti-forestalling" provisions effective from April 2009 to prevent individuals accelerating their pension savings to take advantage of current tax reliefs while they still exist.

The "retro-acting provisions" created substantial urgent work for the Committee and included drafting a response to the invitation to improve on the Bill provisions as they applied for those who have made irregular contributions in the past; and preparing a overall more detailed initial commentary on the draft legislation.

More recently the Government issued a consultation on its stated policy from 2011 on how this will be implemented in practice, alongside further changes in the threshold announced in the December 2009 Pre-Budget Report.

The Committee's work has also focused on matters relating to the pensions tax regime introduced by *Finance Act 2004,* as revised by subsequent Finance Acts, and on related regulations; and the Registered Pension Schemes Manual (RPSM) giving HMRC's guidance on the regime and interpretation of aspects of the law.

The 2008 Budget announced the new simplified trivial commutation facility for occupational pension schemes, on a per-scheme basis for benefit values up to £2,000; and some other new provisions to assist in avoiding "stranded funds". HMRC presented draft regulations to give effect to this in March 2008. The Committee reviewed these and co-ordinated input from several pensions bodies, to provide detailed suggested changes to HMRC to make the regulations as workable as possible, and there were various subsequent discussions with HMRC.

Other areas of the pensions tax regime that came under our consideration, some of which involved formal representation either directly for ACA or via JWG, include comments on draft regulations; response to consultation from HMRC on how HMRC should best communicate to "the man on the street"; input on the difficulties involved in the collection process of taxes associated with unauthorised payments; and obtaining formal clarification on Finance Act 2004's constraints on pension decreases in times of deflation.

Public Relations Committee

During the year, the main area of activity of the **Public Relations Committee** has been in support of the pension reform campaign of the ACA referred to in the introduction of this section. This was against a back-cloth of the debates and consultations ahead of the passage of the *2008 Pensions Act*, the ongoing deregulatory review of private pensions and the promotion of an amendment to the legislation to allow for conditionally indexed schemes.

The ACA continues to act as the Secretariat to the All-Party Parliamentary Group on Occupational Pensions. Members of the Group regularly attend ACA events and draw on the Association for help when considering pension issues in the House. Recent meetings of the Group have been addressed by Helen Dean, Policy and Product Development Director at PADA, Alan Rubenstein, Chief Executive of the PPF, who was guest at the annual lunch, and Andrew Vaughan and Dr Deborah Cooper, who spoke to the group on the need for 'middle way' pensions.

Over the period, the PR Committee managed the production of the reports of the *2008 ACA Smaller firms pension survey*, which attracted 394 responses from firms employing 250 staff or less and then of the *2009 Pension trends survey*, which attracted 309 responses from employers of all sizes. Copies of the reports were circulated widely to the press, Ministers, Opposition spokespersons, civil servants, trade and professional bodies, as well as think tanks. Media coverage of these surveys and the issues raised by the results was very good, including articles in most of the national newspapers, as well as TV and radio coverage.

Public Sector Outsourcing Committee

The **Public Sector Outsourcing Committee** was established in August 2007 to reflect the increasing complexity of the legislation and guidance covering the pensions and related benefits which are provided to employees who are transferred out of public sector employment under Public Private Partnership (PPP) outsourcing contracts, such as the Private Finance Initiative (PFI) and the Best Value requirements which apply to local authority employers.

Over the period, the Committee met with representatives of the Confederation of British Industry (CBI) to discuss and provide input to a CBI report on reform of pensions provisions in public sector contracting.

The Committee also made submissions to two Government consultations relating to the LGPS:

- In April 2008 regarding the DCLG review of the Admission Body Arrangements in the LGPS.
- In April 2009 regarding the draft revised guidance issued by the DCLG on the operation of LGPS admitted body status provisions

Small Schemes Committee

The main item of interest to the **Small Schemes Committee** has again been around developments concerning the 2006 tax simplification changes (e.g. the freezing of the Lifetime Allowance announced in the November 2008 Pre-Budget Report and HMRC actions on QROPS during the course of 2008).

More recently, the 2009 Budget announcement regarding restrictions on higher rate tax relief for pensions has raised major concerns for employers running smaller schemes and their members. The Committee has liaised closely with the Pensions Taxation Committee on this matter along with the Association of Member-Directed Pension Schemes (AMPS).

Smaller Firms Committee

Sessions for smaller firms have again been organised by the **Smaller Firms Committee** at the Members' Conferences in Gatwick over the last two years. The most recent was attended by about 40 actuaries from 27 different Firms.

Topics covered at the session included expert witness work and pensions on divorce; the impact of recent market volatility on the second round of scheme-specific funding valuations and the work of BAS with particular reference to smaller firms.

2010: IT'S TIME TO GET POSITIVE ABOUT WORKPLACE PENSIONS

In 2010, the new Government must begin to do much more to back employers who are prepared to offer quality pensions schemes in the private sector. The recent survey we conducted on workplace pension trends[i] (further details, see pages 29 – 35) found that just 6 per cent of employers were happy with the Government's record in this important policy area, down from 38 per cent two years ago.

Given this climate, it is unsurprising that as each week goes by we hear of more closures of long-standing, 'quality' employer sponsored schemes, often making way for lower-cost and more lightly regulated arrangements. The rising cost and risks involved with many of these existing schemes that are being closed cannot be overlooked. But, just as important, is the loss of confidence amongst employers that Government is prepared to take the actions necessary to promote good pensions.

Government actions designed to protect existing scheme members' pensions have been and are important, but these do nothing to make sure quality schemes remain open to existing, new or younger employees. Unfortunately, the cost and added regulation from these protective measures has also contributed towards the closure of existing, now over-burdened arrangements.

Getting worse?

But, there could be worse to come! Our pension trends survey also found that as we move towards 2012 – when the Government's low-cost National Employment Savings Trust (NEST) scheme is due to be launched – **15 per cent of employers of all sizes may consider closing their existing pension schemes in favour of offering just NEST to all employees. A further 24 per cent are likely to revise existing pension benefits to mitigate the cost if, instead, they auto-enrol all employees into an existing better scheme.** This duty to auto-enrol all employees into a qualifying workplace pension scheme or NEST will begin in 2012 with larger employers, and then move on to smaller businesses over the next few years, including those with just one employee.

Whilst the ACA strongly supports the extension of pension coverage to more employees – at present over half the UK workforce does not have access to such schemes – we are concerned that not enough has been done to help existing quality schemes or to encourage employers to offer new variants beyond NEST.

We also wonder whether the timing of the launch of NEST and auto-enrolment will give them the best start. We fear opt-out rates could be very high, particularly amongst smaller employers where employees' incomes tend to be lower. ONS figures do not suggest very many employees around and below average earnings (£26,000 per annum)[ii] and certainly around and below median earnings (just £21,000 per annum) have any spare income to devote to pension contributions. Indeed, many are over-committed with debt and everyday spending, even without any extra tax take or benefits squeeze by Government, both of which seem inevitable from 2010/2011 onwards. Without the right economic and fiscal backcloth, a perverse outcome of auto-enrolment could be to make everyday living more difficult for those on lower incomes who fail to be decisive in opting out. That is no way to encourage savings into the longer term, especially given the complex interactions with means-tested benefits.

A recent B&CE Insurance Survey found 28 per cent of people intend to opt out of auto-enrolment ... with 21 per cent saying they could not afford contributions.

The Equality and Human Rights Commission recently reported that 24 per cent of men and 64 per cent of women plan to keep working beyond the State Pension Age.

Is there hope? Step one-the need for later retirement

On State pensions, whilst all the political parties seem committed to linking the Basic State Pension (BSP) to earnings growth within the next 5 years or earlier, it already seems likely that the gradual increases in State Pension Age (SPA), due over the next 40 years (rising in steps to age 68 by 2046), will prove insufficient to keep pace with rising longevity. Currently, longevity is increasing by around one year every 10 years.

The incoming Government, of whatever colour, needs to take a second look at the timescale for increasing SPA and face the need for accelerating the changes. Inevitably, an earlier move in SPA will drive adjustments to both private and public sector pension schemes. As the dependency ratio deteriorates and longevity improves (fewer at work, supporting more retired and young people not at work), the reality is that good pensions can only be granted by the State and private employers into the future if we recognise that advances in longevity must lead onto longer working lives and later retirement, or higher pension contributions.

Whilst the State pension changes following on from the Pensions Commission reports seem to have widespread backing across the political divide, the future pressures on Government finances and the need to focus resources could easily mean a re-think in the not too far distant future. Already, some (including Lord Turner himself) are calling for the increases in SPA to be accelerated. And proposals to allow NEST members to concentrate the decumulation of their savings to boost income in the early years of retirement, with a much higher BSP applying from, say, age 75 may suit both individuals and Government.

To address the need for changes in retirement ages and to keep State, public and private pensions responsive to economic, regulatory and demographic changes, we believe there is a need for these matters to be kept under review by a standing Retirement Income Commission, charged with making recommendations to Government on a periodic basis. This is part of our *Retirement Income Manifesto* (see page 3 and 4).

A key mission of this body would be to make recommendations on how to promote 'quality' pension provision over and above base levels – a step well beyond the regulatory architecture of today which focuses on protecting the pensions of existing pension scheme members. We have called on the political parties to make a commitment to promoting this wider objective in their respective manifestos ahead of this year's General Election and in their actions thereafter.

Is there hope? Step two – greater pension design freedom

On private pensions, for the last 5 years or so we, and others, have called for legislative changes that would allow employers the option to offer a wider choice of 'middle way' quality pensions. The articles in our discussion paper *Placard*, enclosed in the back-pocket of this review, enlarge upon the possibilities for sensible reforms. These reform options would include the ability to deal with increasing longevity, as well as providing funding respite in difficult financial markets. Middle way schemes would still protect members against the consequences of employer or provider failure, and would provide greater certainty of benefits for members compared with defined contribution schemes, where volatility in outcomes remains a major hazard, particularly for those on lower incomes and with limited other savings.

New middle way schemes would offer greater certainty of cost for employers than current defined benefit schemes, the vast majority of which are now closed off to new and, increasingly, existing employees. And, importantly, the designs would recognise the efficiencies in collective schemes that can add a significant amount to pension outcomes as compared to individual defined contribution contracts.

Greater certainty of costs for employers

These new designs should also feature greater flexibility to allow early access so members can remove a proportion of funds to help, for example, with house deposits or life's emergencies. As pensionable age moves ever later as life-spans extend, the public will expect a right to access funds that are otherwise locked away for many years. Quite reasonably, such changes need also to be extended to existing schemes, wherever possible.

Whilst HM Treasury has been resistant to reform of annuities, there seems to be a groundswell of opinion across the body politic in favour of further restricting the compulsion to buy an annuity, allowing savers above a certain 'pot' size greater freedom to invest and retain capital, with any compulsion at a later age. There is also growing interest in greater flexibility as to when and how annuity income might be structured.

Demand for new generation of 'quality' pensions will grow

Is there hope? Step three - retirement income: what should the target be?

Over the next few years controlling future pension liabilities and crystallising existing ones, where financially feasible, is a clear priority for employers with legacy defined benefit schemes. However, over the longer term the level of replacement income in retirement that workplace retirement plans produce is likely to be of mounting concern to employees and those many employers who appreciate the value of benefits beyond the here and now.

