Spotlight on Pensions
PRESENTS
Le Grand View

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Pensions' contribution to a more equal society

Inequality currently has a very high profile. Huge discrepancies exist in living standards (in the broadest meaning of that term) across the globe. The UK is not immune.

Many are driven by economic factors. Education, health, longevity and tolerance of others' rights to live as they wish, can all be affected by wealth – or, more often, the lack of it. The COVID-19 pandemic and the resulting lockdown has both highlighted and exacerbated discrepancies, but also provides opportunities for change.

Inequalities can arise through direct discrimination, but also occur indirectly, as consequences of underlying social conditions, or of otherwise sensible rules or actions. The former are usually clear and are consequently relatively straightforward in principle to address. The latter can be less clear. Identifying and correcting those can be more complex.

A growing body of evidence highlighted inequalities in a number of areas before the pandemic struck. Evidence that the impact of the pandemic, both direct and indirect, is also greater upon those already disadvantaged has strengthened the case for action. The privations forced upon the population as a whole seem to have focused minds and sharpened the desire to see action in respect of at least the most pressing issues. As with any major global event with a strong negative impact upon whole populations, there is a widespread feeling that it creates an opportunity to take stock and to make changes.

Pensions influence

The pensions world is closely tied to individuals' welfare, both directly and indirectly, through economic factors. Whether provided by the state, or through private arrangements, income in later life when the ability to do remunerated work diminishes is a fundamental part of the economic lifecycle. Private arrangements also involve saving and investing monies, which exposes pension provision to a set of wider economic issues. Consequently, it will tend to mirror any inequalities existing in the wider world order.

The pensions industry is only one player in the equality arena. We cannot solve all inequalities alone, but there are selective actions that we can take, across a wide range of areas in which we have influence. Given our size and importance, changes that are within our power have the potential to make a significant difference across all levels of society, both directly and indirectly.

Pensions-specific issues

Progress has already been made in respect of areas of direct pensions involvement. An example is the suite of anti-discrimination provisions prohibiting inequitable differences in benefits for people on the grounds such as age, race, colour, gender, religious belief and marital status. Those are enshrined in law to govern private pension schemes. Similar principles also affect how state provision is designed. In an encouraging sign that monitoring of the issue is alive and well, aspects of both cases are regularly tested in the courts.

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However, there are other factors that promote inequality, and which implicate pensions. Examples include:

- Postcode lotteries on health levels and longevity rates
- Differences in opportunities for particular member cohorts to accrue benefits. Changes in pension arrangements, tax bases and underlying economic factors are generally perceived to adversely affect particular cohorts' relative ability to save
- Restrictions around qualification for automatic enrolment for those employed by a business, and
- The absence of an equivalent system for the self-employed (an issue that has been on the Government's "too difficult" pile but could now be addressed given that a financial support system for this group devised during the pandemic overcame similar issues over identifying affected individuals and assessing their income).

Whilst some issues are firmly in the Government's realm, the pensions industry can lobby hard to promote change, as well as taking more direct actions in our specific sphere of influence and control, within the current regime.

Indirect inequality

Inequality goes much wider than issues of direct discrimination. Fundamental social and economic issues underpin many of the inequalities that plague wider society and are reflected in pensions provision. The pensions world has significant influence in wider economic and societal matters, which gives us an opportunity – and a responsibility – to exercise that influence in positive ways where we can.

ESG

An important and growing movement is the application of Environmental, Social and Governance (ESG) principles when investing. The pensions industry has been slow to embrace these principles, but progress is being made through greater awareness, supplemented by such measures as new obligations on scheme trustees to report specifically on their approach and actions.

One prominent governance issue gaining traction is that of equity in staff remuneration levels, including pension provision. In a largely DC world, automatic enrolment requires that all employees are entitled to a minimum level of employer contributions. Good employers recognise the importance of higher contributions and partner with employees to encourage additional levels for contributions from both parties. However, cases where arrangements involve inequalities, primarily between different levels of staff, increasingly attract investors' attention. There has been a consequent increase in shareholders, including pension scheme trustees and investment managers, exercising their voting power to reject executive remuneration packages deemed to be excessive.

