The UK pensions landscape: from leader to laggard?

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Pension Corporation

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PENSION CORPORATION

Overview of presentation

- About us
- Part 1: Pre-crisis: a changing pensions landscape
- Part 2: The economic and financial crisis and its impact on British pensions
- Part 3: The new Government's take on pensions
- Concluding comments

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About us

- Pension Corporation is a market leader in offering risk transfer solutions to private sector DB schemes
- Pension Corporation supports a Thought Leadership programme on pensions, focused on providing quality independent research
  - ► sponsors the Pensions Tomorrow initiative at the London School of Economics
  - ► launched in early June www.pensionomics.com
- Frank Eich is on secondment from HM Treasury to Pension Corporation. Working for PC offers valuable insights into the pensions industry, complementing his government expertise
- Bob Swarup is a partner at Pension Corporation. His research focuses on macroeconomic issues in pensions, the role of financial markets and asset-liability management.

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Part 1: Pre crisis: A changing pensions landscape

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Part 1: Pre crisis: A changing pensions landscape

- Post Labour victory in 1997, a “golden decade” with steady economic growth, low unemployment and modest inflation
- An ambitious state pension reform agenda
  - the Pensions Commission and the 2007 and 2008 Pension Acts
  - increase the state pension age in three steps to 68 years by mid 2040s
  - re-index basic state pension to earnings in “next parliament”
  - create NEST (National Employment Savings Trust), with personal accounts starting in 2012 and fully up and running by 2016 (later postponed to 2017). Auto enrolment major feature of new scheme
- Incremental parametric reforms to public sector pensions
  - e.g. cap and trade, raising retirement age to 65 years for new joiners, reduced accrual rates etc.
  - politically challenging due to the public sector’s relatively high degree of unionisation

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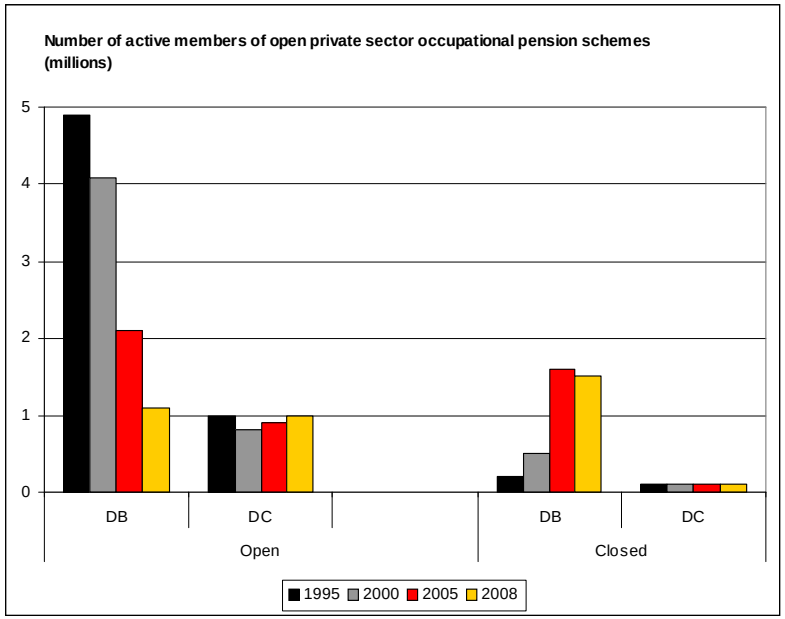
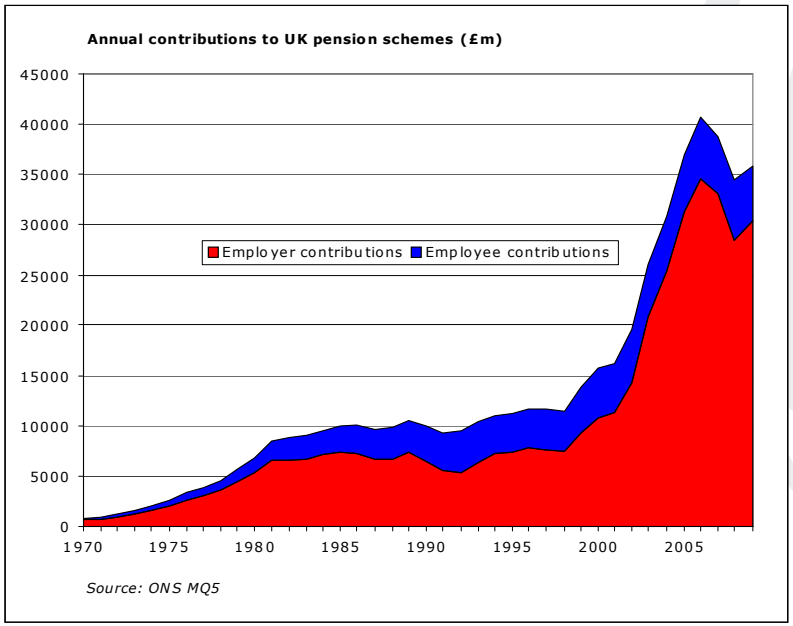
Part 1: Pre crisis: A changing pensions landscape