For employers, the ongoing need to recruit and retain the best and most skilled employees will not diminish. Indeed, their value will be enhanced in an advanced knowledge-based economy. The obligations on sponsors of existing schemes, much enforced by legislation and regulation post their introduction, has destroyed many private sector 'quality' schemes for existing employees. **However, we believe the demand for a new generation of 'quality' pensions will grow in importance as the public's awareness of the need for a meaningful private retirement income over a long period is better appreciated.** Already, the rising number of over 65s at work indicates the pressures on personal finances and recent surveys suggest we are only at the early stages of a wider realisation amongst those approaching the current normal retirement age of the worries ahead.[iii]

The likelihood that the default retirement age of 65 will be removed or extended in the not too far distant future may also prove significant. It will become increasingly important that employees have good private retirement income prospects, otherwise many more employees will feel they have to work on to afford a semi-comfortable income in old age. The absence of a good pension will present considerable managerial challenges. Coping with ageing workforces, reluctant to make way for younger generations will not be easy in such circumstances.

For employees, the contribution from private pensions and savings will become ever more important for a comfortable or semi-comfortable retirement. It is not difficult to picture the situation where the relative scale of State benefits available now to pensioners and others may deteriorate in value or coverage as the economic and demographic challenges of an ageing society mount up. Reliance on State benefits may lead to a very uncertain and unwelcome future.

As things stand, an employee on average earnings (currently £26,000 pa), contracted-in to the State Second Pension (S2P) can expect his or her State pensions (with a full NI record) to deliver replacement income at retirement of around 25%-30% of earnings. To achieve a replacement income, before tax, of 65%-70% of pre-retirement earnings would therefore require a private pension delivering an additional 40% of replacement income. But, what does it cost these days to target such a replacement income figure?

Let us assume an individual is aged 30 now, having made no private pension contributions to date – an increasingly prevalent situation. The expectation now might be to retire at age 68 – the State Pension Age as it then will be (in 2048) under current Government plans.

Depending on the individual's retirement objectives, the scale of private pension contributions into a defined contribution scheme necessary to target a 40% replacement income on retirement over the period would be of the following order:

	Private pension contributions needed (as a percentage of earnings): Employee + Employer	
	Employee	Employer
Single pension to keep pace with inflation	**4%**	**6%**
Single pension to include a 25% maximum tax free lump sum on top of 40% replacement income	**4%**	**10%**
To include a pension for your partner (no tax free lump sum)	**4%**	**8%**
To include a partner's pension and a 25% maximum tax free lump sum on retirement on top of 40% replacement income	**4%**	**12%**

(**Note:** Current age 30 with no private pension savings to date, retirement age 68. Figures are derived from the FSA's *Moneymadeclear* website, which gives general information. The above is not advice, nor can it take account of individuals' particular circumstances. For advice with a view to making decisions about individual circumstances, readers should consult a financial or other professional adviser.)

The above example, whilst it assumes no private pension contributions from age 16 to age 30, when many individuals will be repaying student loans or saving for house deposits etc., does assume persistency of contributions from age 30 to retirement and national insurance contributions for at least 30 years (the minimum required now for a full Basic State Pension). As many people have interrupted careers, or move from one career to another reflecting changes in the economy, it would be wise for individuals to save additional monies to help meet the likely cost of any interruptions.

The scale of the difference in contributions needed to target a single pension increasing with inflation and that to deliver a pension for a partner as well and/or a 25% tax free lump sum on top of the 40% target replacement income, as can be seen, is significant. **This underscores the need to plan early to meet such eventualities and to seek advice on a regular basis to ensure financial plans respond to changing family circumstances and life-style aspirations.**

Whilst the above example relates to a defined contribution scheme, the levels of contributions needed to fund a defined benefit scheme or a 'middle way' risk sharing scheme would be similar, if the benefits target was also similar. In most cases, we would expect such schemes to deliver any target replacement income with less volatility and, additionally, benefits might well be more generous for members as the contributions would be invested in collective arrangements, where appreciable cost savings can be achieved and, hence, either higher pensions or wider benefits (such as higher levels of life cover) could reasonably be targeted.

Figure 1.

Targeting a replacement income of 40% of earnings: what pension contributions are needed?

The assumptions used in any projection are key in delivering these numbers, but it remains the case that if employers and employees combine together, 'reasonable', if not generous, retirement incomes are achievable for many more of our citizens, probably at costs somewhat lower than many might expect, even when retirement planning is delayed for a number of years.

This conclusion contrasts with the rather dismal headlines over recent years about deteriorating private pensions if individuals are left on their own to finance retirement incomes from modest incomes. That dismay has also been fuelled by the closure of many existing defined benefit schemes and lower than expected investment outcomes from defined contribution plans, endowments and other savings products over the recent past. However, if we are to avoid ever growing dependency on State benefits (where there can be no guarantee that generous benefits can be afforded into the future) we must look beyond this disappointing recent past and re-affirm that 'reasonable' private pensions are affordable, provided common sense decisions are taken by society as a whole, employers and employees. But, what are these decisions?

Prudent approach: Pension savings of 12 -16% of earnings

To target pension arrangements that can meet the cost of partners' pensions and that provides for the popular lump-sum, whilst also providing adequate levels of regular income, **it would seem prudent for society i.e. all of us - to accept that we need to plan for combined employer and employee private pension contributions of the order of 12-16% of earnings**.

At low to mid-income levels, the Government has effectively targeted a range of replacement incomes under its NEST scheme. We believe the levels of contributions sought from both employers (rising to 3% of band earnings) and employees (rising to 4% of band earnings) are too modest given the changed economic circumstances and the variables involved. **Additionally, the employee 'opt out' that is being allowed, if this persists into the future, will continue to undermine this retirement income objective for many millions of people (opt out rates of upwards of 40% would not be a surprise). And – of course – the reform for those who do not opt out will take at least 30 years to mature in terms of full career pensions being built up by new savers**.

The paucity of our BSP also means that for those on lower incomes, many – particularly pensioner couples supported by just one income – will continue to need State support to boost their incomes if they are to enjoy a life-style above subsistence or poverty levels. In an ideal world, for those who have worked through to retirement, replacement income from State pensions, any private pensions and savings combined should be no lower than the Minimum Income Standard (MIS) for a pensioner couple, currently around £11,000 pa (after housing costs)[iv], which presently equates to around 85% of replacement income for those with a pre-retirement income of half average earnings (£13,000pa). Whilst, pension contributions along the lines of those proposed above would take most pensioners close to this level of replacement income provided contributions were persistent from age 30, it needs to recognised that at lower income levels, some continued and ongoing State support will be needed.

There must also be a concern that the replacement income target from workplace schemes for those on above average incomes may fall away over the years ahead. This may happen as greater employer pension spend is focused on wider coverage of those in lower income groups, as quality schemes close or downgrade benefits due to worries about the additional costs of auto-enrolment and competition from NEST.

Other pressures on savings may come from wider economic challenges over the coming years, such as higher taxes falling on employers (and employees) and reduced pension tax relief as Governments attempt to close the gap between public spending and income. The move from this year to downgrade the State second pension (S2P), which will eventually become flat-rate irrespective of NI contributions paid, is an early sign of these pressures to restrict State spending. The reduction in pension tax relief for those on higher incomes is a more recent example.

The Retirement Income Commission we have proposed would consider just these kinds of issue. **The Commission might, for instance, recommend to Government and employers that by 2020 all workplace scheme designs should target a replacement income equivalent to, say, 35 to 40% of career average earnings after 30-years of contributions, subject to a cap, with much restricted 'opting out' rights over age 30 and a minimum employee contribution of, say, 4 or 5% of earnings. Broad guidance might be given on the total (employer and employee combined) levels of private contributions needed to meet such a target, with these reviewed from time to time.**

Such a recommendation might be conditional on the Government being in a position to adopt a long-term fiscal strategy that would significantly reduce employer and employee tax and NI costs to balance the extra savings needed from many employers and employees. Such a Government commitment is probably some years away in delivery! We have noted earlier that ONS figures suggest very few employees on incomes below average earnings have room for new or additional pension contributions without lower taxes, new incentives to save or radical changes in spending patterns (which Government will find difficult to influence in a free society).

If these kinds of targets for retirement income are to be pursued jointly by employees and employers, the latter will need to address what pension designs are most likely to deliver the desired results, cost effectively and with greatest certainty. Inevitably, this will raise questions about how the volatility in outcomes of defined contribution plans can be softened, raising the need to look at guarantees and the cost thereof and consideration of concepts such as structured DC arrangements. However, softening the volatility in defined contribution is likely to eat into investment returns, particularly from non-collective arrangements, NEST or otherwise.

And, if legislation allows greater design freedoms, employers will want to look at middle way designs that look to share risks between themselves and members – these designs offer the prospect of reduced volatility in pension outcomes, whilst controlling employer costs into the future.

References

[i] ACA *2009 Pension trends survey*, see pages 29 – 39 of this Review

[ii] ONS figures, 2008

[iii] See *The Aviva Real Retirement* Report, February 2010

[iv] The *Minimum Income Standard for Britain (MIS)* was first published in 2008. The standard is based on research into what members of the public, informed where relevant by expert knowledge, think should go into a budget in order to achieve a minimum socially acceptable standard of living. *A Minimum Income Standard for Britain in 2009*, a report produced for the Joseph Rowntree Foundation by Donald Hirsch, Abigail Davis and Noel Smith. For further details go to: www.jrf.org.uk/sites/files/jrf/minimum-income-standard-2009-summary.pdf

Employees also need to ask if the combined employer and employee contributions into their schemes or plans, of whatever design, given the number of years they may contribute, are likely to deliver sufficient income to meet their personal retirement budgets and plans. **We need to recognise that whilst better financial education from school age may increase the numbers able to plan their finances themselves, for the vast majority individual advice will be needed**.

Yes, it's a complex world...

"There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns - the ones we don't know we don't know."

Donald Rumsfeld,
US Defence Secretary,
February 2002

In conclusion

Finally, we must take nothing for granted. Whilst at first hearing, we were amused or bemused by Donald Rumsfeld's perceptions, there really are 'known unknowns' and 'unknown unknowns' that beset the best laid plans. **Both the level and persistence of State and private pensions are dependent on economic success – the projections of any model can be blown off course if economic performance in the UK or worldwide falters for any lengthy period of time.**

We must convey to the public that risks can be managed by careful planning, but that in a rapidly changing world, there can be no absolute certainties promised by either the State or the employer when it comes to the delivery of pension income many years ahead. As a society, via the State or employers, we can target what we want to achieve, but we cannot guarantee the outcome, come what may.

Whilst the major political parties are presently committed to funding an earnings linked BSP, there can be no certainty if UK economic growth remains poor that such a commitment can be honoured in the longer term, even if the pension age moves away from us more quickly than currently planned.

And, as we all know, private pensions are subject to threats from extensions in life-spans, regulatory risks and lower than anticipated investment returns over extended periods. Therefore, it is important that, wherever possible, extra savings are made to cushion against investment returns falling below expectations. **Such are the complexities of the 'known unknowns' allied to the 'unknown unknowns', employers and employees will continue to need expert guidance, probably more so than ever before as we endeavour to build 'good' pensions for many more of our people into the future.**

Consulting actuaries are well placed to lead the way in providing that guidance…

PENSIONS SURVEY HIGHLIGHTS NEED FOR ACTION IN 2010

The results of a survey on pension trends in organisations with combined total assets of £139bn, conducted during 2009 by the ACA, has found 9 out of 10 defined benefit schemes (DB) in the sector are closed to new entrants with 1 in 5 now also closed to future accrual (double that of 4 years ago).

That position continues to deteriorate. Just 6% of the respondents to the survey said that the Government's stated policy of supporting quality pensions was working – this is a real crisis which the next Government needs to tackle as one of its top priorities after the General Election.

The failure of public policy in preserving and promoting quality pensions in the private sector cannot continue, as our latest pension survey results points to more and more employers closing good schemes. It's time for a standing Retirement Income Commission that will challenge the legal and regulatory hurdles standing in the way of sensible long-term pension designs...