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It is not inconceivable that the principle could extend in due course to other aspects of the remuneration offering where the effects are perceived to generate inequalities which in the wider sphere threaten to harm the business.

Climate change

No discussion of inequalities would be complete without considering climate change. Like the pandemic, it is a factor that impacts everyone on the planet: As with the pandemic, that impact is likely to be greater upon those already disadvantaged.

The effects of climate change will impact businesses themselves, not just directly in the case of those closely tied to fossil fuels, such as oil companies, aviation and car manufacturers, but also indirectly from such things as disruption from extreme weather events, and restrictions on travel and transport. As the impact on individual businesses and sectors will differ, so will their responses. In the fluid situation that will ensue, there will undoubtedly be examples of unintended consequences, amongst which unequal impacts on individuals will feature.

Pension schemes, as investors, will have a responsibility to be alert to such impacts and to use their influence to encourage more equitable practices.

Post-pandemic world more unequal?

The pandemic will change some of the fundamentals underpinning the pre-existing world order. The response may be to continue the old order, enduring any negative effects that ensue. However, there are signs that attitudes may be changing, including a growing desire to make changes that expedite progress towards a more equal world.

Already there have been shifts away from "business as usual". Digital activity has increased significantly, replacing many transactions that were formerly conducted face to face. This trend will continue and will increase the pace of further development.

Retail activity is a practical example. Transactions have moved online, reducing the number of retail outlets that will continue to be economic, increasing the number of home delivery instances, and switching from cash to electronic payments.

Less activity has meant that GDP has declined. Recovery to former levels will take time – with the most pessimistic forecasts suggesting that it never will. The pandemic has also highlighted the weak link in many businesses – humans. Developments in automation and the use of artificial intelligence (AI) which were already moving apace before the crisis, are likely to achieve a new velocity.

Employment will look different

All this will change the nature and extent of employment, with implications for the pensions world. Currently pension provision is directly connected to employment. In private provision, contributions and benefits are variously related to employment periods, and remuneration. The dates from which pension savings may be accessed are set by reference to traditional employment periods. This is all reinforced through the taxation system, which relates tax relief to the old norms of employment practices. Similarly, rights to a state pension accrue on the back of national insurance contributions derived from employment.

If the future is indeed one of fewer employments, fewer working hours, more self-employment, a growth in the gig economy and lower overall remunerated employment, then that will impact the fundamentals by which the pensions world operates. It will call into question the rules which tie pension provision to employment, including the way in which the taxation system seeks to influence provision.

Whilst it is not feasible (or desirable) to ensure that everyone has an equal pensions outcome, the principles of equity require an equality of approach. Future changes will require an unwavering focus on inequality. That future begins today.

One of the fundamentals underpinning those rules is the assumption that remuneration during a working lifetime will be relatively stable and will follow a largely predictable trajectory. In the new world, there is likely to be far more flexibility around how individuals work and the amount and timing of remuneration. Those who are less able to adapt for any number of reasons are likely to swell the ranks of the disadvantaged.

To adjust to the changes, pensions and tax rules and practice will have to change. That may imply a widespread move towards a universal simple DC arrangement, with tax relief at a single rate on contributions (i.e. independent of the income tax rate bracket of the individual) but with no restrictions on timing of relief, to allow for relieved contributions to reflect earnings fluctuations over a working lifetime.

It would also be helpful to see more flexibility in the state pension. This could include greater flexibility around terms for accrual of a full state pension, and over the age from which a full pension commences payment, to compensate for some of the social and economic factors mentioned above.

What can we do now?

Such changes will not happen immediately – if they ever do – and should only follow careful consideration. Meanwhile, schemes and employers can continue to fight unfair inequalities, whilst keeping a close eye on how COVID-provoked changes are affecting the real-world outcomes of their decisions by:

- Practising good scheme governance and ensuring that good governance principles are followed in businesses in which pension monies are invested
- Ensuring that contribution rates to DC schemes are equitable across the business
- Implementing green policies, both in the investment of scheme monies, and in working practices, such as continuation of remote meetings requiring no travel and electronic-only documents
- Providing assistance for members faced with difficult financial decisions, together with high-grade protection from fraud, since disadvantaged groups are more likely to need assistance in these areas.

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