

Alternative Approaches to the NPSS

The Pensions Reform Group (PRG) principles – a framework for pension reform.

Summary

The PRG proposal is for a universal funded defined benefit pension – called the Universal Protected Pension(UPP) - to sit on top of the existing Basic State Pension. Those who are in the UPP would cease to accrue State Second Pension.

A full Basic State Pension plus UPP would pay 25-30% of national average earnings throughout retirement. Our primary aim is therefore to establish an acceptable level of minimum pension, although the governance and fund management structure we propose could be used for additional voluntary low-cost pension provision.

Principles

We have established six principles around which we believe reform should be based:

Abolishes pensioner welfare: The key is that the new pension should be set at such a level that the Government can, with absolute confidence, announce the phasing out of Pension Credit. The Universal Protected Pension is a guarantee based on a fixed minimum percentage of national average earnings for all who contribute to society including carers. The payment would come in part from the basic state pension (to which the Government would have to make a contractual commitment) plus a centrally but independently administered fund to top it up to achieve a minimum national average earnings-related pension.

No new forms of compulsion: the scheme would be compulsory for all in work, but there would be no new forms of compulsion. Contributions to the fund would be collected through the NIC system by the Contributions Agency. Compulsion is essential in a scheme which is redistributive.

No miss-advising or miss-selling: because the scheme is compulsory there is no need for advice. The charges of miss-selling for the private sector providing additional pensions are minimised. Likewise the Government is not open to charges of miss-advising.

Redistributive: broadly, this scheme is as redistributive as the Basic State Pension scheme. This meets the key tests of fairness (“something for something”) and the more practicable one of affordability. PRG does not see how one can establish an incentive based scheme which can honestly address the needs of those who most need to save for their retirement but cannot afford to do so, or that can guarantee take up by those who need it most – hence the need for compulsion and redistribution.

Funded: it is a critical element of the proposal that the scheme should be funded – to distance it from Government – “it is our/my money: they cannot fiddle with or expropriate it’. The fund, administered by independent trustees, would be invested in a range of assets around the world to diversify investment risk.

Independent: It is critical that there should be a governance structure that puts significant distance between the scheme and politicians. The trustees would be

appointed by the Governors. The trustees would be ratified by both the active members and pensioners. Apart from administering the fund (subcontracting day to day administration to private sector managers), the trustees would determine the fixed minimum pension level, subject to the minimum guaranteed amount, and the level of contributions.

These principles are listed separately but, in reality, they are intimately inter-related.

PRG's reform plan

PRG's proposal is to provide a **Universal Protected Pension** of between 25 to 30 per cent of national average earnings at retirement with the real value of the pension maintained against earnings throughout retirement. Trustees will set contribution rates which will deliver this guarantee. The reform is built by a number of steps: .

1. Maintaining the existing Basic State Pension indexed to prices, but indexing it to earnings for members of the UPP. This would be factored into the overall contribution rate.
2. Building up a funded pension that, together with the Basic State Pension, will guarantee a minimum income of 25 per cent of national average earnings throughout retirement.
3. The funded provision will cover the cost of uprating the BSP component of this guarantee in line with earnings for members of the UPP while meeting the overall cost of a pension of not less than 25 per cent of national average earnings and maintaining this overall pension in line with earnings throughout retirement.
4. Investment risk in this scheme is spread amongst all contributors. Pre-retirement longevity risk will rest with the individual year cohorts to the extent that the UPP pension age could be altered up to, say, 15 years before planned pension age. Post-retirement longevity risk rests with contributors – i.e. if pensioners live longer than expected it is funded by an increase in contribution rates.

A public private pensions partnership

We are proposing a creation of a non-state universal pension scheme. This status would have been easily recognised and understood before welfare was nationalised in 1948. Since then collective provision has been defined exclusively in state terms. The PRG's proposal helps redefine the meaning of "public".

The governance of our scheme is crucially important to its success. The proposal is for the scheme's governance to be modelled on the Bank of England's Monetary Policy Committee and to be housed at the Bank. This proposal is fundamental. Few members of the scheme are likely to think that their funds would be secure if they were held by the Government. Likewise, guaranteeing the abolition of poverty in retirement is simply too an important objective for government to be completely excluded. The government sets the inflation target for the MPC. Under the UPP scheme the government would enact a minimum pension provision of at least 25 per cent of average earnings. Likewise, as the Chancellor appoints members of the MPC so too, we propose, the governors of the scheme being appointed by the government on long staggered terms and chaired by the Governor of the Bank.

The PRG proposes a partnership with the private sector in carrying out its fund management duties. The funds of the scheme are estimated to be peak at 10 per cent of the UK stockmarket – although trustees will not be limited in their investment policies to British equities or gilts. They will have a duty to act in the best interest of members as do all current pension trustees.

The introduction of the UPP will offer private financial institutions the guarantee that they cannot miss-sell savings and pension products to clients who could be better off claiming means-tested welfare. Full members of the scheme will retire on a pension guaranteed to lift every full contributor above means-tested help. Up until now the private sector has been extremely wary of selling savings products to possibly 40 per cent of the workforce for fear of miss-selling charges. With the UPP's introduction the private sector will no longer have to try and raise national savings levels with one hand tied behind its back.

The advantages of the PRG's proposals

1. It builds on the success of Pension Credit and maximises the opportunity to introduce a radical reform to abolish poverty in retirement which will take decades to roll out fully.
2. It spreads investment risk across all contributors and shares longevity risk between individual year cohorts for pre-retirement longevity risk and contributors for post-retirement longevity risk.
3. It will offer the lowest administrative cost of any scheme on offer. It would be possible to leverage these low administrative costs for additional voluntary contributions – probably defined contribution in nature.
4. It will help meet the government's objective of reversing the 40-60 ratio of private to state provision.
5. As the UPP will become a large fund with a guaranteed stream of new contributions it will be able to maximise the extent of its investments in equities which historically out-perform gilts.
6. It will safeguard occupational pensions in that the introduction of the UPP will be accompanied by regulations allowing existing company schemes to off-set the UPP to a final salary commitment.
7. It minimises miss-selling. Pensions are too big an issue for the Government not to offer advice, but advice is inextricably linked in the public mind to the idea of a safe haven. Given the dangers attached to giving advice, let alone providing a collecting agency, the UPP has the advantage of setting a minimum return and placing the responsibility for delivering that return full square with the scheme's trustees. Members will be called upon to fund their scheme without arbitrary levies being placed on taxpayers.
8. Allows the Government to promote an unambiguous message 'Your UPP will take you above Pension Credit so you will have a totally reliable basis on which to plan your additional savings'.

The costing of PRG's proposals

The PRG's proposals are currently being costed by the Government Actuary.