KEY SURVEY RESULTS

- **87% OF DEFINED BENEFIT SCHEMES NOW CLOSED ...**
- **59% OF EMPLOYERS SET TO REVIEW PENSIONS AHEAD OF 2012 ...**
- **24% OF EMPLOYERS WILL CONSIDER PENSION BENEFIT REDUCTIONS WHEN THEY HAVE TO AUTO-ENROL ALL EMPLOYEES INTO A SCHEME ...**
- **JUST 6% OF EMPLOYERS SAY GOVERNMENT'S STATED POLICY OF SUPPORTING QUALITY PENSIONS IS WORKING ...**

Pension outcomes deteriorating

Contributions into defined contribution (DC) schemes are increasing slowly, but still over half of all DC schemes reporting to the survey are attracting employer contributions of less than 6% of earnings and less than 4% from employees. As a result, given much lower investment returns in recent years and longevity improvements, pension outcomes for an increasing number of private sector employees are likely to worsen significantly in coming years. Concerns over the affordability of auto-enrolment[1] are a genuine threat to existing schemes of all types, with 59% of employers set to review arrangements ahead of 2012 and a quarter considering benefit reductions to offset the cost of increased membership via auto-enrolment.

With taxes on business and individuals likely to rise over the next few years, it is difficult to see anything other than a deteriorating climate for pension savings unless there is a radical change of approach.

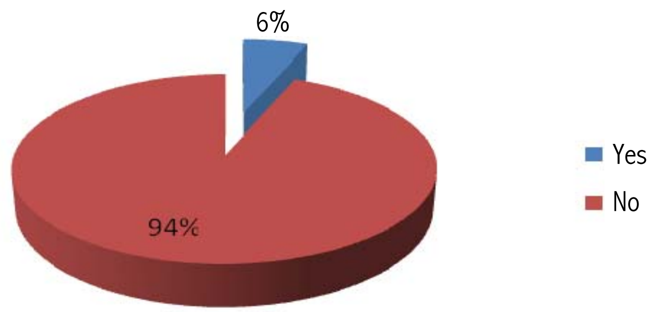
[1] From 2012, larger employers (and later all employers) must enrol all employees over age 22 into either the National Employment Savings Trust (NEST) or a qualifying pension scheme at least equivalent to NEST.

Our *2009 ACA Pension trends survey,* collected responses from over 309 employers of all sizes with combined assets of £139 billion. Key findings featured in the results are as follows (the full statistical analysis is available in the appendix to this Review):

- **stated public policy of supporting quality workplace pensions isn't working**

  Just 6% of employers say the Government's stated policy of supporting quality workplace pensions is working, **down 32 points from two years ago.**

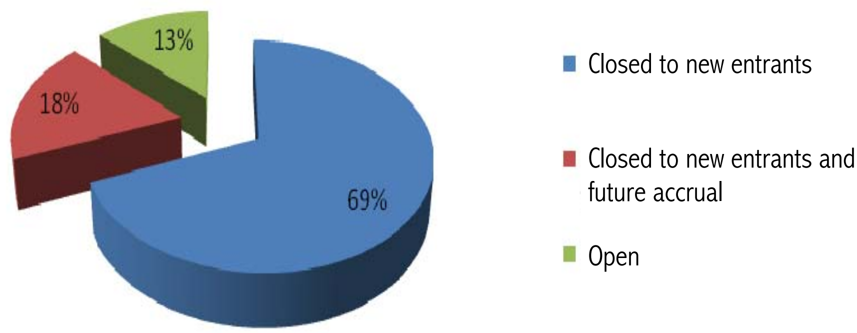
Figure 1: Is the Government's stated policy of supporting quality workplace pensions working?



- **open defined benefit schemes are all but extinct**

  87% of the defined benefit schemes are closed to new entrants with 18% of these also closed to future accruals. A third of these schemes are currently under review, with changes in forward accrual (39%) and a move to career average (35%) being considered.

Figure 2: Status of defined benefit schemes



- **defined benefit scheme funding deteriorates**

  at the time of the survey, 91% of schemes were in deficit, with the average ongoing funding level at 79%, down 8 points on two years ago. A fifth of schemes reported recovery periods of over 10 years.

Funding Level	Percentage of schemes
+ 100%	8% (14%)
+95 – 100%	10% (9%)
+85 – 95%	39% (44%)
+75% - 85%	29% (23%)
Below 75%	14% (10%)
Average ongoing funding level	**79%** (87%)

Figure 3: Bands of ongoing funding level as a percentage of liabilities at the last actuarial assessment

Period over which firms say scheme deficits are expected to be removed.

0 – 5 years	25% (15%)
6 – 10 years	53% (56%)
11 – 15 years	15% (20%)
+15 years	7% (9%)

(Note: Figures in (brackets) are from our ACA's 2007 Pension trends survey)

- **pension costs climb for employers**

  employers funding defined benefit schemes are on average contributing over 3 times as much per member (average 23.2% of earnings) compared to those funding defined contribution pensions (average GPPs - 6.0%; DC Trusts - 6.7% of earnings)[2].

Figure 4: Average of contributions paid into pension schemes (as a percentage of total earnings)

Average employer contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	11.5%	13.1%	15.1%	16.5%	21.0%	22.6%	23.0%	23.2%	18.8%
Defined contribution	5.1%	5.2%	5.8%	5.9%	6.0%	6.2%	6.5%	6.7%	7.0%
Group Personal Pension	5.6%	5.6%	5.8%	6.1%	5.8%	6.0%	5.9%	6.0%	6.0%
Stakeholder (see note)	5.0%	5.2%	4.3%	4.5%	4.0%	4.1%	4.5%	4.5%	5.0%

[2]As most DC schemes are contracted-in, employers (and employees) pay higher NI contributions, narrowing the contribution gap. Most DB schemes remain contracted-out, paying lower NI contributions

Average employee contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	4.3%	4.5%	4.9%	5.5%	5.8%	6.1%	6.1%	6.3%	6.5%
Defined contribution	3.4%	3.5%	4.0%	4.1%	4.1%	4.1%	4.2%	4.3%	4.5%
Group Personal Pension	3.6%	3.8%	3.6%	3.8%	4.0%	3.9%	3.7%	3.9%	4.0%
Stakeholder	3.3%	3.5%	3.7%	3.8%	4.1%	4.1%	4.0%	4.0%	4.5%

Average combined employer and employee contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	15.8%	17.6%	20.0%	22.0%	26.8%	28.7%	29.1%	29.5%	25.3%
Defined contribution	8.5%	8.7%	9.8%	10.0%	10.1%	10.3%	10.7%	11.0%	11.5%
Group Personal Pension	9.2%	9.4%	9.4%	9.9%	9.8%	9.9%	9.6%	9.9%	10.0%
Stakeholder (see note)	8.3%	8.7%	8.0%	8.3%	8.1%	8.2%	8.5%	8.5%	9.5%

(Source: Our ACA 2003, 2005, 2007 and 2009 Pension trend surveys)
Note: Stakeholder figures exclude nil employer contributions made into 22 per cent of Stakeholder schemes

- **support for new 'middle way' pension designs**

  76% of employers say public policy should be more supportive of 'middle way' designs. Half of employers would consider such a scheme, if legislation allowed.

- **one-quarter of employers say they will level-down pensions ahead of 2012**

  24% of employers expect to reduce their existing pension scheme benefits to mitigate the cost of higher auto-enrolled membership, beginning in 2012. **15% are considering closing their scheme altogether, including 41% of smaller employers[3]**. Only 32% of employers have budgeted for the costs of auto-enrolment.

Figure 5: If employers auto-enrol their employees into existing schemes, are they likely to revise benefits to mitigate the extra costs of additional members?

[3]Employers with up to 249 employees

- **NEST should target replacement income with a passive approach**

  47% of employers say the National Employment Savings Trust (NEST) scheme's default fund should target replacement income and should predominantly use passive managers.

- **investment: defined benefit schemes**

  Just 49% of defined benefit scheme assets are now held in equities as funds switch into bonds. The swing to passive management continues. A wider number of fund managers are being used – 14% of schemes use more than ten managers.

- **investment: defined contribution schemes**

  85% of defined contribution schemes offer default funds, up 6 points on two-years ago, with 84% of members estimated to be invested in default funds. **Employers say 76% of members are uncomfortable with the DC risks they are taking on** and **fewer than one in five understand the issues involved**.

"These are worrying times for all those looking to retire in the years ahead. Whilst the Government's NEST initiative eventually may bring on board more pension savers, it has to be remembered that this scheme is designed to 'fill the gap' with a low-level pension, where no better pension scheme exists. Quality pensions require higher contribution levels," says ACA Chairman, Keith Barton.

"Just 6 per cent of employers responding to the survey say they feel the Government's stated policy of supporting quality workplace pensions is working, down from 38% two years ago.

"The huge public policy gap at present is meaningful action to protect good existing private sector schemes and to promote new pension designs that aim to check uncertain and volatile pension outcomes. Our survey found that three-quarters of employers (76%) feel their employees are uncomfortable in taking on the entire investment, inflation and longevity risks that come with defined contribution schemes. However, this is exactly what is happening as defined benefit schemes are replaced by defined contribution.

"In the last year or so, the Government has ruled out changing the law to allow employers to offer pension schemes where indexation of benefits is conditional on a scheme being adequately funded and, more recently, it has blocked collective defined contribution schemes, where there could be efficiencies in provision. The Government seems to think instead that there are lots of 'risk sharing' designs presently available to employers under current law. The reality is that there are very few and these usually involve complexity as schemes are 'manufactured' to meet the different and mutually exclusive legal requirements of the current DB and DC pension regimes. The vast majority of existing so-called 'hybrid' risk-sharing schemes are in fact no such thing. They are just 'sectionalised' schemes where the DB section is usually closed and just a newer DC section is open. Worse still, some schemes which for years have been regarded as DC have been judged to be DB by the Courts.

"Public policy seems to be locked into justifying ever heavier regulation and cost under the banner of protecting accrued benefits for generally older employees, but with scant regard for the future pension security of millions of younger private sector employees. There needs to be a more balanced approach where the rising numbers of under-pensioned in the private sector get a better deal with employers' costs capped and with proportionate protection across all age groups.

"Our survey found 76% of employers want public policy to be supportive of 'middle way' pension designs that look to widen the choice of good scheme that employers can offer to their employees."

Our *2009 ACA Pension trends survey statistical results* are featured in the appendix to this Review.

Statistical Appendix:
2009 pension trends survey results

Pensions Reform:

The run up to 2012

Respondents: 309 employers

Figures in (brackets) are where comparable 2007 figures are available.

Table 1

Breakdown of respondent organisations by number of employees

Up to 249 employees	250-999 employees	1000 employees +
25%	24%	51%

Table 2

Do you currently operate auto-enrolment into your workplace pension scheme(s)? (i.e. employees are automatically enrolled in your scheme on joining your organisation or shortly after joining

	Yes	No
Up to 249 employees	7% (6%)	93% (94%)
250 employees and above	25% (20%)	75% (80%)
All schemes	**20%** (18%)	**80%** (82%)

If 'No', are you likely to decide to auto-enrol all employees into your scheme(s) before it becomes a requirement from 2012?

	Yes	No
Up to 249 employees	13%	87%
250 employees and above	26%	74%
All schemes	**22%**	**78%**

If 'No', are you likely to decide to auto-enrol all eligible employees into your scheme(s) from 2012 or are you likely to continue to restrict entry into the scheme(s), with auto-enrolment into personal accounts (now 'Nests') for those not offered your workplace scheme(s)?

