SIXTY SECONDS
ON COMPULSORY PENSIONS

Is compulsion in pensions the last refuge of a marketing scoundrel, or the only way forward if we are to ensure Britain's pension system remains fit for purpose for the next fifty years, as it has by-and-large been for the last fifty? Overwhelmingly the latter, if our succinct contributors here are to be believed.

If you disagree, write and let us know. In the meantime, read and reflect on our panel's comments. As you will see, even in the pro-compulsion camp, there are still plenty of opposing views!

The involvement problem

Financial products, especially pensions, are highly technical, but are "low involvement" products. That is why on TV you get great ratings for shows like *Top Gear* (highly technical and high involvement) or *House Doctor* (low technically but high involvement), but you can't even find a decent personal finance programme. So why should we expect, now that it's suddenly evident to every politician who can operate a calculator that if no action were to be taken we are going to be in a fine pensions mess in thirty years, that all of the Crown's subjects will start to save like squirrels for the winter?

We can't. People think about house prices, school fees, paying off credit cards or, as one student put it, "where's the nearest cash point". It is clear to me that we need compulsion for funded systems, not only in the UK but all over Europe, in whatever shape, as pay-as-you-go systems start to be phased out or are reduced to provide a minimum pension. If you don't have compulsion, workers on lower incomes and people with "compulsive shopping disorder" won't save, and either all tax-payers will have to pick up the bill via means-testing, or we won't care about millions not having heating in the winter.

The issues in the proposed National Pensions Savings Scheme (NPSS), designed by Lord Turner's committee, are not about compulsion (except the complete nonsense of opting out entirely), but about the way it is supposed to be administered.

The financial services community has already expressed great concerns about low fee levels, bureaucracy and liquidity swamping the UK stock market. I agree with most of these comments. This new scheme needs two things:

1. Flexibility of choice, so that we don't create gigantic tracker funds, distorting equity markets.
2. Advice – in my opinion, not only should savings be compulsory but also individual advice, either by a company chosen by the employer or an individual's IFA.

If, then, fee structures are such that the industry receives quality revenue for quality products and advice, this scheme might actually work.

Sven Kuhlbrodt **MARKETING DIRECTOR, J O HAMBRO CAPITAL MANAGEMENT**

Pragmatic necessity

Not enough people will forgo current consumption for future security voluntarily, so, unless you are forever in the Frederick Hayek/Robert Nozick minimal state camp, pensions seem to be a stretch too far for the market economy. The market doesn't always work, and if people don't buy enough of something they definitely need, then dusting down the deckchairs won't avert the catastrophe.

So middle Britain should get its core pension provision through compulsion, which after a while will not feel like compulsion. And inertia will rule, so few will opt out, and the pensions gap will narrow – thus averting demographically-driven deprivation. All will be well.

Who loses? Well, the financial services industry, of course.

A new national scheme will not have margins for advice, nor for specious active management. The six funds mooted will presumably be low-risk, low-cost vehicles, perhaps offering absolute returns or some form of graduated lock-in. So there might be a role for fund managers, but the life offices – who only stumbled into pensions in the first place – are unlikely to emerge as the natural winners of any outsourcing tenders, either for fund management or for administration.

But then, maybe, this is the much-heralded Copernican moment.

Brendan Llewellyn PARTNER, C4B

Wrapping it up

Although there are many compelling intellectual and logical arguments against compulsion, from a practical perspective I see no viable alternative. We tend to lose sight of the fact that, for the majority of people, the thought of dealing with investments and pensions is about as appealing as a trip to the dentist. Furthermore, whilst those approaching retirement may start to save for this, those in their twenties and thirties will not postpone current consumption to provide for their later years. Encouragement and education alone are not enough.

My views on this issue have been developed from a personal perspective, as I spent eight years living in Australia in a compulsory retirement savings environment. This forced my hand to start saving at an age when otherwise I frankly would not have bothered. When everyone from the local barmaid to your CEO has 9% of their annual salary paid into a pension scheme, people take a more active interest in their savings and investments, and the Australian public seem much more informed about their finances than the average person in the UK. Having an IFA is not just the domain of the well-off, and this widespread usage in turn boosts the quality of the industry.

