



In addressing policy challenges, inter-generational imbalances must be reversed if the UK is to prosper in an ever-more competitive world...

ACA Chairman says we should address pension and long-term care challenges in a co-ordinated way

10 September 2010: Speaking at a major industry dinner, ACA Chairman, Stuart Southall, has said that we need to address our pensions and emerging long-term care crises in a co-ordinated way. Government can lead in this approach by pursuing joined up policies.

Stuart Southall said:

“We all need to take a more holistic approach to the consideration of financial needs in retirement and, in particular, the implications of ever-improving life expectancies and the demographically driven increase in demand for long-term care.

“The probable “lumpiness” of retirees’ income needs is a reason for greater flexibility around the uses of pension “pots”, but policymakers must somehow reach for a joined up solution to retirement saving and one that is fair as between generations.

“At the moment too many employers and employees have put pension provision in the “too difficult” pile, whilst the same appears to be true with regard to public policy on long-term care; notwithstanding the Dilnott review.

“It’s difficult to see why we are not considering a solution that looks to provide a decent pension for all, taking account of State pensions, whilst at the same time encompassing sufficient flexibility to make sure those who need long-term care have their costs largely met from the same package, but again without shifting those costs unfairly onto future generations.”

Stuart Southall noted that the Coalition Government has spoken much about ‘fairness’, but fairness always means different things to different people. However, perhaps as a minimum, he said, there should be widespread support for the notion of fairness across the generations. Considerable inter-generational imbalances have already developed but these must be reversed if the UK is to prosper in an ever-more-competitive world.

“Our children and grandchildren should not be unreasonably burdened with the current or future debts of the greying baby boomers. On the other hand, perhaps the inter-generational transfer of pension assets, or assets which could be used for long-term care, could and should be made easier and be better incentivised.”

Looking at the issues facing those working and clients in the sector, **Stuart Southall**, commented:

“Despite a de-regulatory review and many aspirational statements by successive Ministers, the pension landscape just seems to get more and more complex. Whilst some of this might be seen as well-intentioned, the reality is that over-regulation makes for higher costs, often borne by members, a much reduced propensity of employers to offer good voluntary work-based pension schemes, widespread consumer incomprehension and a flight to apparently simpler investment products, or worse to none at all.

“In terms of generational behaviour there is also something rather unedifying about developments in the private sector pensions space, much since June 2003; when you may remember that overnight the solvent sponsor’s guarantee was ratcheted-up to a full buy-out basis. Like the occupants of a gated community with its own private police force, an ever-shrinking group of active members and a growing pensioner population enjoy pensions that are often considerably better – and better protected – than those of many younger or newer employees.”

Stuart Southall added that one of the perceived disadvantages of pension saving, especially for the young, is the lack of flexibility. “For too long now”, he noted, “policymakers have only ever managed to flex the rules and regulations whilst aggregate provision in the private sector has withered on the vine”.

“Besides amending and reducing legislation, now is the time to think about and enact changes that might genuinely re-invigorate and incentivise voluntary pension provision. This may be more difficult within the new tax framework but our recent surveys (see 1 *Note for Editors*) suggest that a failure to meet this challenge could well lead to a further levelling-down of benefits and sponsor migration to less favourable pension models in larger organisations as auto-enrolment impacts on employment costs.

“So, what sort of flexibilities do I envisage might help?”

“First, for many years now the ACA has argued that employers (and hence their staff) are not well-served by a bipolar world where a pension scheme is either pure DC or treated as fully DB. Genuine hybrid arrangements in the middle are few and far between. All would benefit from the opportunity to provide, or enjoy, arrangements which are genuinely risk-sharing in nature

and which are treated as such under the regulatory regime. The public sector pension review might re-ignite this debate and other bodies seem now to be talking about risk-sharing with more enthusiasm than they used to, including the TUC at senior levels. That said, I suspect that some brave and material deregulatory action may now be needed if there is to be any hope of kick-starting employer interest in any type of 'new' quality arrangements.

"Second, flexibilities around annuities are already being discussed but it remains to be seen if the level of any Minimum Income Requirement largely negates the effectiveness of the outcome. Steve Webb too has made fairly regular references to the possibility of "early access" to pension savings and within a proper and prudent framework the ACA agrees that this could be a useful idea.

"Third, a number of Think Tanks have suggested that, to some level at least, it should be possible to transfer pension savings between generations outside the IHT net. If one really accepts that significant inter-generational inequalities exist then isn't this a means of redressing the balance? And why stop with death bed transfers? To a modest level it is already possible for individuals to fund pensions for non-earners whilst enjoying basic rate tax relief and in my view this should not be criticised as a tax dodge by the wealthy but as a mechanism by which many more could be encouraged to kick start long-term savings for younger generations."