	(a) We are likely to auto-enrol all employees into our workplace scheme(s) from 2012	(b) We are likely to restrict entry into our workplace scheme(s), auto-enrolling the balance of employees into Nests	Neither
Up to 249 employees	17% (31%)	55% (42%)	28% (27%)
250 employees and above	77% (58%)	17% (29%)	6% (13%)
All schemes	**59%** (54%)	**28%** (31%)	**13%** (15%)

If 'Yes' to (b), will those auto-enrolled into personal accounts (now 'Nests') be based on:

	Employment category	Earnings of employee	Other
Up to 249 employees	65%	25%	10%
250 employees and above	66%	17%	17%
All schemes	**65%**	**24%**	**11%**

Table 3

Has your organisation budgeted for what the potential cost increase will be when you have to auto-enrol all employees into either your existing scheme(s) or Nests?

	Yes	No
Up to 249 employees	16%	84%
250 employees and above	38%	62%
All schemes	**32%**	**68%**

What presently is your organisation's approximate annual cost of providing workplace pensions as a percentage of payroll and what do you estimate that will increase by (if at all) when auto-enrolment/personal accounts are introduced?

	Average present pension costs as a percentage of payroll	Average estimated increase in payroll costs after auto-enrolment/ Nests introduced
Up to 249 employees	11%	3.1%
250 employees and above	16%	3.7%
All schemes	**15%**	**3.6%**

Table 4

If you decide to operate auto-enrolment into your workplace scheme(s), are you likely to revise the benefits offered to mitigate the extra cost of additional members?

	Yes	No
Up to 249 employees	54% (36%)	46% (64%)
250 employees and above	15% (20%)	85% (80%)
All schemes	**24%** (23%)	**76%** (77%)

Table 5

Will auto-enrolment into a pension scheme and the introduction of Nests lead you to:

(a) A review of your current pension scheme(s) ahead of 2012

	Yes	No
Up to 249 employees	86%	14%
250 employees and above	51%	49%
All schemes	**59%**	**41%**

(b) Consider closing your scheme(s) in favour of offering Nests to all employees

	Yes	No
Up to 249 employees	41% (36%)	59% (64%)
250 employees and above	6% (10%)	94% (90%)
All schemes	**15%** (15%)	**85%** (85%)

Table 6

From 2012, if you presently do not contribute to a workplace pension, you will be required as a minimum to auto-enrol all employees into Nests with an employer contribution rising to 3% of each employee's earnings (phased in over 3-years). How do you think you will cope with this change?

Costs will be borne by reduced profitability	Costs will be borne by reducing headcount	Costs will be met by increased prices
35% (37%)	11% (5%)	7% (26%)
A combination of three answers above	**Expect high opt-out to hold costs down**	**Expect Nests to be postponed/ abandoned**
24% (32%)	18% (NA)	5% (NA)

'Middle way' pension scheme designs

Table 7

Do you believe existing legislation allows for simple 'middle way' pension designs so schemes can share investment, inflation and longevity risks between employers and employees?

Yes	No
23%	77%

Table 8

Do you believe public policy should be more supportive of 'middle way' pension designs?

Yes	No
76%	24%

Would your organisation consider introducing a 'middle way' pension design if legislation was changed to make this easier?

Yes	No
51%	49%

Are you aware of how any of these types of 'middle way' pension schemes operate?

	Very aware	Aware	Know a little	Not sure	Not aware
Hybrid DB/DC schemes	30%	30%	24%	9%	7%
Cash balance schemes	11%	19%	15%	29%	26%
Conditional Indexation schemes	9%	12%	12%	18%	49%
Collective DC schemes	5%	14%	17%	22%	42%

Other possible pension reforms

Table 9

Do you agree with proposals that above a certain size of individual pension 'pot' (below which an annuity should normally be purchased to ensure State benefits are not claimed), retirees should not be constrained as to how they invest or use their pension savings?

Yes	No
73%	27%

Table 10

Do you agree with proposals that a proportion of accrued pension savings should be available for pension scheme members to draw on for major lifetime events such as house purchase deposits or illness?

Yes	No
44%	56%

Table 11

Overall, do you feel the Government's stated policy of supporting quality workplace pensions is working?

Yes	No
6% (38%)	94% (62%)

What should the Government's MOST IMPORTANT PENSION POLICY CHANGES be?

	2009	2007
1	**Deregulate/simplify pensions**	(Reduced regulation/ increased simplification)
2	**Better financial incentives for pension saving/reverse ACT change**	(Better financial incentives to encourage pension saving)
3	**Reverse 2009 Budget pension tax changes**	(Remove over-regulation of good quality schemes)
4	**Close private/public sector pension gap**	(Reduce means-testing)
5	**Improve Basic State Pension**	(Improve Basic State Pension)

Nests investment

Table 12

PADA is seeking views on what the overarching investment objective of the Nests default fund should be (which it expects most members will sign up to) and how to balance what members want with what is in their best interests. Where do you think this balance should be struck for the Nests default fund?

Target replacement income	Benchmark-driven return objective	No explicit target – best efforts
47%	37%	16%

Table 13

Should the Nests scheme use alternative asset classes (such as hedge funds, commodities and infrastructure funds) to benefit from potentially improved diversification and investment performance?

'Yes' answers:

Hedge Funds	Private Equity	Commodities	Infrastructure	Property
57%	56%	66%	74%	79%

Table 14

What should be the balance between active and passive managers in the Nests default fund (taking into account its low-charge basis)?

Heavily passive managed	c75% passive	c50% passive /50% active	c75% active	Heavily active managed
30%	27%	41%	1%	1%

Table 15

Securities lending can potentially bring extra investment returns. Should the Nests scheme participate in securities lending?

Yes	No
29%	71%

Table 16

As individuals approach retirement, is a traditional 'life-styling' approach (switching an individual's savings to lower risk as they approach retirement) appropriate for Nests, or should a target-date approach (where the switch to lower risk takes place at the fund level) be considered?

Traditional life-styling	Target-date	Both options in different funds	Other approach
40%	18%	41%	1%

Table 17

Should socially responsible investment be a matter for the personal accounts default fund alone, of for all fund choices?

Default fund only	Not default fund, should be fund choice	All funds
9%	65%	26%

Table 18

What degree of choice beyond the default fund should be offered to personal account members?

(1= high priority, 2= medium priority, 3= low priority)

	High priority	Medium priority	Low priority
None	32%	11%	57%
Risk-graded fund	57%	32%	11%
Religious compliant	20%	29%	51%
Ethical fund	23%	39%	38%
Diversified growth	49%	46%	5%
Gilt fund	54%	31%	15%
Guaranteed fund	45%	37%	18%
With-profit fund	11%	43%	46%

Table 19

Should costs associated with wider fund choice be spread, where possible, across all personal account members, or only apply to those members who choose alternatives to the default fund?

Costs should be spread across all members to encourage choice	Costs should be met by those choosing the alternative funds
28%	72%

Pension Scheme Design

Table 20

What type of pension arrangement do firms offer and what is the total value of scheme assets?

Type of pension scheme	Percentage of firms with such schemes	% Closed to new entrants	% Closed to new entrants and future accruals/ contributions	Total Asset Values (£bn)	Average of eligible employees in membership
Defined benefit scheme	66% (68%)	69% (67%)	18% (14%)	£88.4	72%
Career average scheme	8% (NA)	25% (-)	- (-)	£5.0	75%
Defined contribution	42% (38%)	14% (12%)	5% (4%)	£11.9	62%
Mixed DB / DC	11% (9%)	10% (-)	-	£10.5	64%
Group Personal Pension	22% (21%)	4% (5%)	-	NK	58%
Stakeholder	29% (24%)	-	-	NK	NA
Industry-wide	2% (2%)	33% (50%)	-	£22.9	69%
All Schemes	-	-	-	**£138.7**	66%

(NK: the majority of respondents did not disclose or were unaware of total assets held)

Percentage of schemes contracted-out of SERPS / S2P

	Percentage contracted-out
Defined benefit	80% (92%)
Defined contribution	9% (14%)

Table 21

Spread of pension designs of organisations responding to survey

Employees:	0-249	250-999	1000+
Defined benefit scheme only	3%	27%	17%
Defined benefit + contribution	23%	49%	70%
Defined contribution only	74%	24%	13%
Total sample of firms	**25%** (17%)	**24%** (21%)	**51%** (62%)

What is the distribution of membership of schemes?

	Active	Deferred	Pensioners
Defined benefit	25%	42%	33%
Defined contribution	62%	36%	2%
All schemes	**43%**	**40%**	**17%**

(Scheme average)

Table 22

Why do firms provide employees with pension arrangements (in ranked order)?

	All Schemes
We consider it is our responsibility as a good employer to make adequate arrangements for our employees retirement	**1** (1)
The scheme helps us to compete in the labour market for skilled staff	**2** (2=)
The scheme helps us to build our image as a caring employer, motivating and encouraging loyalty from employees	**3** (2=)
The scheme has been in existence for many years and could not easily be discontinued	**4** (5)
The scheme enables us to retire employees on reasonable pensions in an orderly way to suit our business	**5** (4)
We were required to introduce a scheme under the Stakeholder rules	**6** (6)

Table 23

The Chancellor's 2009 Budget proposed major changes to pensions taxation that mean, for those with 'income' over £150,000, pension saving could be tax inefficient from 2011. Income is a wide term, not just pensionable salary: it includes most items subject to income tax, such as salary, bonuses, benefits in kind, personal investment income etc. This involves looking back up to 2 years, so currently someone with high income in 2007/08 or 2008/09 would be caught. Based on your current staff in all your pension arrangements, what percentage of employees do you think may fall into this category?

	None	1-9 employees	10-49 employees	50-99 employees	100 or over employees
Up to 249 employees	53%	28%	16%	3%	-
250 employees and above	4%	44%	29%	7%	16%
All schemes	**16%**	**40%**	**26%**	**6%**	**12%**

Do you think that these Budget proposals will lead to wider changes to company pension arrangements than just changes impacting these members?

Yes	No
68%	32%

Table 24

Changes in pension arrangements over last few years

	In last year	In last 5 years
Closed defined benefit scheme to new entrants	6% (5%)	43% (41%)
Closed defined benefit scheme to future accruals	7% (5%)	8% (8%)
Reduced defined benefit accrual rate for future service	7%	7%
Introduced defined contribution scheme to some or all employees	7% (8%)	28% (22%)
Converted existing defined benefit to mixed DB/DC scheme	2% (2%)	4% (-)
Set up a career average scheme	3% (1%)	5% (3%)
Reduced percentage of employees covered by organisation's scheme	-	2% (4%)
Implemented full or partial scheme buyout	3%	-
Placed one or more schemes in wind-up	5% (4%)	3% (4%)
Established a flexible benefits package with wider benefits option	3% (1%)	8% (6%)
Introduced access to group benefits largely paid for by employees	- (1%)	1% (3%)
Contracted some or all of members back into State Second Pension	5% (8%)	5% (6%)

Table 25

Average of contributions paid into pension schemes (as a percentage of total earnings).

Average employer contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	11.5%	13.1%	15.1%	16.5%	21.0%	22.6%	23.0%	23.2%	18.8%
Defined contribution	5.1%	5.2%	5.8%	5.9%	6.0%	6.2%	6.5%	6.7%	7.0%
Group Personal Pension	5.6%	5.6%	5.8%	6.1%	5.8%	6.0%	5.9%	6.0%	6.0%
Stakeholder (see note)	5.0%	5.2%	4.3%	4.5%	4.0%	4.1%	4.5%	4.5%	5.0%

Average employee contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	4.3%	4.5%	4.9%	5.5%	5.8%	6.1%	6.1%	6.3%	6.5%
Defined contribution	3.4%	3.5%	4.0%	4.1%	4.1%	4.1%	4.2%	4.3%	4.5%
Group Personal Pension	3.6%	3.8%	3.6%	3.8%	4.0%	3.9%	3.7%	3.9%	4.0%
Stakeholder	3.3%	3.5%	3.7%	3.8%	4.1%	4.1%	4.0%	4.0%	4.5%

Average combined employer and employee contributions into:									
	2002	2003	2004	2005	2006	2007	2008	2009	Longer term
Defined benefit scheme	15.8%	17.6%	20.0%	22.0%	26.8%	28.7%	29.1%	29.5%	25.3%
Defined contribution	8.5%	8.7%	9.8%	10.0%	10.1%	10.3%	10.7%	11.0%	11.5%
Group Personal Pension	9.2%	9.4%	9.4%	9.9%	9.8%	9.9%	9.6%	9.9%	10.0%
Stakeholder (see note)	8.3%	8.7%	8.0%	8.3%	8.1%	8.2%	8.5%	8.5%	9.5%

(Source: ACA 2003, 2005, 2007 and 2009 Pension Trends Surveys)

Note: figures exclude nil employer contributions made into 22% of Stakeholder schemes.

