

MINUTES OF AN ALL-PARTY PARLIAMENTARY GROUPS' JOINT MEETING HELD AT THE HOUSE OF LORDS, TUESDAY, 13TH DECEMBER 2005

GROUPS INVOLVED

APPG FOR PENSIONS CONSENSUS

APPG ON OCCUPATIONAL PENSIONS

APPG ON INSURANCE AND FINANCIAL SERVICES

GUEST SPEAKER

LORD (ADAIR) TURNER, CHAIR OF THE PENSIONS COMMISSION

PRESENT

Members of Parliament

Sir John Butterfill MP, in the Chair

Lynne Jones MP

John Greenway MP

Adrian Bailey MP

Anne Begg MP

Clive Betts MP

Greg Clark MP

James Duddridge MP

Kelvin Hopkins MP

Chris Huhne MP

Douglas Hogg MP

Andrew Love MP

Rt Hon Peter Lilley MP

Anne McIntosh MP

John Penrose MP

Terry Rooney MP

Sion Simon MP

Peter Viggers MP

Baroness Greengross

Researchers

Ruth Hydon (Office of Jessica Morden MP)

Guests

S W Ashby (Civil Service Pensioners Alliance)

John Batstone (UNITE)

G A Blackman (AESP)
R G Causton (Thorn & EMI Group Pensioners Assoc)
M Cox (BBCPA)
Donald Duval (ACA)
Ian Farr (ACA)
Nicholas Hillman (ABI)
Richard Hobbs (Beachcroft Wansbroughs Consulting)
Mervyn Kohler (Help the Aged)
Ellie Lusty (Pensions Commission)
Brian Marks (Occupational Pensioners Alliance)
David Morey (PwC)
M Moriarty (AESP)
Bob Morris (UNITE)
Csilla Oldland (ACA)
T Rivers (BBCPA)
Nyree Stewart (IFA Online)
Roger Tierre (UNITE)
Roger Turner (UNITE)
Andrew Vaughan (ACA)
G J Williams (Occupational Pensioners Alliance)
Aaron Woolner (Life & Pensions)

Secretariats

Keith Boyfield (Occupational Pensions)
Matt Bryant (Pensions Consensus)
Hugo Legh (Pensions Consensus)
David Robertson (Occupational Pensions)

Purpose of the Meeting

This specially arranged meeting was organised by the three All Party Parliamentary groups in order to hear Lord Turner talk about the Pensions Commission's Second Report on *A New Pensions Settlement for the Twenty-First Century*, published on 30th November 2005.

Lord Turner

Lord Turner began by summarising the main points in the Pensions Commission's analysis along with the report's main recommendations.

The Pensions Commission's Key Points

Today's pensioners are on average better off relative to average earnings than in the past. That reflects two factors which will pass: 1) the peak generosity of the SERPS system, and 2) the fact that many people are retiring today with more generous Defined Benefit promises than ever before, Defined

Benefit promises which will be enjoyed by far fewer people in future. Significant groups of people, however, such as women, carers and those on lower incomes working in small and medium sized companies continue to be at risk of receiving a poor pensions package

The UK state pension system is one of the least generous in the western world. Looking forward, the state plans a reduced role in pension provision for the average earner. If current indexation arrangements remain unchanged, the state pension age remains at 65 and total state expenditure on pensioners remains stable at approximately 6-7 per cent of UK GDP, then the average earner would find that they received substantially less by 2050 than they do at present.

However, private sector pension saving is not expanding to fill the gap created by declining generosity in the state system. In fact, private sector provision is in underlying decline.

Furthermore, there has been a pronounced trend away from defined benefits (DB) schemes to money purchase (MP) pension schemes, whose recipients' are likely to receive lower pensions than those in DB schemes, due to much lower contribution levels. In 1998, there were five million active members of open private sector DB schemes; in 2004 there were only 1.9 million.

Without reforms, the Pensions Commission estimates that around 10 million people could be at risk of under providing for their retirement. A substantial and growing proportion of Britain's population will be dependent on means-tested benefits unless action is taken.

And the problem is exacerbated by the fact that people are living longer. Average life expectancy for a man aged 65 has risen from 14 years in 1980 to around 18 years in 2000 and the most recent projections of life expectancy suggest that by 2050 average life expectancy for a man aged 65 will be 24 years (26 years for women.) After 2020 we could face a major problem as the post war baby boom generation will begin to retire.

From our analysis the Pensions Commission has concluded that there is no current crisis of pensioners income, but unless action is taken, pension provision will become more inadequate and unequal. And a number of specific problems require attention, notably pension provision for those people, women and carers, who have fallen through the gaps in the contributory system and the real and perceived disincentives to save for retirement created by means-testing state provision.

These problems will not solve themselves. Lord Turner identified five inherent barriers to a free market solution:

- (1) **Behavioural:** Most people do not actively choose to join a pension scheme. They do so because an employer offers them a pension, or because the state requires them to join a pension scheme, or because an insurance company sells them a policy. Only a very

small proportion – around 0.5 per cent of the adult working population – voluntarily goes out and buys a pension scheme.

