Spotlight on Pensions

PRESENTS

Le Grand View

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Improving workplace pensions – back to first principles

Despite their obvious importance both to individuals and generally to wider society, retirement pensions are haphazardly provided. Some of the blame may be due to the blurring of what is, at its heart, a simple concept.

A retirement pension arrangement puts money aside when one has more than sufficient for current financial needs, invests it to maintain value, and then applies it to provide financial support in later life when earned income declines or ceases. Over several decades of workplace arrangements, this basic concept has been muddied by repeated piecemeal reforms that have built in complexity and confusion, leading to the devaluation of retirement pensions to the status of simply a form of general savings.

On its face, the distinction may appear to be pedantry. After all, at its simplest level a money purchase pension arrangement looks very like a savings arrangement. However, the wider consequence of this apparently subtle change of interpretation is important. When we lose sight of the fundamental objective of a pension arrangement, practices that are deemed unacceptable are more likely to arise.

The 2015 Freedom and Choice reforms are a good example of this perception shift in action. The link to retirement is broken by allowing a member full access to accumulated funds at any time from age 55, regardless of employment status. Regarding pension funds as the member's savings on the same basis as, say, a cash savings account used to save up for a holiday or a new washing machine removes the discipline of applying the funds for what they are really intended for – retirement income. The minimum access age is a nod in the right direction, but is not strong enough to overcome the "general savings" perception.

This loss of focus on the real purpose of a pension arrangement also contributes to the wide variation of pension scheme coverage and amounts, even discounting wider issues of social inequality. Employees in similar industries have widely differing pension provision, and thanks to the widespread move from defined benefit to defined contribution the differences in benefits between colleagues working alongside each other can be significant and unfair. Employer liability is a strong driver of this change, but the shift away from the true purpose and outcome of an arrangement contributes to the choice of arrangement design.

Recent news stories illustrate some current effects of poor focus on pensions basics.

Automatic enrolment minimum contribution increases

Automatic enrolment should encourage focus on pensions. Last year's increase in minimum contribution rates encouragingly resulted in only a relatively small number of existing members opting-out, suggesting that members largely do appreciate pensions.

The further increases from April this year generated considerable media coverage, in a welcome (but brief) respite from Brexit bad news stories. However, the "glass half empty" headlines presented the increase in a very negative light, in the worst cases bizarrely implying that members were effectively losing that money. Even the more balanced coverage relegated to small print the key point that the increases are to provide better pensions. Without that focus, the importance of adequate pension saving could be lost.

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Employer contributions as "pay"

One criticism of the automatic enrolment minimum contribution increases was the split between employer and employee contributions, arguing that employers should pay more. That arises from the emphasis on contribution rates being primarily just another component of remuneration for work performed today.

This viewpoint can also drive pension contributions for senior employees. The Investment Association has announced a tougher approach in the coming AGM season. Its Institutional Voting Information Service on pension provision for executives, reflects growing concerns about the size of those contributions in some cases. In its publication "Principles of Remuneration" it stated "Pension related payments should not be used as a mechanism for increasing total remuneration. The pension provision for executive directors should be in line with the general approach to the employees as a whole. The UK Corporate Governance Code states that pension contribution rates should be aligned with those available to the workforce. IA members consider this to be the rate which is given to the majority of the company's workforce."

A focus on the true purpose of a pension would help address the issues that are directly concerning investors, as well as encouraging appropriate levels of pension contributions across the whole of a business.

The self-employed

A group that would particularly benefit from a wider pensions refocus is the self-employed. It is understandable that automatic enrolment has been applied initially to the employer/employee relationship situation while the principle of compulsion (whether "hard" or "soft") gains traction. However, applying the principles of retirement pension provision, although there are practical implementation differences to address, there is no logic for treating someone differently simply because they are both employer and employee.

Encouragingly, DWP has announced an intention shortly to publish a paper on pensions for the self-employed. Hopefully it will lead to the plugging of the last great gap in UK pensions coverage (4.6 million people and rising, in 2015 according to Office for National Statistics figures). However, to ensure good levels of take-up in any soft compulsion scheme for the group, it will be necessary to send a strong message about the true purpose and benefits of pension provision.

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Legislative anomalies

Reversion to first principles should also address anomalies that have crept into pensions legislation. Taxation and related systems should not impose different outcomes on ostensibly identical members. One such anomaly requiring urgent attention is the net pay vs relief at source issue; another is the application of the lower earnings threshold and minimum age requirement on qualification for automatic enrolment. Whilst the Government has pledged to address the latter, any change is still a number of years away.

The pensions tax system's poor focus also impacts GPs and other senior NHS staff. The impact of the annual allowance and lifetime allowance rules are leading to the loss of valuable medical practitioners to early retirement. Although the Government has (belatedly) just acknowledged the problem, its proposed solution is still not a pensions one.

(Re)focus for success

Pensions provision used to provide pensions. The dilution of the concept has at the very least contributed to outcomes that are causing difficulties in a wide range of situations. Is it time to refocus on the basics?

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