The majority of these pension schemes are run by platforms, which explains why a small country like Australia leads the world in relation to wrap. Many of these platforms offer the customer the ability to "household" their financial affairs, to use the platform to manage both retirement savings and other investments, hence gaining access to a consolidated "personal balance sheet". Daily balances can be accessed by SMS or online, and monthly statements are received, really keeping consumers in touch with their savings and investments.

If compulsion is introduced gradually and incrementally, and viewed and accepted as part of a total salary package, I think the benefits are clear.

It will provide retirement savings for those who will not otherwise save; it will encourage financial awareness and interest; it will boost the professionalism of the financial planning industry; it will provide positive benefits for the asset management industry.

It also poses some key questions about how these schemes should be administered and distributed. I am particularly interested in the potential in this environment for the asset consultants to join forces with a platform, to offer outsourced defined contribution schemes to companies. Equally, what is to prevent companies from employing salaried financial advisers to assist employees with both their pensions and investments as an employee benefit, addressing issues of lack of trust and apathy?

Rather than viewing compulsion as a threat, I prefer to see it as an opportunity to address the current savings deficit, and also to involve, interest and educate people about their financial affairs.

Holly Mackay UK DIRECTOR, ALLFUNDS BANK

Workplace solution

Of all the myriad issues identified in Lord Turner's report on reforming the UK pensions system, perhaps the most contentious is that of compulsory saving. Turner noted the broad consensus on the diagnosis of our pensions problem: we are not saving enough to support rising expectations and longer lives in retirement. More difficult, though, is agreeing how we solve that problem: the issue of compulsion is at its heart.

The ABI has long argued that the workplace is key in increasing overall savings levels. Existing workplace pension schemes are popular, and joint employer/employee contributions are generally sufficient to provide an adequate retirement income. Incredibly, though, there are around five million British employees with current access to workplace schemes to which the employer contributes, but who do not join them. They are effectively forgoing a "free" contribution to their pension, because of a combination of inertia, ignorance and other factors. What's more, ABI research shows that when an employer makes a contribution to employees' pensions, those employees are five times more likely themselves to pay money into their schemes.

These facts alone make a powerful case for the idea of "soft compulsion", under which employees would be automatically enrolled into pension schemes, and into which a matching employer contribution would be paid. Properly introduced, Lord Turner's proposals in this area would transform the landscape for private saving. Delivering this vision is now the key issue, and the pensions industry is working to create a model, at the request of Pensions Reform Minister Stephen Timms, in which the private savings industry would administer and run the system. The ABI believes that its proposals will meet the government's objectives, increase overall levels of saving, and ensure that people benefit from the long-standing expertise of the pensions industry.

Helen McCarthy **HEAD OF PENSIONS AND SAVINGS DEVELOPMENT ABI**

Phased approach

The UK pension system presently faces serious challenges that require a radical solution. Historically, our model of pension provision has been based on the idea of shared responsibility between the state, the individual and employers. However, the continued erosion of the state pension, combined with a collapse in commitment to pension provision amongst employers, is leaving individuals in a very precarious position.

They face either a serious reduction in their expectations for retirement, or a dramatic cut in their day-to-day income as they seek to make up the shortfall in their retirement savings. If they do not increase the level of their savings, they face the very real possibility of having a lower standard of living in retirement than their parents. This cannot be right in a modern, prosperous society.

The TUC believes there is an overwhelming case for considering whether an additional degree of compulsion should be introduced into the pensions system, which would require employers to contribute to their workers' retirement savings. Furthermore, the TUC believes that employers should once again be able to make it a condition of employment that workers, other than the very low paid, should join an employer's pension scheme.

Working people simply cannot afford to save the necessary amount to provide for their retirement by themselves. And if, as all evidence suggests, employers will not pay a sufficient amount into a scheme voluntarily, then they should be compelled to do so.