Table 26

Current range of employer contributions

Contribution as % of earnings	Defined Benefit	Defined Contribution	GPP	Stakeholder
0%	-	-	-	22% (28%)
Up to 3%	- (-)	3% (2%)	6% (12%)	15% (11%)
Over 3 – 6%	1% (1%)	48% (53%)	50% (42%)	46% (43%)
Over 6 – 9%	2% (4%)	26% (23%)	38% (35%)	12% (11%)
Over 9 – 12%	11% (14%)	21% (19%)	4% (7%)	4% (7%)
Over 12 – 15%	16% (14%)	2% (3%)	2% (4%)	1% (-)
Over 15 – 20%	17% (18%)	-	-	-
Over 20 - 25%	16% (15%)	-	-	-
Over 25%	37% (34%)	-	-	-

Current range of employee contributions

Contribution as % of earnings	Defined Benefit	Defined Contribution	GPP	Stakeholder
0%	5% (6%)	1% (-)	2% (-)	- (-)
Up to 2%	1% (-)	3% (6%)	12% (7%)	7% (9%)
Over 2 – 4%	8% (10 %)	55% (51%)	49% (50%)	42% (42%)
Over 4 – 6%	39% (42%)	36% (33%)	34% (38%)	50% (46%)
Over 6 – 8%	36% (32%)	5% (10%)	3% (5%)	1% (3%)
Over 8%	11% (10%)	- (-)	-	-

Table 27

Has the normal retirement age of the scheme changed or is it likely to in the near future?

Change in retirement age	
60-65	7%
61-65	2%
62-65	4%
63-65	1%
No change	86%

Defined Benefit Schemes

Table 28

Number of defined benefit schemes advised by their actuaries that their scheme is in deficit when considering it as an ongoing entity

In deficit	Not in deficit
91% (86%)	9% (14%)

When was the most recent scheme valuation?

Year	
2005	3%
2006	29%
2007	31%
2008	31%
2009	6%

Table 29
Bands of ongoing funding level as a percentage of liabilities at the last actuarial assessment

Funding Level	Percentage of firms
+ 100%	8% (14%)
+95 - 100%	10% (9%)
+85 - 95%	39% (44%)
+75% - 85%	29% (23%)
Below 75%	14% (10%)
Average ongoing funding level	**79% (87%)**

Period over which firms say scheme deficits are expected to be removed?

0 – 5 years	25% (15%)
6 – 10 years	53% (56%)
11 – 15 years	15% (20%)
+15 years	7% (9%)

Table 30
If in deficit, have scheme actuaries recommended an increase in contributions?

Yes	No
87% (91%)	13% (9%)

Change in employer defined benefit contribution rates

Employer contribution rate increases	Percentage of firms
+10% of earnings	21% (8%)
+5% - 10%	17% (20%)
+3% - 5%	24% (56%)
0 – 3%	38% (16%)

Have additional employer contributions been made expressed as fixed monthly amounts or significant lump sums?

	Yes
Additional contributions expressed as fixed annual/ monthly amounts	48% (34%)
Significant lump sum contributions	51% (31%)

Have employer contributions been increased to meet future service benefits?

Yes	No
61% (65%)	39% (35%)

Table 31
Number of schemes reporting increase (or future increase) in defined benefit employee contribution rates

Yes, already increased	Yes, will be an increase	No
32%	7%	61%
(45%)		(55%)

Change in employee contribution rates

Employee contribution rate increases	Percentage of firms
+2% of earnings	28% (15%)
+1% - 2%	66% (74%)
0 - 1%	6% (11%)

Change in the accrual rate of benefits in the last year or so

Moved from better than 60ths to 60ths	4% (3%)
Moved from 60ths to between 60ths to 80ths	2% (3%)
Moved from 60ths to 80ths	7% (1%)
Moved from between 60ths to 80ths to more than 80ths	1% (-)

Table 32
Is your defined benefit scheme under review at present?

Yes	No
34%	66%

If 'Yes', what options are being considered?

Changing forward accrual	Changing pension age	Move to career average	Move to mixed DB/DC	Move to DC
39%	9%	35%	8%	22%

Investment Issues - Defined Benefit Schemes

Table 33

Schemes reporting change in investment strategy to a greater proportion in bonds and lower proportion in equities

Yes	No
60% (44%)	40% (56%)

Table 34

Current split of scheme assets between equities, bonds and alternative assets such as property, private equity and hedge funds. Within the next year expectation of how this will change.

		Change expected in next year		
	Present	Increase	Decrease	No change
UK Equities	26% (37%)	4% (6%)	28% (26%)	68% (68%)
Overseas Equities	23% (25%)	6% (11%)	24% (28%)	70% (61%)
Gilts: Fixed Interest	11% (8%)	10% (16%)	1% (7%)	89% (77%)
Gilts: Index linked	10% (5%)	15% (14%)	3% (7%)	82% (79%)
Corporate bonds	15% (10%)	21% (15%)	3% (14%)	76% (71%)
Property	4% (5%)	4% (18%)	4% (13%)	92% (69%)
Private Equity	2% (2%)	2% (6%)	- (8%)	98% (86%)
Hedge Funds	2% (2%)	4% (5%)	2% (5%)	94% (90%)
Cash / deposit	2% (1%)	8% (5%)	2% (4%)	90% (91%)
Active currency	2% (1%)	2% (18%)	1% (-)	97% (82%)
Commodities	1% (2%)	3% (12%)	1% (-)	96% (88%)
Infrastructure	1% (1%)	7% (17%)	- (-)	93% (83%)
Tactical Asset Allocation	1% (1%)	5% (16%)	- (-)	95% (84%)

Table 35

How many fund managers do schemes use?

	Percentage
One	22% (31%)
2 to 4	36% (38%)
5 to 10	28% (25%)
More than 10	14% (6%)
Median	4 managers (4)

How many of these are passive managers and what percentage of assets do they manage?

Percentage that are passive managers	Average percentage of assets managed
21% (15%)	44% (40%)

Defined Contribution Schemes

Table 36
Investment choices offered by DC schemes

	Percentage Offering
UK Equity	96% (94%)
Overseas Equity	83% (86%)
Global Equity	96% (98%)
Gilts: Fixed interest	84% (82%)
Gilts: Indexed linked	84% (86%)
Corporate bonds	79% (74%)
Cash / deposit	84% (84%)
With profits	31% (47%)
Mixed managed fund	72% (76%)
Life-style / default	91% (79%)
Other	18% (8%)

Number offering a default fund

Yes	No
85% (79%)	**15%** (21%)

Is it a Life-style fund?

Yes	No
88%	12%

Estimated number of members invested in the default fund	84%

Table 37
Fund options offered to members

	Percentage
Under 5	13% (28%)
6 - 10	29% (31%)
Over 10	58% (41%)

Number of fund managers offered

	Percentage
Only one	38% (58%)
2 - 10	48% (32%)
Over 10	14% (10%)

Schemes offering a with-profits fund

Yes	No
30% (47%)	**70%** (53%)

Table 38
Defined contribution pension schemes place investment, inflation and longevity risks primarily with the individual. Do you feel most employees are comfortable with taking on these risks?

Yes	No
24%	76%

In terms of understanding the financial issues and risk involved, do you feel most of your employees are capable of determining how they should manage their defined contribution pension saving?

Yes	No
19%	81%

Table 39
Percentage of firms facilitating financial advice / retirement counselling services to members / employees

Yes	No
44% (68%)	**56%** (32%)

If 'yes', percentage where cost fully met by employer

Yes	No
69% (56%)	**31%** (44%)

Are retirees helped with their open market option prior to purchasing an annuity?

Yes, we provide a range of quotations	No, we leave to individual
43%	57%

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ASSOCIATION OF ACA CONSULTING ACTUARIES

As at April 2010

ASSOCIATION OF
Placard
CONSULTING ACTUARIES

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Hardly a week goes by without more companies announcing the closure of their existing pension schemes, increasingly to existing employees as well as to new entrants. And survey after survey this year – including the ACA's – has flagged up 'UK pensions in decline', but surely it's time for fresh thinking and alternative approaches to be taken seriously...

Workplace pensions: a new hope?

It's a stark fact, but if you work in the private sector, a good pension is becoming a scarce commodity. But, what do we mean by a good pension? For many, a final salary defined benefit scheme remains the benchmark – and certainly this remains the case in the public sector, where upwards of 5 million employees enjoy such a benefit. In truth, 'good pensions' can take many forms and, legislation permitting, 'good' pension designs can be shaped to suit employer and employee aspirations alike. Designs can achieve the dual aims of controlling employers' costs and reducing the volatility in pension outcomes, so feared by those approaching retirement. There's just one problem, in the UK, pension legislation has become overly restrictive in the pursuit of 'safety first', frustrating innovation and, thereby, damaging the pension future for millions of employees. This issue of *Placard* examines what is a genuine crisis in pension provision in the private sector and explores a number of ways in which that crisis can be addressed providing new hope.

The articles that follow necessarily approach our pension crisis from a number of viewpoints. Some look to clear changes in pension legislation that are commended to the incoming Government to be implemented in quick time after the forthcoming General Election, early in 2010. It is to be hoped the main political parties pick up some of these ideas to include in their manifestos – *Placard* will be monitoring how the parties respond in our special General Election issue, in which we will analyse the parties' commitments on pensions and savings.

Fresh challenges

Another article in this issue considers how the inevitable reductions in public spending over the years ahead might impact on public sector pensions, where quiet changes in some areas of provision are already underway and where greater transparency in identifying the true cost of forward liabilities is likely to hasten reform, as is the pressure to outsource services to the private sector.

And we also look at the one growth area in current provision - defined contribution schemes, where legislative reforms are

Continued on Page 12

Welcome to this Winter edition of *Placard*, the discussion journal of the Association. In this issue, we examine the immense challenges experienced by employers in supporting ongoing workplace pensions and a range of our members' views on what needs to be done to reinvigorate provision.

We continue to believe that auto-enrolment and the introduction of Personal Accounts from 2012 is not enough – indeed, there is evidence both are driving scheme reviews. This is why we are continuing to champion legislative changes that allow employers to offer a range of new 'middle-way' pension solutions, which would give a greater ability for employers to control costs whilst also allowing more employees to enjoy good pensions.

For more details about the Association's views, go to our website at www.aca.org.uk

Adam Gillespie, Editor

Until the late 19th century you worked until you dropped or your family looked after you. Could we now, in the early part of the 21st century be heading back to this rather unsavoury Victorian value?

The golden age of retirement provision has passed

By Jeremy Dell, Partner, Lane Clark & Peacock and ACA Main Committee

It has been more than a century since the advent of formal pension provision in the UK when the *Old Age Pensions Act 1908* was introduced, providing 70 year olds with 5 shillings (25p) a week. Over the ensuing 100 years the UK's pension system has, rather inadvertently, gone from being relatively straightforward to comprising a complex web of public and private provision.