A copy of Stuart Southall's speech to the ACA Annual Dinner is available on the ACA website at www.aca.org.uk (see 'latest news')

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Note for Editors

About the Association of Consulting Actuaries (ACA)

The Association of Consulting Actuaries (ACA) is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body. The ACA has 1750 members working in around 75 firms. ACA Members are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries' Code. The ACA forms the largest national grouping of consulting actuaries in the world.

Note¹: ACA 'Auto-enrolment and NEST' survey found 41% of larger employers were likely to level-down future pension benefits to mitigate the potential extra costs of auto-enrolment (see www.aca.org.uk ('publications' page, 31 August 2010)

**SPEECH BY STUART SOUTHALL, CHAIRMAN OF THE
ASSOCIATION OF CONSULTING ACTUARIES (ACA),
AT THE ASSOCIATION'S ANNUAL DINNER
ON 9 SEPTEMBER 2010 AT CLARIDGE'S**

“As UK citizens and as actuaries predominantly employed in the fields of pensions, savings, insurance, investment and health care we live in worrying times. Both at the State and individual level the UK has been through a period of chronic budgetary denial; the saving habit has deserted us and, buoyed by unsustainable asset values and easy credit, an appetite for current consumption has overwhelmed any thought of spending deferral as protection against the inevitable rainy day.

“The Coalition Government has so far sent robust signals to suggest it intends to put the Nation's house in order; but its challenge must surely be to try and do this in a way that minimises long-term damage to the country. Spreading the repair bill in as fair a manner as possible, whilst still addressing the essential need to re-invigorate an almost extinct savings culture, will present a major challenge.

“Fairness always means different things to different people but, perhaps as a minimum, there should be widespread support for the notion of fairness across the generations. Considerable inter-generational imbalances have already developed (some by accident, some through demographic inevitability and some through economic effects and policy errors) but these must be reversed if the UK is to prosper in an ever-more-competitive world.

“Our children and grandchildren should not be unreasonably burdened with the current or future debts of the greying baby boomers. On the other hand, perhaps the inter-generational transfer of assets – particularly pension assets, or assets which could be used for long-term care – could and should be made easier and be better incentivised.

“Aside from the obvious tensions between the macro-level budgetary remedies and what may be needed for savings re-invigoration, what do I see as the greatest problem areas in the ACA's current areas of activity?

“I would like to talk briefly about four aspects:

“**Firstly, regulation:** In this month's “Pensions World” Steve Webb is quoted as saying “in opposition politicians always say they want to simplify things; and in government they always complicate them”.

“Despite a de-regulatory review and many aspirational statements by Ministers and civil servants about simplification, the pensions landscape just seems to get more and more complex. Whilst some of this might be seen as well-intentioned, the reality is that over-regulation makes for higher costs (often borne by members), a much reduced propensity of employers to offer voluntary work-based pension schemes, widespread consumer incomprehension and a flight to apparently simpler investment products, or worse to none at all.

“In terms of generational behaviour there is also something rather unedifying about developments in the private sector defined benefits space, much of them since June 2003; when you may remember that overnight the solvent sponsor’s guarantee was ratcheted-up to a full buy-out basis. Like the occupants of a gated community with its own private police force, an ever-shrinking group of active members and a growing pensioner population enjoy pensions that are often considerably better and certainly better protected than those of many younger or newer employees. Of course, this is not to denigrate the valuable work of either the Pensions Regulator or the PPF, but to my mind their creation has added, in part at least, to the likelihood that a thirty-something worker will now only have a rather poor pension scheme at best.

“And so my plea to Ministers is that, in the pensions space, can you please be more ambitious on de-regulation and ensure that two or three pieces of legislation are withdrawn for every new one introduced. And, in terms of the bigger picture, can any new legislation please be considered both for its likely cross-generational impact and within the wider European context?

“In this latter regard, the gestation of Solvency II is of great interest to the ACA’s members. On the one hand, it will certainly increase the demand for the services of our many members in the life and general insurance fields. On the other hand, I doubt there is huge enthusiasm amongst our pension actuaries or their clients to the extension of its approach adding a further prescribed basis of valuation to the five or six we are already required to run and explain.

“**Secondly, products and pricing:** I would like to hope that as a profession we have always done all we can, and will continue to do all we can, to ensure that pension and other life assurance and savings products are designed and operated with the consumer firmly in mind. But, even if we have generally met that challenge, the pension and savings markets have not been immune from damaging scandals and this has most likely exacerbated the deteriorating propensity to save.

“It is not our role to force feed consumers pension and savings products but, to the extent we are involved and responsible, we should do all we can to see that these are fairly priced, properly explained and sold on the basis of meeting real financial needs. Our advice must evolve as the market develops but the market may need to evolve too to ensure that available and relevant advice is both sought and paid for through transparent charging structures.