On a practical level, if individuals have to opt out of employer schemes rather than opt in, then the level of scheme membership remains higher.

- (2) **Cost barriers.** It is difficult for the private sector to provide personal pensions to people of low to medium income earners that are good value for money for the consumer and still profitable for the provider. Generally speaking, workforce pension schemes must have a minimum of twenty members, plus an employer's contribution, for them to prove sufficiently attractive for anyone to run. Whereas administrative costs consume only 2-3 per cent funds invested in of a typical large employer scheme, they can absorb up to 25-30 per cent of smaller schemes (i.e. with 20 members). Critically, this hits those on lower to average incomes of between £15,000 to £25,000 a year.

- (3) **Employers' move away from DB Schemes:** Increasingly, employers have decided to opt out of providing pensions, particularly DB schemes, as part of their employment package. Once they discontinue such schemes, there is little chance that they will revert to paying similarly generous pensions in the years ahead.

Focus group evidence suggests that small to medium sized enterprises (SME) doubt that they get value for money from the pensions they offer employees. It is increasingly common to see employers pay higher salaries rather than offer improved pensions.

- (4) **Complexity:** The UK has one of the most complex pension sectors in the world. It is even more of a labyrinthine than Japan's confusing pension system. Lord Turner said that his Commission had found that many individuals were in a 'complete fog': they do not understand the issues associated with contracting out, nor do they understand the schemes offered by the state - in focus group discussions none understood S2P.

- (5) **Means-testing:** while Lord Turner acknowledged that the system will inevitably involve a certain amount of means-testing, the Report concludes that if current indexation arrangements continued indefinitely, 70 per cent of pensioners would find that they were eligible for means-tested State benefits by 2050. This must be a major disincentive on private saving. Significantly, independent financial advisers (IFAs) are concerned about advising those on lower incomes to take out private pension plans for fear of being accused of mis-selling at a later date. This situation would get worse if the numbers eligible for means-tested benefits increased from year to year.

The Way Ahead: The Commission's Recommendations

The Commission's recommendations focus on two key elements, namely a simple, low-cost *National Pension Savings Scheme* (NPSS) into which employees would be automatically enrolled with the right to opt out. The NPSS would be under-pinned by reforms to the state pensions to make them more generous and less means-tested to provide a sound foundation on which people can build private savings.

The changes to the state system, if implemented from 2010, would mean that every UK citizen should receive a basic pension of £75 a week (in today's money). The Commission would like future accruals to be on a universal residency basis but a residency test should not be applied retrospectively, except possibly for the oldest pensioners. Importantly, the BSP should grow in line with earnings so those in retirement enjoyed the benefits of growth in national income and that the BSP provides a stable foundation on which people can build their private savings. Employees should be able to take part of their State pension and continue to work part-time.

The State Second Pension (S2P) should not be immediately consolidated into the BSP, as suggested by those favouring a 'Citizen's Pension', but should evolve into a flat-rate payment.

Some increase in public expenditure as a percentage of GDP will be necessary in order to establish a more coherent State pension scheme according to the Pensions Commission's recommendations. The planned increase in the SPA for women allows some flexibility for improvements to State pension provision over the next 15 years without the need to increase public expenditure as a percentage of GDP but expenditure would rise to somewhere between 7.5-8% of GDP by 2050. After 2020 increased expenditure would be offset by the State Pension Age (SPA) rising to around between 67 and 69 by 2050, with further changes possible to reflect further increases in longevity.

At the same time the State should strongly encourage people to save. The Commission is keen to see automatic enrolment introduced for many occupational schemes (New Zealand will make auto enrolment compulsory in a few years' time).

Where employees have no access to a private schemes or the scheme on offer is inferior to the NPSS, the Commission wants to see all employees opted-into the NPSS. Employers would make a compulsory contribution to employees' pension plans, equivalent to 3 per cent of their gross pay. Additionally, employees would pay 5% of gross pay (4% of net pay and and 1% effectively paid by the government through tax relief), making 8% in all. Employees would have the right to opt-out. Employers could effectively opt-out by offering a scheme that was superior in terms of overall contributions paid provided members are auto-enrolled.

The Commission feels that the NPSS scheme could be established with charges of 0.3 per cent, achieved partly through bulk buying services from the fund management industry. Individuals would also be able to invest in the open market but charges would be higher. Administration of contributions would be via a new collections agency or via PAYE, although there would need to be changes if the latter was used to enable the system to allocate contributions to individual accounts on a monthly basis. The self-employed would be able to opt-in to NPSS if they wished.

The Pensions Commission estimates that the overall cost of NPSS to private employers will be around 0.6% of labour costs (1% for smaller employers).

Open Forum: Questions

A number of points as well as questions were raised, including:-

What was the base from which the Pensions Commission measured the cost of its proposals?