- In private sector *the* key trend was the closure of DB pension schemes
  - ► new accounting rules such as FRS 17 revealed true accrued cost of pension liabilities
  - ► update of actuarial assumptions such as longevity
  - ► increased funding requirements by corporate sponsors to meet these shortfalls
  - ► transfer of risk from the corporate sponsor to the individual BUT decline of DB schemes has not been offset by increase in DC membership





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Part 1: Pre crisis: A changing pensions landscape

- Between 1991 and 2008 active members in pension schemes in the
  - ► private sector dropped from 6½m to 3.6m (~22m people in private sector employment) but
  - ► public sector increased from 4.2m to 5.4m

Number of members of occupational pension schemes: by membership type and sector, 1991 to 2008 (Millions)

	1991	1995	2000	2000	2004	2005	2006	2007	2008
Active members	10.7	10.3		10.1	9.8		9.2	8.8	9.0
Private sector	6.5	6.2		5.7	4.8	4.7	4.0	3.6	3.6
Public sector	4.2	4.1		4.4	5.0		5.1	5.2	5.4
Pensions in payment	7.0	8.5		8.2	9.0		8.2	8.5	8.8
Private sector	3.8	5.0		5.2	5.6	5.3	4.6	4.8	5.0
Public sector	3.2	3.5		3.0	3.4		3.5	3.7	3.9
Preserved pension entitlements	4.5	7.0		6.7	9.3		9.4	9.4	9.9
Private sector	3.3	5.2		5.2	7.1	6.4	6.5	6.3	6.7
Public sector	1.2	1.8		1.5	2.2		2.9	3.1	3.2
Total	22.2	25.8		25.0	28.1		26.7	26.7	27.7
Private sector	13.6	16.4		16.1	17.5	16.4	15.2	14.7	15.3
Public sector	8.6	9.4		8.9	10.6		11.5	12.0	12.4

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Part 2: The economic and financial crisis and its impact on British pensions

