

Developing alternative approaches to a National Pensions Saving Scheme

A submission from the Pensions Reform Group

Following the publication of the second Pensions Commission Report the Minister for Pensions Reform issued a challenge to the pensions industry to come up with a more robust alternative. The PRG willingly accepts that challenge and does so because it believes the Pension Commission proposals squander the unique opportunity which is now presented to the country on long-term sustainable pension reform.

This opportunity arises from the success of pension credit. All attempts to reform pensions since the late 1950s have been stymied because the government of the day battled to come up with a long-term reform which simultaneously gave generous help to those pensioners who were then poor. Thanks to the record redistribution through pension credit to pensioners who were poor when Labour came to power in 1997 the Government has the opportunity of being single-minded in its structural reform of pension provision. The Pensions Commission proposals blow this once in a life-time opportunity by proposing reforms which will not achieve the long-term goals of taking practically all future pensioners off means-tested benefits.

The Pension Commission proposals embodied three structural weaknesses.

1. They do not aim to eliminate future pensioners covered by its reforms from being dependent on means-tested assistance.
 - under the pension credit the number of pensioners dependent on this means-test will top 70 per cent in 2050. The Pension Commission proposals if totally successful will still leave over 30 per cent of pensioners on means-test – i.e to around the level it was before pension credit was introduced.

2. Their proposals open a future government to mis-selling on a massive scale.
 - the government already faces serious miss-selling charges from aggrieved pensioners over producing a leaflet which suggested that people who could should join an occupational pension. What would be the scale of charges of mis-advice from members of the National Pensions Saving Scheme retiring during a down-turn of the market? Moreover, the movement into bonds which takes place in individual schemes as the contributor moves towards retirement does not counter the risk that can face an individual just before equities are switched into bonds if, at this point, there is a collapse in the equity market. The individual's savings for retirement are depleted at the point of buying bonds, rather than at the movement from bonds into an annuity.

3. The UPP has the best of both worlds – it is funded and invested in a range of assets around the world but also provides a guaranteed level of pension. Because it will cover practically the whole population the risks which inevitably occur can be spread over the entire population and thereby across generations if need be.

4. Their proposals are likely to lead to the final demise of occupational pension schemes being major providers of income for pensioners.
 - four-fifths of final salary occupational schemes have closed to new members over the past 10 years but around four-fifths of these closures have occurred since 2000. Many and perhaps most of the occupational schemes open to existing members – both DC as well as DB - will seize the opportunity to cut the firm’s pension contribution rate opting instead for a three per cent NPSS contribution. Far from the three per cent contribution becoming a floor the NPSS rate could quickly become a ceiling to employers’ contributions. Its most significant impact might therefore be to switch members from occupational schemes to the NPSS.
 - The PRG believes that it is crucial to understand what it is in the Government’s power to do and what is properly left to the private sector. Our view is that the Government can and should concentrate all its attention on ensuring that there is a basic pension which has universal coverage. All additional

pension coverage should come from the private sector. But in making changes to the basic pension the Government should be vigilant that its actions do not further weaken the role of occupational pension schemes.

The PRG principles – a framework for pension reform.

We reiterate that the UPP proposed core scheme is merely a proposal for others to adapt. However, we have established five principles which define its strength and which should be immutable:

- **Guaranteed pension** 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 existing price indexed 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 that minimum national average earnings-related pension; this fund would use the Contracted Out Rebate (COR) as part contribution to the scheme. The key is that the pension should be set at such a level that the Government can, with absolute confidence, announce the phasing out of Pension Credit.
- **No new 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.

- **Redistributive:** this scheme is as redistributive as the basic state pension scheme – over the relevant National Insurance bands, everyone puts in the same percentage of income for the same monetary pension at the end. 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 scheme which can honestly address the needs of those who most need to cover their retirement but cannot afford to do so or that can guarantee take up by those who need it most – hence the need for 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 would be administered by independent trustees who would select private sector professional fund managers to manage the money. The fund would be invested in a range of assets around the world to diversify the 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 the present and future 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 are for a major new initiative between the public and private sectors aimed at providing a universal adequate minimum pension. Its aim is to provide a **Universal Protected Pension** of between 25 to 30 per cent of 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 on the following moves.

1. Maintaining the existing basic state pension linked to prices during a person's working life.
2. Building up a funded pension which will guarantee a minimum income of 25 per cent of average earnings during retirement.
3. The funded provision will cover the cost of uprating the BSP component of this guarantee in line with earnings only at retirement while meeting the overall cost of a pension of not less than 25 per cent of average earnings and maintaining

this overall pension in line with earnings throughout retirement.

A public private pensions' partnership

The PRG's proposals are for a PPP with a significant addition to current practice. 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 our 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, do 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 British Stock Market – 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 a Universal Protected Pension will offer private financial institutions the guarantee that it 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 have 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 of its hands tied behind its back.