“Defined contribution (DC) pensions are a case in point. These are an increasing feature of our world and are likely to remain so, but are they in their raw form fit for purpose in terms of meeting members’ reasonable expectations and likely retirement needs? It seems to me that for most members such arrangements carry too much risk, are endemically underfunded in terms of contribution rates, and have far too many aspects that are misunderstood. Worse still, investment selections (where there is a choice) tend to be by default or based on reckless conservatism and, generalising to make a point, some of the observed investment performance is pretty lack lustre.

“Some campaigners would have it that the whole UK investment industry is poorly run and over-expensive. Whilst there are no doubt very poorly performing funds run at excessive cost, my belief is that the well-advised investor can find high quality managers and that their costs are well worth paying. Many ACA members operate in the investment consultancy field and can help clients with appropriate investment strategies, implementation and manager selection; but bringing these services to a less than willing DC market is not entirely straightforward.

“Meanwhile there are signs of regulatory arbitrage at play as an increasing number of DC sponsors move from a trust-based structure to a contract-based one, in the hope of saving time and money and perhaps of reducing their responsibilities. I know that the Pensions Regulator is aware of these developments but there is some way to go before proper member-focused governance of DC arrangements becomes the norm rather than the exception. But, of course, in addressing this we must take great care not to repeat the mistakes made in the DB arena of Over-regulation, which could promote still more levelling-down.

“**Thirdly, flexibility:** One of the perceived disadvantages of pension saving, especially for the young, is the lack of flexibility. For too long now policymakers have only ever managed to flex the rules and regulations whilst aggregate provision has withered on the vine.

“Besides amending and reducing legislation, now is the time to think about and enact changes that might genuinely re-invigorate and incentivise voluntary pension provision. This may be more difficult within the new tax framework but our recent surveys suggest that a failure to meet this challenge could well lead to a further levelling-down of benefits and sponsor migration to less favourable pension models in larger organisations as auto-enrolment impacts on employment costs.

“So, what sort of flexibilities do I envisage might help?”

1) For many years now the ACA has argued that employers (and hence their staff) are not well-served by a bipolar world where a pension scheme is either pure DC or treated as fully DB. Both would benefit from the opportunity to provide, or enjoy, arrangements which are genuinely risk-sharing in nature and which are treated as such under the regulatory regime. In Opposition the Conservative Party, supported by the Liberal Democrats, came very close to getting some legislative amendments through which would have opened the way to these “middle way” solutions and we hope that the Coalition Government might rise again to this challenge. The ACA cannot guarantee that there is now an immediate appetite for such solutions and the 54 page Information Note published by the DWP in March only really served to show how difficult risk-sharing is at present. On the other hand, the public sector pension review might re-ignite this debate and other bodies seem now to be talking about risk-sharing with more enthusiasm than they used to, including the TUC at senior levels. That said, I suspect that some brave and material deregulatory action may now be needed if there is to be any hope of kick-starting employer interest in “new” quality arrangements.

“However, it is interesting to note that the Senior Salaries Review Board report this summer, making its recommendations on the future of Parliamentary pensions, had this to say (to quote): ‘It is not clear that DC schemes alone will provide adequate occupational pension provision for large numbers of the UK’s workforce. Furthermore there may be beneficial interactions between DB and DC schemes: for example, research from the US suggests that typically risk-averse investment behaviour of DC scheme members may be mitigated if the member has a DB plan in addition, providing a degree of security.’

2) Flexibilities around annuities are already being discussed but it remains to be seen if the level of any Minimum Income Requirement largely negates the effectiveness of the outcome. Steve Webb too has made fairly regular references to the possibility of “early access” to pensions savings and within a proper and prudent framework the ACA agrees that this could be a useful idea.

3) A number of Think Tanks have suggested that, to some level at least, it should be possible to transfer pension savings between generations outside the IHT net. Whilst one can almost hear the Treasury and tabloid press objections, if one really accepts that significant inter-generational inequalities exist then isn’t this a means of redressing the balance? And why stop with death bed transfers? To a modest level it is already possible for individuals to fund pensions for non-earners whilst enjoying basic rate tax relief and in my view this should not be criticised as a tax dodge by the wealthy but as a mechanism by which many more could be encouraged to kick start long-term savings for younger generations.

“My final thought is to suggest that we all need to take a more **holistic approach** to the consideration of financial needs in retirement and, in particular, the implications of ever-improving life expectancies and the demographically driven increase in demand for long-term care. The probable “lumpiness” of retirees’ income needs may be another reason for greater flexibility around the uses of pension “pots” but policymakers must somehow reach for a joined up solution to retirement saving and, once again, one that is fair as between generations.

“At the moment too many employers and employees have put pension provision in the “too difficult” pile, whilst the same appears to be true with regard to public policy on long-term care; notwithstanding the Dilnott review. It’s difficult to see why we are not considering a solution that looks to provide a decent pension for all, taking account of State pensions, whilst at the same time encompassing sufficient flexibility to make sure those who need long-term care have their costs met from the same package, but without shifting those costs unfairly onto future generations.”

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