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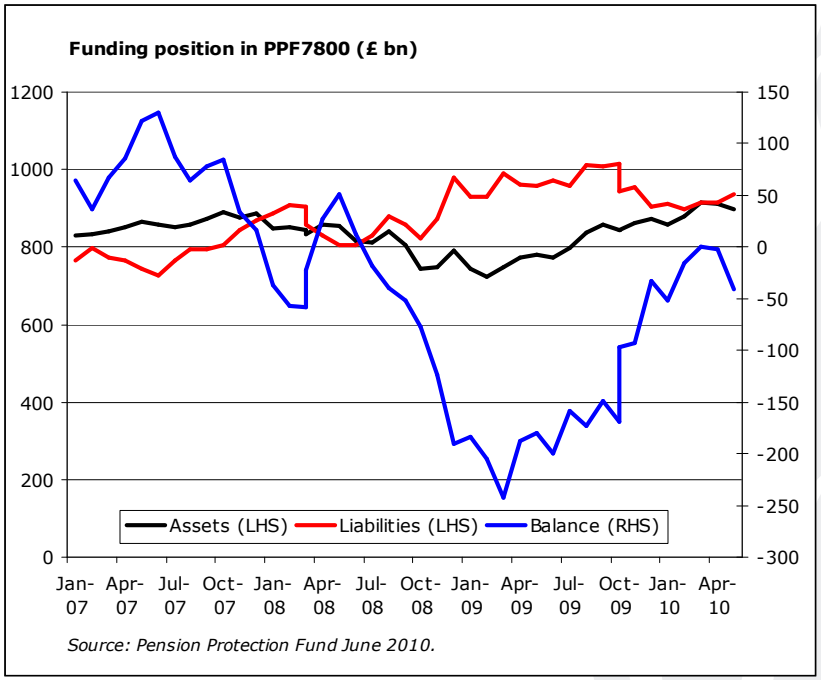
Part 2: The economic and financial crisis and its impact on British pensions

- A major discontinuity – “things will never be the same again”
  - ▶ rapid deterioration and continued volatility in net funding position of DB schemes, while DC schemes have fared badly too: a “lost decade”
  - ▶ hits to revenues and lack of access to credit for many businesses
    - – increasing stress on corporate balance sheets
    - – growing tensions between shareholders and pension obligations
    - – elevated sponsor risk due to continuing headwinds in the economy
  - ▶ high profile DB closures in 2009
  - ▶ further shift of risk allocation to individuals



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Part 2: The economic and financial crisis and its impact on British pensions

- record low interest rates and quantitative easing, the latter hitting annuity rates and DB liabilities
- fiscal stimulus and QE increase worries over future inflation and state of government finances – particularly troublesome for DB schemes
- households savings rate up despite drop in interest rates, much of it though to rebuild their balance sheets and pay down mortgages
- employee contributions dropped between 2007 and 2008 (and probably also 2009)

Member and employer weighted-average contribution rates to private sector occupational pension schemes: by benefit structure, contributor and status, 2007 and 2008 (%)

		Member		Employer		Total	
		Open	Closed	Open	Closed	Open	Closed
Defined benefit	2007	5.5	4.3	15.0	16.1	20.5	20.5
	2008	5.1	4.8	14.6	18.1	19.7	22.9
Defined contribution	2007	2.6	3.2	6.4	7.0	9.0	10.2
	2008	3.0	3.4	6.0	7.0	9.0	10.4

- emerging market in pension buy outs – rapid growth during crisis
- corporate sponsors held back by funding positions leading to huge increase in other types of risk transfers (including longevity risk)