Following on from the arrival of State provision, the end of the Second World War saw the widespread adoption of occupational pension schemes. Employers were motivated to set up retirement plans both through a sense of paternalism and – because people were starting to live longer – a desire to make room for younger employees.

However, rather than the initial recipients of occupational schemes being the greatest beneficiaries, it appears instead to be those individuals born during this period – the baby boomers – who look set to reap the rewards.

Many of those born during and immediately after the war are already in retirement and enjoying generous final salary pensions that provide incomes of which their parents would have been envious and their children incredulous. Today, the near death of defined benefit (DB) schemes, along with a shrinking formal State pension, has left the current workforce facing an uncertain financial future.

Retreat by the state

The State's commitment to securing retirement income has never been generous and for much of the last 30 years, its increasing parsimony, causing the basic and State second pension to become largely inadequate by themselves, has been justifiable only with the presence of good quality occupational pension schemes for those who have access to them, and complex means-testing for those that do not.

This trend was set to reverse, but only if you count Personal Accounts as within the State sector and only if you believe that it will succeed. Already the omens are not good. The current Government is again putting back the date of its full implementation and has yet to address the fundamental weaknesses of the scheme. The official opposition will review the scheme entirely should it win next year's election.

Elsewhere within the State sector, pension provision is under attack. Whoever wins the election will have to face up to the fact that there is a huge deficit that needs tackling. Social security costs and public sector pensions will be far from immune to these pressures.

The shrinking role of the employer

And it's not just Government that has come to appreciate the true cost of providing people with an income in retirement. Employers, too, have recognised that keeping their pension promise under existing DB arrangements, with all the statutory restrictions on curbing cost and controlling risk, is no longer tenable. The promise is too expensive and too risky and employees often seem to undervalue it. Employers have therefore acted rationally.

According to the ACA's 2009 pensions trends survey, 87% of DB plans are closed to new members, while 18% are closed to all future accrual. And as the challenging economic environment persists and demands on company resources grow, the terminal decline in existing DB pensions can only continue. Not a week seems to go by without an announcement of further closures. Those in political circles who thought this time last year that the ACA were being Jeremiahs are regrettably being proved wrong.

Saver apathy

Retreat by the State and employers is a lethal combination. It is all very well extolling the virtues of individuals taking greater responsibility for funding their retirement but it just isn't going to happen.

Defined contribution provision is now the norm for workplace pensions; a situation which sees the transfer of all risk from employer to individual, placing a far greater responsibility on the employee.

However, there is widespread concern that many individuals are neither engaged in retirement savings nor furnished with the appropriate knowledge and support to make key investment decisions. While some employers are more than willing to offer robust DC schemes, with a wide range of choice to suit a diverse workforce supplemented by independent financial advice, for many companies the costs of such an arrangement are prohibitive.

And with the mind-numbing complexity of auto-enrolment and quality-assurance requirements on the horizon, which the Government is in a hurry to implement, there is a huge risk of levelling down or outright abandonment of good quality DC provision.

Consequently many individuals feel cut adrift and disconnected from retirement saving, leaving the UK suffering from a culture of ‘spend today and save tomorrow’. Many people, in my experience, are so intimidated by the amount they need to save today to deliver a decent level of retirement income, and believe it would impact their lifestyle so significantly, they choose not to save at all. As such, many people could be facing a very difficult retirement.

Think hard or it’s back to the future

With the Government averse to any loosening of the current system of regulation and no one willing to pick up the pensions tab, it is unsurprising the press describes the UK pensions system as ‘in crisis’. It seems that the only way to meet this burden is for people to work for longer and postpone retirement until they really cannot continue to work or their families are prepared to support them. Chances are the UK’s workforce will in future include a large proportion of those in their late 70s or even 80s who have been forced to continue in employment to make ends meet.

A society that requires its oldest citizens to work until such a late age because no one is prepared to foot the bill for their retirement is neither practical nor moral. And a return to the 1930s where older workers prevented younger generations from gaining jobs and progression is not commercially sound either. But this is where we are heading.

To avoid this, my view is that we need to re-engage employer interest. Any further pension provision should be applied in a way that works best for the employer and therefore should be free of most of the existing Department for Work and Pensions restrictions. We need to allow companies to apply their creativity to deliver a form of pension provision that is best for employer and employee, and in that way encourage companies to contribute more to their workers’ personal savings.

What we really need from Government is vision; micro managing pensions and limiting the form of benefit provision cannot hope to improve the current position. We need incentives for individuals to save more and accumulate wealth while in work – ideally through tax incentives – and this should be supplemented with an insurance aspect that spreads risk across individuals so that benefit outcomes are not too widely spread, but are much more flexible than DB is today.

But is this just dreaming?

Re-invigorating UK private sector pensions

By Ian Farr, ACA Immediate Past Chairman

Final salary defined benefit pension plans have become unaffordable for most private sector employers in the UK whilst defined contribution (money purchase) plans have typically failed to provide the certainty of pension expected by their members. A pensions system which was once the envy of the world is now the subject of adverse criticism. The current Government's attempts at pension reform to encourage and protect good quality pension plans in the private sector have amounted to no more than tinkering around the edges. What is needed to re-invigorate private sector pensions in the UK is a change in mindset and a change in the law.

Change in mindset

It used to be that, if you worked for a major UK private sector employer, you could expect a pension, reflecting your period of service and your earnings near retirement, which would broadly maintain your standard of living in retirement. Such expectations cannot be sustained today. Given the significant increase in the cost of providing each £1 per annum of pension, an employee of a major private sector employer in the UK should nowadays expect a company pension which, along with the State pension, would meet the basic expenditures of life in retirement. The comforts and luxuries of retirement should be met from the individual's own resources – possibly funded in part by money purchase AVCs .

Consistent with such an approach is the pension funded by the employer being a lower proportion of the employee's earnings at retirement for those on higher earnings levels. The corollary is of course that the pension would be a higher proportion of the employee's earnings at retirement for those at lower earnings levels.

If the pension is to be capable of being reasonably predictable by the employee before retirement, a defined contribution (DC) arrangement is not the answer. Defined benefit (DB) plans, where the pension is based on the member's average earnings and service over the period of plan membership and up-rated to take into account price inflation, are coming back into fashion as a way of delivering a good basic level of pension. This 'career average' type of plan automatically produces a pension of a higher proportion of final earnings for employees whose earnings grow steadily throughout their employment compared to those whose earnings increase more rapidly. Capping pensionable earnings in real terms for high earners would be compatible with a philosophy of providing a good basic level of pension, and no more.

Changing the law

In the UK, the law divides company pension plans into either DB or DC. There is a different legal regime for each of these two broad categories of pension plan. That is one reason why the hybrid approach of a DB plan topped up by a DC arrangement is not attractive to employers – due to the expense and complexity of having to comply with two regimes rather than one.

Whilst the legislation applying to DB plans is more onerous currently than that applying to DC, the latter is catching up fast as the Government sees the amount of DC funds increasing dramatically and the Pensions Regulator becomes involved.

Private sector DB plans are in danger of being regulated out of existence. This is tragic given that this is the only type of plan which offers the member some predictability before retirement of the amount of pension likely to be paid at retirement. What is needed is changes to the law which allow employers greater freedom to design DB plans whilst keeping the security of members' benefits at an acceptable level.

There are two changes to the law which can be made in quick order and would create significant opportunities for private sector employers. They would allow the risks of adverse investment conditions and increasing longevity to be shared between employers and plan members in ways which the law currently prohibits.

Indexation of pension

The UK is the only country in the world which requires private sector DB plans to index pensions, both before and after retirement, in line with price inflation (subject to a cap). The first change to the law should be to remove this requirement for pensions in payment but only in respect of pension earned after the law is changed. If such a change is politically unacceptable, then conditional indexation should be allowed, whereby indexation is pre-funded but indexed increases can be withheld for a temporary period if the funding of the plan falls into deficit (and retrospectively made good when the funding returns to surplus).

Conditional indexation, particularly when applied to a 'career average' pension plan, would reduce significantly the risk of employer contributions having to be increased due to adverse investment conditions. This is because of the cushion of the funding reserves held in respect of future pension increases. Members of the plan would enjoy a much more predictable pension than under a DC arrangement.

Importantly, the expected cost of each £1 per annum of pension could be significantly less than in a DC plan. This is due to the investment risks being pooled amongst all the members and investments only having to be sold when cashflow requires – unlike in a DC plan, where investments are earmarked to individuals and sold at retirement for an insured annuity.

Conditional indexation has for many years been the most common and successful form of pension provision in The Netherlands. And earlier this year, the OECD published a paper[1] which concluded that conditional indexation was the most cost-effective form of risk sharing for pension plans.

Changing normal pension age to reflect increases in longevity

Increasing the normal pension age, which is a key element in the design of a DB plan, to reflect increases in longevity should be non-controversial. It can be done as the law stands, but only in respect of pension earned during the period after the increase in normal pension age. Whilst this is a sensible protection for those where normal pension age is coming into sight (say in 15 years or less time), is it reasonable to require an employer to have to provide a 25 year old employee with a pension in respect of the next year's service payable from a fixed date 40 years hence? Employers are effectively being asked to underwrite the plan member's life expectancy from age 25. Given the uncertainties of the rate of increase in longevity, this is an entirely unreasonable proposition and one that the Government is not prepared to hold to in respect of State pensions. Therefore, the law should allow the normal pension age in a new DB plan to be changed retrospectively BUT NOT for those members in receipt of pension or with 15 years or less to go until the current normal pension age – in other words only for the young members who are very many years away from retirement. To protect members, the law should require that any such increase in normal pension age would have to be justified actuarially by reference to actual increasing longevity.

The Government's consultation on conditional indexation

The changes to the law described above were considered by the current Government and a consultation paper was issued in 2008. In the end, the Government decided not to implement these changes for the reasons shown below. The ACA does not consider that the reasons given stand up to proper scrutiny and its comments are shown opposite each reason.

Government reasons against implementation- ACA's views:

- Significant additional regulation required - *but not according to leading pensions lawyers who worked with ACA.*
- Complexity would hamper member understanding – *surely could be managed and no more difficult than for either DB or DC plans.*
- Not sufficient demand from employers – *results of the very small Government survey highly questionable and not borne out by much larger surveys carried out by ACA.*
- Experience in The Netherlands rooted in Dutch industrial relations model – *but UK version based on the UK work and pensions environment.*
- No workable consensus apparent – *legislation is not always based on consensus; what is required here is leadership. Moreover, offering new choices – and conditional indexation need not be the only new option offered – does not require a consensus approach. The aim should be to offer a range of designs that employers can choose from suited to their business needs and the desires of their employees.*

[1] *Evaluating the Design of Private Pension Plans: Costs and Benefits of Risk-Sharing*, OECD Working Paper on Insurance and Private Pensions No. 34, March 2009 www.oecd.org

Changes need to be made before 2012

Because of the impending auto-enrolment requirements and the dangers of levelling down associated with the Government's plans for new personal accounts, the changes to the law described in this article are needed before 2012. They can be made quickly and act as a stepping stone to further changes to free up benefit designs in due course. But urgency is of the essence. These are by far the most developed and thought through changes - which have been scrutinised extensively and no technical flaws found. They would help to save existing good quality pension plans in the private sector.

Also they would encourage those larger private sector employers, who can afford to take some risks but not all (as under final salary plans), to re-think the nature of the pension arrangements for their employees. Many of them may be attracted to a new way of providing a largely predictable pension at a level to fund just the basic needs of retirement. This could be an important step in the re-invigoration of pensions in the private sector in the UK.