The advantages of the PRG's proposals

1. It builds on pension credit success and maximises the opportunity to introduce a radical reform to abolish poverty in retirement which will take decades to roll out fully.
2. It will offer the lowest administrative cost of any scheme on offer.

3. It will help meet the government's objective of reversing the 40-60 ratio of funded to pay-as-you-go provision.
4. As the UPP will become a large fund with a regular growth in new members it will be able to maximise the extent of its investments in equities which historically out-perform gilts.
5. 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.
6. 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.
7. 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

PRG's original proposals were costed by the Government Actuary and published in **Universal Protected Pension Modernising Pensions for the Millennium** (Report by the Pensions Reform Group, October 2001). There then followed a series of consultations through three working parties and the membership of which are given as an appendix. The results of the consultations lead to a review of the UPP proposals and these were published as **Universal Protected Pension The Follow-Up Report** (July 2002). These proposals have undergone further revision and are currently being costed by the Government Actuary and will be published at the end of February.

Appendix

List of membership of PRG and its working parties. The position of members are the ones held when they were part of the working parties.

Pensions Reform Group Review – Participants

Pensions Reform Group

Kate Barker	Monetary Policy Committee, Bank of England
Professor Alan Deacon	Professor of Social Policy, University of Leeds
Frank Field MP (chair)	Former Minister for Welfare Reform
Howard Flight MP	Shadow Paymaster General
Ben Forsyth	Secretary, Pensions Reform Group
Peter Gray	Chairman, Welfare Reform Unit, Hertford College, Oxford University

Carolyn Hayman	Director, Foyer Federation
Nicola King	Former Director of Rothschilds
Tim Lefroy	Head of Radical Consultancy
Simon Linnett	Managing Director, NM Rothschild & Sons
Alison O'Connell	Director, Pensions Policy Institute
Paul Ormerod	Director, Volterra Consulting
Matthew Owen	Morgan Stanley
Sir Steve Robson	Former Second Permanent Secretary to the Treasury
Tom Ross OBE	Principal, Aon Consulting
Lord Vinson of Roddam Dene	
Steve Webb MP	Liberal Democrat Work and Pensions Spokesman

Compulsion and Redistribution Seminar Group

Richard Astie	Director of Corporate Affairs, AMP
Deborah Cooper	Actuary and Senior Consultant, William M Mercer
Mary Davies	Director, Pre-Retirement Association
Jane Falkingham	Reader in Population Studies and Social Policy, London School of Economics
Frank Field MP	Former Minister for Welfare Reform
Ben Forsyth	Secretary, Pensions Reform Group
Mervyn Kohler	Head of Public Affairs, Help the Aged
Alison O'Connell (chair)	Director, Pensions Policy Institute

Steve Webb MP	Liberal Democrat Work and Pensions Spokesman
David Willetts MP	Shadow Secretary of State for Work and Pensions
David Yeandle	Deputy Director of Employment Policy, Engineering Employers' Federation
Andrew Young	Directing Actuary, Government Actuary's Department

Governance and Investment Seminar Group

Kate Barker	Monetary Policy Committee, Bank of England
Frank Field MP	Former Minister for Welfare Reform
Michael Foot	Managing Director, Financial Services Authority
Ben Forsyth	Secretary, Pensions Reform Group
Ram Gidoomal	Better Regulation Task Force
Sheenagh Gordon-Hart	Head of Strategy and Research, EMEA Investor Services, JP Morgan
Peter Gray	Chairman, Welfare Reform Unit, Hertford College, Oxford University
Malcolm Gray	Finance Director, Railways Pension Trustee Company
Tim Lefroy	Chief Executive, Radical
Simon Linnett (chair)	Managing Director, NM Rothschild & Sons
Alison O'Connell	Director, Pensions Policy Institute

Paul Myners	Former Chairman, Gartmore; Chairman, Guardian Media Group
Sir Steve Robson	Former Second Permanent Secretary to the Treasury
Roger Unwin	Global Head, Investment Consulting, Watson Wyatt Worldwide
David Willetts MP	Shadow Secretary of State for Work and Pensions
Andrew Young	Directing Actuary, Government Actuary's Department

Occupational Pensions Seminar Group

David Bright	Pensions Management Institute
Frank Field MP	Former Minister for Welfare Reform
Ben Forsyth	Secretary, Pensions Reform Group
Peter Gray	Chairman, Welfare Reform Unit, Hertford College, Oxford University
John Hough	Managing Director, Aspen plc
Kevin LeGrand	Head of Technical Services, Buck Consultants
Chris Lewis	Head of UK Pensions, Unilever
Andrew Mitchell MP	Former Minister for Social Security
Peter Murray	Chairman, Railways Pension Trustee Company
Peter Thompson (chair)	Chairman, National Association of Pension Funds
Ed Vaizey	Head of Public Affairs, Consolidated Communications

Steve Webb MP

Liberal Democrat Work and Pensions
Spokesman