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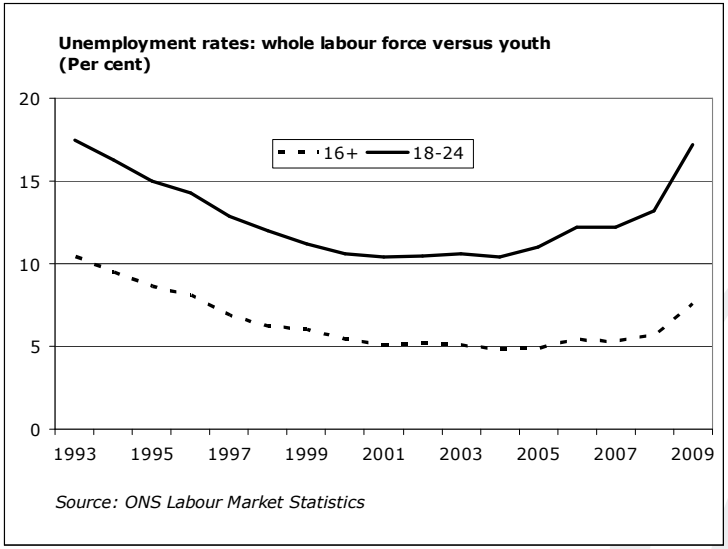
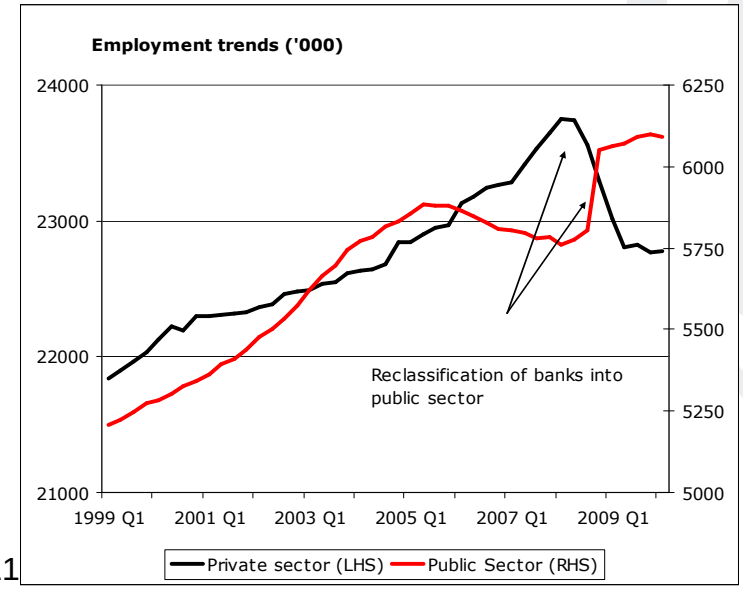
Part 2: The economic and financial crisis and its impact on British pensions

- **longer term**, significant fiscal imbalance will make it difficult to offer more generous state pensions and encourage raises in state pension age
- public sector continuation of DB pension schemes has led to claims of a “pensions apartheid” and increasing public discontent
- employment fell in the private sector (with youth unemployment increasing strongly) but remained pretty stable in public sector
  - more people with broken employment records
  - economic activity for over 65s continues to rise
- society also has to prepare for the economic and fiscal consequences of population ageing, married to the retirement of the baby boomers





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Part 3: The new Government's take on pensions

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Part 3: The new Government's take on pensions

- New Government announced number of policies and initiatives in coalition agreement, including
  - an independent commission to look into the future of public sector pensions while guaranteeing accrued entitlements
  - offering a "triple guarantee" to pensioners, with Basic State Pension indexed to earnings from 2011 onwards (earlier than previously planned despite fiscal position) and rising at least by inflation or 2½ per cent, whichever is higher
- Less high profile announcements
  - reviewing the "scope" of NEST and the structure of personal accounts
  - eliminating need to buy annuity by age 75 years, perhaps allowing early access to pensions savings
  - phasing out default retirement age of 65 years
- No announcements with respect to private sector occupational pensions

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Part 3: The new Government's take on pensions

- (Additional) budget measures
  - raise income tax allowance aims to help those on low incomes. As many pensioners are on low incomes, this benefits them too
  - review plans to reduce pension tax relief for people on high incomes. New Govt shares business concerns that policy is too complex but determined to raise the same amount of money
  - increase in State Pension Age to 66 years for males by 2016 (from 2024) and later for females

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Concluding comments

- UK pensions landscape in a state of flux pre crisis and now hit by downturn
  - former envied private/public mix has proved unsustainable in current form; UK no longer a “leader” but interesting lessons can be learnt for other countries
    - e.g. when assessing long-term sustainability of public finances, important to consider credibility of overall pension strategy
  - “once in a generation” reforms left system as complex as ever and likely to be revisited again soon
  - questions remain over NEST/Personal Accounts
  - related, still no strategy to help those above modest incomes save for retirement – property market continues to be obvious choice for many
  - lack of appreciation of long-term challenges: there is greater support for “levelling down” public sector pensions to private sector levels than to try to make the latter more generous

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