Shake-up in pensions

By Raj Mody,
Partner and Chief Actuary,
PricewaterhouseCoopers LLP

Managing the costs and risks associated with what is frequently one of a company's largest creditors – the final salary pension scheme - is presenting challenges at every turn. With further tax and regulatory changes looming, the size of the challenge is set to increase and it is not surprising that news emerges on a weekly basis of household names making wholesale changes to their pension arrangements.

In particular, a growing proportion of employers are looking to change future benefits for current employees. This is being driven not only by the current economic climate and the need to reduce costs, but also by a desire to ensure value for money being spent on pensions is consistent with the employment package for the organisation overall.

Drivers for change

Companies are questioning how much their pension arrangements are costing and whether the organisation is getting good value for this expenditure. Drivers for change include:

- rapidly declining number of executives who still participate in defined benefit (DB) arrangements;
- desire to drive a culture of pay-for-performance;
- dealing with increasing 'pensions polarisation' between employees enjoying DB accruals and those who are not;
- increasingly diverse and flexible career paths;
- increasing need to flex how reward is provided to different individuals to reflect different wants and needs; and
- impact of the Finance Act 2009, proposed restrictions to tax relief from April 2011 and the introduction of auto-enrolment from 2012.

'Shake up' in pensions

PricewaterhouseCoopers LLP recently conducted a survey of UK employers, including 65 with over 5,000 UK employees and 33 of the FTSE100. The survey revealed that the cost and risk associated with pensions are still the main drivers for change but that the Finance Act 2009 is accelerating change in the UK pensions landscape.

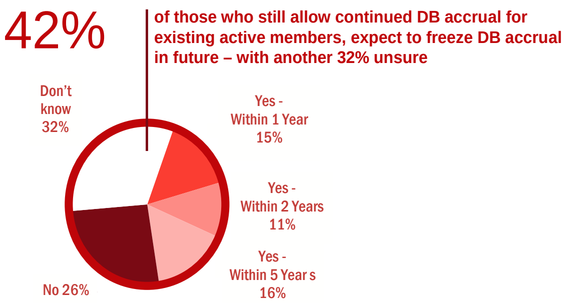
Survey findings revealed that some employers are losing motivation to offer workplace pensions beyond the minimum required under auto-enrolment, while others wish (in a relatively high-tax environment) to find ways in which they can help their employees build retirement savings for acceptable cost and risk. Companies will increasingly compete by offering employees understandable choice, ease of access and better value savings vehicles that they can obtain on their own.

Sustainability of defined benefit schemes

The survey found that 96% of respondents believed DB schemes are becoming increasingly unsustainable for UK employers and that fewer than one in twenty employers expect their DB schemes to be open to new members in five years' time. Further, only about one in five are saying they will not freeze future benefit accrual for existing members, potentially leaving UK businesses with a legacy of 'zombie' pension funds.

However, companies need to manage the closure or freezing of DB schemes carefully. While closure reduces future costs and risks, it can result in increased cash calls from trustees at a time when businesses are cash-strapped. That is why some companies are opting to keep their DB schemes open to future accrual while reducing benefit levels.

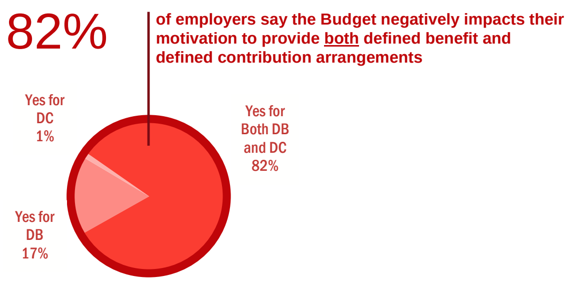
Scheme closures and changes



Budget 2009 - implications for pensions and reward PricewaterhouseCoopers LLP

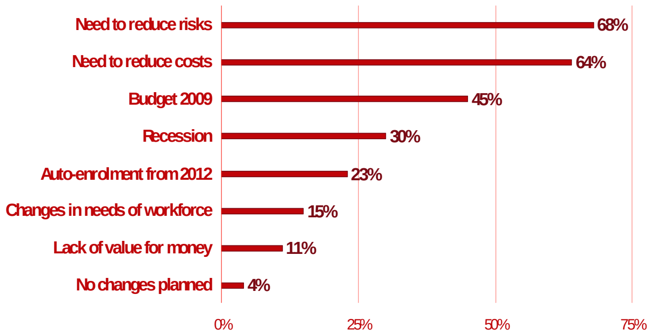
The shake-up in pensions provision is now being extended to defined contribution (DC) offerings as companies re-evaluate the role that pensions play in overall employee reward and business strategy, primarily as a result of the Finance Act 2009 and subsequent proposed changes to higher earner tax relief.

Impacts both DB and DC arrangements



Budget 2009 - implications for pensions and reward PricewaterhouseCoopers LLP

The survey also provided interesting insight into other factors leading companies to make changes to their DB and DC company pension provision, as illustrated by the following chart:



What does the future hold?

With the demise of DB, we may see the UK catch up with the global trend for DC schemes, and eventually find itself finally on a par with the rest of the world. Countries like Australia and South Africa shifted away from DB to, in their case, pure DC some 25-30 years ago.

Larger employers may introduce a broader range of choice for people to receive the delivery of their reward, including for their retirement savings. The attractiveness of different delivery vehicles will depend on the employee's individual circumstances. This includes marginal rate of income tax and whether they are a 'higher-earner' caught by the proposed new restrictions on pensions tax relief that will essentially make pensions taxable as a 'benefit-in-kind'. Expect to see greater use of non-registered pension schemes (e.g. Employer Financed Retirement Benefit Schemes), share-based arrangements and a wide range of non-pension trust-based arrangements e.g. Employee Benefit Trusts.

Add in the auto-enrolment requirements from 2012 and we expect yet more changes in the overall nature of pensions reward. Some big name employers have recently launched SIPP (Self Invested Personal Pension) schemes to sit alongside their existing schemes, while others have adopted them as their mainstream vehicle. We may see SIPPs more widely become the choice of a 'top up' to the Personal Accounts Pension Scheme.

Conclusion

While this all sounds exciting, the reality is that the pace of enforced change is too much for most companies to bear. Action is needed to restore stability to the pensions savings system. Some employers have lost trust in the regulatory and fiscal framework governing pensions as they struggle to keep up with changes. And many employees have ceased to trust workplace pensions due to changes, coupled with a general lack of understanding of unavoidably complex arrangements.

As a result, less is being saved for employees' retirement, both by their employers and by themselves. While we have 'super protection' for defined benefit pension benefits earned to date, employers' motivations to provide quality retirement savings for the future continue to decline.

What will it take to resurrect employers' motivations to provide quality workplace pensions? For a start, pensions need to be depoliticised, and we suggest some kind of independent 'retirement savings panel' to become responsible for the pensions framework. It should have the authority to think the unthinkable and do the unprecedented – including overriding changes which give employers the option to alleviate legacy pension burdens imposed by previous legislative changes. However, as it would take some time to set up such a panel and for its influence to start having an effect, in the meantime some quick practical changes would be welcome.

Two ideas to get us started would include:

- Reduce the Annual Allowance instead of the new proposed restrictions on tax relief for higher earners from April 2011.
- For the Personal Accounts Pension Scheme, remove the cap of £3,600 a year on contributions and remove the ban on transfers from other pension arrangements.

Public sector pension schemes – the future landscape?

By Bart Huby, Partner, Lane Clark & Peacock LLP and Chairman, ACA Public Sector Outsourcing Committee

A recent Office of National Statistics survey showed that in 2008 there were 5.4 million active members of public sector defined benefit (DB) pension schemes, an increase from 5.1 million in 2006. Over the same period, active membership of private sector DB schemes fell from 3 million to 2.6 million, and this is undoubtedly significantly lower now a year later, following the recent wave of private sector schemes closing to future accrual.

So, where now for the public sector? Will it be able to justify continuing to offer DB pensions to its employees, once this becomes a genuine rarity in the private sector? If so, what will they look like, how will they be funded and how will their costs be assessed? And how will the pensions of employees be handled when the provision of public services is outsourced to the private sector?

These are very important questions for public sector employees and for the public finances – for both current and future generations of taxpayers. Yet their outcome is at present very uncertain, with public sector employees and unions typically keen to maintain something like the status quo, but a rapidly growing awareness amongst the general population of the potential future costs to taxpayers of providing for these pensions.

In his recent Pre-Budget Report, the Chancellor has proposed implementing "cap and share" reforms from 2012 to "limit the liability of the taxpayer as pensions become more valuable". However, there is very little detail on what this would mean in practice, and no indication that the growing divide between public and private sector pensions will be materially addressed under these proposals.

Rather than trying to use a crystal ball to predict the future, it may be more helpful to consider the main issues involved and what kind of solution may best address them.

Arguably there is nothing fundamentally wrong with providing public sector employees with DB pensions. Indeed they are likely to be a fairer and, in many ways more efficient, way of providing employees with a reasonable level of income in retirement, compared with the main alternative of defined contribution (DC) pensions. Furthermore, the public sector is much better placed than all but the very largest and most stable private sector companies to take a long view and meet the costs in a stable and structured way.

Unfunded issue

A significant issue, however, has been that, with the schemes' benefits generally being unfunded, their costs have not been transparently assessed or explicitly recognised in the public finances. Depending on how you measure them, the UK currently has unfunded public sector pension liabilities of in the order of £1 trillion – these are financial obligations which will have to be met by future taxpayers, in the same way as the interest and capital on gilts, but they do not form part of recognised public sector debt.

There have been significant reforms to the main public sector schemes in recent years to control increasing costs resulting from improved longevity expectations and falling interest rates. However, partly as a result of the lack of transparency, these reforms have been relatively slow and piecemeal. For example, while all the main public sector schemes have now moved to having a retirement age of 65 for new entrants, the large majority of current civil service and NHS employees, who joined before the changes, still retain a retirement age of 60.

So what are the key issues, and how can they best be addressed?

Appropriate, affordable and sustainable

The statistics point to an increasing proportion of older people in the population. The key to affordability and sustainability will be to provide an adequate, but not excessive, level of pension to employees from when they cease to be able to do their work, but no sooner. Employees wishing to retire early or to have a higher standard of living in retirement would need to save more themselves. The State, as employer, should aim to enable its employees to retire on a decent basic level of pension when they are no longer able to perform their duties.

What would such a pension scheme look like? Firstly, it should probably be DB, as this avoids the inefficiencies and perceived unfairness resulting from the "winners and losers" element of DC. Secondly, it should be career average rather than final salary, both to make the costs more predictable, and so that the employee's pension will more closely reflect their contributions throughout their career, compared with a final salary scheme. And thirdly, there should be a cap to DB pensionable pay, so that the DB risks being covered by the State relate to a basic level of income in retirement, with higher earners bearing the risks above that level.

Career average solution?

A possible example benefit structure might therefore be: a career average pension accruing at 1/60th per annum based on pensionable pay subject to a cap of £40,000 per annum in current terms; with DC provision for earnings in excess of this amount. Normal retirement age would be higher generally than now perhaps tying in with State Pension Age, which is currently set to increase to 68, but employees working in physically demanding jobs would be able to retire early on an unreduced pension – either as of right based on their job description, or subject to an occupational health assessment.

Such an arrangement, if achievable within a reasonable timeframe, and seen to be affordable and sustainable to the State, might perhaps even form the basis for a revival of DB pension provision amongst larger and more stable private sector employers. Particularly for the lower paid, DB pensions have considerable advantages in terms of practicality and fairness compared with DC. In recent years there has been a small but significant number of large private sector employers who have introduced redesigned lower-risk DB schemes which are open for new employees, recognising their value both in attracting new employees and in enabling them to retire long-serving employees at the end of their careers. If the State can set an example of an appropriate affordable DB arrangement for its employees, this might encourage many more private sector employers to go this way.