The Pensions Commission has compared the cost of its proposals to current expenditure on pensions (6.2% of GDP). This assumes that improvements to state pension provision could be partly funded from the savings generated from the equalisation of women's state pension age.

How far will people look to property and inheritance as a means of funding their retirement?

Lord Turner said that some people could definitely use these options. As matters stand, 70 per cent of those over 80 years of age in Britain own their own homes. This is an important source of wealth that can be transferred to younger generations. There is far more wealth held in housing than in pension funds. This was one reason why compulsory pension saving could not be justified.

Is there a danger that younger people could be asked to over-save?

This is a crucial matter for those on low incomes. Lord Turner cited the example of a 25 year old who had run into heavy debt on credit cards. It makes far more sense for such individuals to pay off these debts, where high levels of interest are levied, than to force them to save a substantial sum for their retirement.

By opting for auto-enrolment Lord Turner's Commission has sought to arrive at a sensible compromise to encourage and enable individuals to save for their retirement without forcing those people who do not need to save to do so. Lord Turner observed that people were often ambivalent about saving for their retirement: they want to be told how to save, but they resist the idea of compulsory savings.

How can we justify generous tax relief for higher earners on their contributions to pension schemes when those on lower incomes may have to manage on relatively modest State pensions?

Lord Turner acknowledged this was a tricky issue. However, it was extremely difficult to assess within a DB arrangement exactly what relief has been given to members in a particular year because of the way employer contributions were paid. After a lot of thought this had driven the Commission to a conclusion that this was not an area they should consider. He did note, however, that a tax relief cap had been placed on all individuals, currently fixed at £1.4m from April 2006 and this was the most simple way of restricting the pension tax relief given to the higher paid on an annual and lifetime basis.

A number of questions were raised with regard to the National Insurance scheme.

Lord Turner noted that over the last 25 years, both Conservative and Labour governments had tended to increase national insurance contributions whilst lowering income tax rates. National insurance is essentially a tax, but in his judgement, it was not unreasonable to have a payroll tax. Many people, however, are under the misapprehension that their national insurance contributions paid for 'their' future state pension rather than the reality that these payments meet current liabilities to pensioners.

How can defined benefit pensions be justified in the public sector when only a dwindling group of people in the private sector can expect to receive a similar pension?

Lord Turner felt that DB schemes were defensible in the public sector as part of an overall remuneration package, but the wider public would reasonably require that their cost not to balloon because actions were not taken to adjust pension ages as longevity improves. If public sector pension ages were not adjusted, and the cost to the taxpayer of such schemes grew sharply, then politically it would be difficult to see how DB could persist – some future government would be obliged to act.

In the private sector, he noted that defined benefit schemes could be characterised as a tale of unintended promises, since many of the employers who first introduced these schemes in the 1960s and early 1970s had not anticipated the increases in longevity which would occur. This meant that when other factors changed, such as investment returns, the problems for such schemes were more severe than might otherwise have been the case. However, those employers and their advisers reasonably had also not anticipated a raft of costly enhancements would be forced on schemes by law, such as guaranteed increases in pensions in payment and changes to the tax regime.

The open-ended commitment that such schemes now placed on employers meant that some 70% were closed to new entrants and the Pensions Commission estimates that more are likely to close, although some larger

employers would continue with them. What was probably more surprising was how long employers have been prepared to run with such schemes, given the costs, the regulatory risk and the long-term uncertain liability involved.

How far is means-testing a disincentive towards saving for one's retirement?

In the Commission's view, means-testing is a serious forward threat to private pension saving. Whilst in the short-term it has provided an excellent low-cost route to raising the incomes of the poorest pensioners, it should not be the long-term solution. If the Basic State Pension continues to be linked to prices and the Guarantee Credit to earnings then it would not be long before the majority of pensioners would receive means-tested additions. This must depress private pension savings, particularly if IFAs felt they could no longer recommend products because the individual concerned might benefit from 'free' additional State benefits in years to come.

How far has the Pensions Commission considered the possibility of average longevity falling due to obesity and other medical factors that are all too evident in contemporary society?

Lord Turner acknowledged that obesity is a factor that needed to be taken into consideration in forecasting future longevity trends. However, he suggested that potential breakthroughs in genetic science may exert a strong influence on obesity levels in forthcoming decades. There was always the possibility, of course, that if diseases and medical conditions linked to obesity reduced life expectancy in the UK, retirement ages might be cut, but the trends at present certainly did not support such an outcome.

Why was the Pensions Commission so cautious about raising the SPA?

Lord Turner felt that this hinged on public acceptability. The Pensions Commission had sought to keep in step with future projected changes in life expectancy. Under the proposals the number of years in retirement would in general not decrease and those over age 50 would not be affected by a change in the SPA.

The chairman of the meeting thanked Lord Turner for his masterly presentation and response to questions. He then brought the meeting to a close.