In return, we accept that employees themselves should also be obliged to save. We suggest that ultimately we should aim for a joint minimum contribution rate of 15%, with the employer paying 10% and employees 5%. To lessen the impact, the TUC believes that compulsory contributions should start at a low level and be raised over time to the 15% mark. Such a phasing-in strategy has worked for the minimum wage, despite the predictions of the doom-mongers that it would cost millions of jobs at even its original rate, let alone the level it has now risen to.

There will be siren voices that argue against compulsion. Already some have touted incentives as a way of raising savings levels, but we already have incentives, in tax relief on pension contributions and the tax-free lump sum on retirement. Despite these incentives, we have a savings gap that was put at £27 billion a couple of years ago, and is arguably even higher today.* The TUC has compared American incentive-based pensions and the Australian compulsion model, and found that in over twenty years of 401K schemes in America, closures of final salary schemes have increased, and there has been no improvement in pension take-up. In Australia, over 90% of workers have a pension.

Brenden Barber **GENERAL SECRETARY TUC**

* See *Closing the Gap* by Richard Surface in *Argent 2.3,* May 2003, for a fuller discussion of the savings gap. Ed

Voice of opposition

Is compulsion a problem? Isn't it the only answer for short-sighted workers who will not join even the most generous company pension schemes?

Well, I don't think so. Why should governments dictate what people do with their post-tax income? It's not as if they always get these things right!

Is there any guarantee that compulsion would provide an adequate pension anyway? What if things went wrong? Would any government be able to resist demands for compensation?

Perhaps the major objection is that it could actually force people to act against their own financial interests. This is especially so in a system in which nearly half of pensioners are already subject to means-tested benefits; a proportion set to rise to three-quarters by 2050.

One of the more puzzling recommendations of Lord Turner and his colleagues is that entry to a company-run NPSS should be *voluntary* for the employee – the very person who is supposed to benefit. Yet at the same time, contributions would be *compulsory* for an employer. No wonder that Digby Jones at the CBI has described compulsion as a "stealth tax" on business!

Nor is there yet any hard evidence in countries like Australia, where they have introduced compulsion, that there has been an *overall* increase in saving for retirement, rather than just shifting money from one part of the system to another.

Nigel Waterson MP **SHADOW PENSIONS MINISTER**

Practical problems

The argument for compulsion in the UK is bolstered by the inadequacies of the existing pensions system, under which millions of workers do not have access to workplace pension arrangements, and thus face the prospect of a minimal retirement income reliant entirely on the state.

But if compulsion were as straightforward an answer as some have suggested, why is there no sign of a consensus for its immediate introduction?

The fact is that compulsion presents a series of problems, both practical and political. Compelling employers and employees to contribute to pension schemes would be seen, rightly or wrongly, as an extra layer of taxation – which explains why none of the major political parties have expressed any great enthusiasm for the idea.

And in practical terms, how do you compel individuals on low incomes to save towards a pension when they have more immediate financial priorities, such as feeding, clothing and housing their families? Presumably there would have to be some kind of cut-off point, but where would that be? And how complicated would it be to administer?

Compulsory employer contributions, meanwhile, could place enough additional financial pressure on some companies to drive them out of business altogether, which is in no-one's interests, and especially not the employees'.

The recent report from Lord Turner's Pensions Commission advocated a less prescriptive approach, referred to by some as "semi-compulsion", whereby people would automatically be enrolled into a workplace pension scheme, but would retain the right to opt out.

The NAPF has argued that the voluntarist approach has not been given a fair crack of the whip. A simpler, more generous state pension, combined with a lighter regulatory régime and more effective incentives, could lead to market solutions being reinvigorated. Lower earners would benefit from better and more accessible state provision, and employers would find it easier to provide, or continue to provide, workplace pensions.

And stripping away the complexities of the current pension régime would leave a far clearer pensions landscape. Individuals would be in a better position to plan for retirement if they understood the deal on offer from the state, and were encouraged (rather than forced) to join workplace pension schemes.

Andy Fleming **DIRECTOR OF COMMUNICATIONS** **NATIONAL ASSOCIATION OF PENSION FUNDS**