Proper recognition of the costs

Politicians generally find it difficult to view the costs of public sector pensions objectively. It is hard for Government to do so because of the impact on the perception of the state of the public finances, even though (or perhaps because) the cost is off balance sheet. This is also a very sensitive issue when cost control reforms of benefits and employee contributions are under consideration.

Might it therefore be better to place the assessment of the long-term cost of public sector pensions in independent hands, much in the way that inflation management was made the responsibility of the Bank of England rather than politicians in 1997? While there would still be a considerable element of judgement in assessing the costs, in particular regarding appropriate discount rates and longevity assumptions, an independent body (perhaps the Bank of England itself) could make these judgements without being directly concerned or influenced by political issues. Government would still be responsible for the benefits and contributions of the public sector schemes, and would be able to set policy based on independent objectively assessed cost benchmarks.

With such an arrangement, there may also be a window of opportunity to put the cost of accrued public sector pensions on balance sheet. With the country having taken on so much additional debt as a result of the global financial crisis, there will need to be a fundamental review of the public finances following the general election next year – this could be a "blame-free" opportunity to put public sector pension liabilities on balance sheet. They would then no longer be the elephant in the corner, and the impact of future decision making in respect of benefits and contributions would be much more transparent.

Pensions in public sector outsourcing

The gap between DB public sector pensions and the position in the private sector, raises problems when public sector bodies look to outsource services (such as facilities management, IT support, waste management, catering, etc) to the private sector, in order to gain access to private sector expertise and operational management skills.

The Government's stance is that where employees transfer employment on such an outsourcing contract, the new private sector employer must provide the same kind of DB pensions as in the public sector – this is known as the "Fair Deal". Unfortunately, however, the Fair Deal requirements deter many private sector companies from bidding for such contracts, and those that do bid often add significant extra margins to their bids to cover the pensions risks they have to take on - risks that most do not feel able to take for their mainstream employees. This inevitably means significant extra costs for the public sector, as a more competitive tender process and keener bid pricing would result if there were no material pensions funding issues for the bidders to deal with.

To improve the cost-effectiveness of the outsourcing process, and to create a level playing field between all bidders, the Government should recognise that the public sector is better placed to bear the long-term risks of DB pensions than private sector companies - and that if it does so it will in fact get better value for money on outsourcing contracts. This could be achieved by allowing transferred employees working on such contracts (particularly shorter-term contracts of up to say 10 years) to remain in the relevant public sector scheme with the funding risks being met by the State, except to the extent those risks that are directly under the influence of the employer (eg salary growth, early retirement, and augmentations).

Conclusions

There are major issues in public sector pensions which will need addressing soon, relating to the level of benefits offered to public sector employees, the way in which their costs are assessed and accounted for by the State, and how they are treated when employees transfer to private sector employment on outsourcing contracts. Many of these issues have started to be tackled in the Local Government Pension Scheme, for example, many authorities allow retention of some pension risks on outsourcing contracts, and cost sharing arrangements will be implemented in the next few years, but even here there are problems with implementation and overall costs.

Moving towards the kind of affordable and sustainable landscape outlined in this article will not be easy in light of the complexities and vested interests involved. However some form of major change is almost inevitable and, if it is not planned and managed carefully, could result in significantly less satisfactory outcomes for all parties.

DC: it's personal, isn't it!

By Mark Duke, Principal, Towers Perrin and ACA Main Committee

The occupational pensions landscape is increasingly dominated by defined contribution plans. The various governance structures may differ, but at heart they share the common challenge of trying to create a connection between the individual and their savings – a connection that was generally absent when a person's company pension could be described by way of a formula in a rule book.

Finding better ways of delivering pension saving in a DC world is a big topic. Literature is easy to find. Insurers, fund managers, actuaries, governments and academics contribute daily on the subject. In the UK those in charge of the embryonic Personal Accounts system are grappling with the issue.

My aim is not to compete with this cacophony but instead to make some entirely personal observations based on what I see. Consensus may be impossible and, I would argue that, if consensus is achieved, it probably just means everyone has got it wrong. There is room for disagreement!

For the actuary, our skills have generally been applied to the problems of institutions that are making long and short term decisions about reserving, funding and investment in the context of their objectives. Skills that are highly relevant to anyone concerned with the challenges of the DC world when the institution is the individual.

Whose money is it?

Company sponsored DC plans are long term savings vehicles through which employees defer their pay for later consumption. Whether it is a Government or employer making the decisions, this is the starting point. It raises the fundamental question of whether employees should be forced to save and, if so, how much saving should be required, into what type of savings plan should the money go and how much freedom should the individual have to manage their money along the way. For the employer, the choices made will be materially influenced by State pension provision and the regulatory backdrop.

As practical people, we do not always have time to reflect too deeply on these fundamental questions. But it's always worth remembering that when designing any form of pension provision we're making decisions about how people use **their** money.

We have reached a fascinating position where very different philosophical positions are emerging about the way DC provision is delivered. To hugely over-simplify these two positions can be summarised as follow. Perhaps the biggest distinction between them is the extent to which the individual is deemed able to make financial decisions.

Over to you then

In this world the individual is left to choose whether they save. The employer takes no position about whether pay should be deferred – other than to comply with whatever rules are imposed by the State such as auto-enrolment and minimum contributions. The personal circumstances and aspirations of the individual are assumed to be just that – personal.

Information will be made available that (if the individual chooses to pay attention) will encourage the employee to make informed decisions. The employer may use a third party to facilitate access to a range of savings products including pension and possibly advice.

The way the individual chooses to use these products and services will be up to the individual. It is likely that any employer subsidy or support will cease when employment ends. Even in this system there is a decision to be made about what happens if the employee makes no active decisions. Assuming the employer sees themselves as a source of remuneration, not pension, the answer is probably that the default position is cash in hand. Indeed the employer might argue that the employee could be taking the cash and arranging all their savings personally.

You can leave it to us

In this world the employer decides that there is some core level of pay that needs to be deferred. The need to save for retirement throughout a working lifetime is regarded as vital but most employees need to be nudged, compelled or incentivised to save.

There is likely to be a view that no matter how effective the information provided to employees, the majority may be reluctant to engage with topics such as investment risk. Consequently, assumptions have to be made about what a fit for purpose DC investment choice looks like for this silent, disengaged, majority. This does not mean absence of choice. But consistent with the desire to herd the right groups of people into the right choices, attempts will be made to help employees easily to assign themselves to a profile that will lead them to a suitable range of options.

As well as defining a core level of pension saving and the best default investment options, the employer (or trustees) will take an active role in monitoring the performance and efficiency of the underlying products made available through the pension plan.

Health warning

Such a black and white characterisation ignores the many shades of grey that lie between the two approaches. The danger of grey is that key elements of good implementation can get lost. For example, I may be an employer who instinctively favours the "over to you" approach. Unless I want to be completely silent and hands off, there remains the need to explain to employees how they are now responsible for their decisions and ensure that they have the means to plan their finances. Unsupported choice may well produce worse outcomes than no choice at all.

Similarly, taking some responsibility for the selection and monitoring of employees' DC pension options requires diligence and persistence. Treating DC provision as something that can be governed on the cheap with little effort leads to what I would describe as "lazy default". Here, a single off the shelf default is implemented, isn't that well communicated, collects the bulk of the DC money and is infrequently, or only half heartedly, reviewed. As employers and trustees have struggled to deal with a defined benefit pension legacy, while DC has grown materially in importance, this situation may have crept up on some pension plans.

Fortunately there are signs of change as DC governance is taken more seriously as evidenced by the Pensions Regulator's initiatives.

Next - a financial plan

So what might we expect to be involved in as the DC pension saving market develops?

The greater the responsibility passed to the individual, the greater the need for tools that help employees match their circumstances and preferences to a personal financial plan. This will have to embrace more than long term retirement planning. It has to start with the person's immediate concerns which will often be as much to do with expenditure and housing as about the distant and highly uncertain issues around retirement (not least the uncertainty of the balance between working lifetime and length of retirement). These tools need to show outcomes in an intuitive way and ideally capture the risks that arise from using different types of investment. And very importantly, especially for the lower paid, the level of State pension provision needs to be illustrated since for many this is likely to remain the bedrock of their lifetime retirement income.

Any tool also has to be layered such that the employee can quickly get value from "light touch" use but enables a much more rigorous investigation of the wider range of savings options and investments. Potentially it offers a means of managing these savings and executing instructions as well as a way of storing personal information that could be discussed on a one-to-one basis with an adviser.

Many of the building blocks already exist in the tools (and by this I mean all forms of communication) that are being used to support commercial savings products/portals, occupational DC plans and flexible benefits arrangements. Pulling it all together (and working out who pays for the tools and services) is the next step.

Better default

Even where employees are being directed, or defaulted, to a particular DC solution, the market shocks associated with the credit crunch have called into question some of the conventional life styling investment approaches to DC. In particular, there is evolution in the following two areas.

- Simplicity has its virtues but directing, as often happens, most DC money into equity funds may not be ideal. Personal investors generally don't like volatility, no matter how long the long term, and there should be diversification opportunities that are being left unexploited. It is up to the pension plan or product provider to decide on implementation. For example, the outcome could be more use of funds that have a target rate of return (achieved across a broad spectrum of assets) or just greater diversification within the default portfolios and some discretion for the manager to move between asset classes. Whatever the solution, there is a governance issue. Who is taking the fiduciary responsibility for the chosen strategy? Trustees will be wary of "black box" products where they remain ultimately on the hook for setting strategy and selecting product.

- The default world need not be one where the personal dimension of savings decisions is completely ignored. Attempts can be made to create default solutions that recognise that there is probably a difference between the needs of a 25 year old earning £16,000 per annum and a 35 year old earning £100,000 per annum (not least that the tax system will soon remove high income individuals from normal DC plans). This suggests trying to do some segmentation based on what the employer does know about his employees and then direct people to asset mixes that may better reflect their circumstances. For example, there is no reason why the core plus approach cannot be applied to DC so that there is a core of lower risk savings accumulating in respect of a first tranche of earnings and greater risk or personal discretion encouraged in respect of higher income. Individuals could even be encouraged to set target fund levels that they want to achieve and the underlying asset mix is de-risked as the target is approached.

Nobody said it was easy

DC pensions and the personal responsibility that goes with it, gets us straight into the messy world of the individual. Actuaries have much to contribute to the analysis of the underlying financial problems and solutions. Equally we have much to learn about how best to connect with individuals in all their glorious diversity. It really is personal, isn't it?

Continued from Page 1

less of a priority, but where immense challenges remain to engage employees meaningfully and in managing more reliable pension outcomes.

The articles are by no means exhaustive in covering the range of ideas that public policymakers and practitioners in the sector should be considering. The ACA's *2010 Biennial Review*, as well as reporting on the *ACA's 2009 Pension trends survey* and the work of the Association, includes other ideas – including the ACA's Pensions Manifesto – and will be available shortly in printed form and at our website at www.aca.org.uk

Pensions - a divided nation: the challenge still remains to be addressed . . .

A famous TV sketch re-visited, what our characters might say today...
Cleese: *'I look down on them (Barker and Corbett) because I'll retire at 60 on two-thirds final salary thanks to my public sector index-linked pension.'*
Barker: *'I look up to him (Cleese) because he's got a pension paid by tomorrow's taxpayers come what may, whilst my private sector employer struggles to meet the increasing cost of providing a funded pension. I will be lucky to retire at 65. But I look down on him (Corbett) because my pension is still better than his.'*
Corbett: *'I look up to him (Cleese) 'cos he's obviously much more important than me. He's got what I'll never 'ave. I look up to him (Barker) less 'cos his pension is a bit like mine - uncertain, because of shocks and scares. I know my place - first a 'stake-burger' pension, now a work 'til you drop one!'*

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