End of a pensions era

PETER WILLIAMS TAKES A LOOK AT FUTURE DIRECTIONS FOR RETIREMENT PLANNING IN THE UK.

Executive summary

- **The generous final salary company pension scheme is all but dead, leaving many employees sticking their heads firmly in the sand over how they will fund their retirement. The only silver linings to the clouds that darken the pensions landscape are the rise of alternative savings products and the return of some stability to bond yields.**

With so much noise around the issues of pensions, it can be hard to hear what's really going on. Research suggests that the public have woken up to the fact that many people will be poorer than they would have hoped in their old age. But with companies increasingly unable or unwilling to play the paternalist by funding defined benefit pension schemes, the problem is going to get worse, with the burden falling increasingly heavily on individuals and the state.

It seems that the era of heavy corporate involvement in individuals' pension arrangement could be coming to an end. As with any movement in pensions, these trends will become clear only over decades rather than months or years. At the same time it does appear that the stream of news about pensions has raised awareness among employees, even if that awareness has not yet translated into definite action. As the politicians debate how to finance the well-being of an increasingly elderly population with longer lifespans, evidence is starting to emerge that employees and employers are both looking to take control of the pension problem.

Pensions have barely been out of the news in the last few years and the financing and risk management of pensions have become important strategic tasks for treasurers. The area is deluged with statistics and research from a whole variety of sources. Government, regulator and the private sector all have a point to make and facts and figures to trade. And while politicians arguing over the state pension age may not seem to be the most pressing issue for treasurers to deal with currently, the plans introduced in the Pensions Act 2008 to automatically enrol employees into workplace pension plans or personal accounts are on track for 2012; in terms of business planning, that's just around the corner. Indeed, the government advertised at the end of September for applicants for the position of chair of the body that will run the personal accounts scheme.

Unless your company is selling retirement services or products, pensions have become a source of unremitting gloom, with the size and the length of the problem at times appearing overwhelming. Research published this autumn offers little hope of substantial good news. The research, published as the Business Case for Pensions and conducted by the Chartered Institute of Personnel and Development (CIPD) and investment management firm BlackRock, attempted to shed light on employees' and employers' view of pensions.

It found that fewer than half of private sector employees regard pensions as the best way to save for retirement. Employers, on the other hand, tend to consider pension provision to be a core part of the reward package. The report quotes one employer as saying: "We want to be an employer of choice, and therefore we recognise the need to have a good pension scheme."

Only one in four (28%) private sector employees know how much they should be saving for a comfortable retirement, although more than half (56%) are worried they won't have enough. While most private sector workers (61%) believe that investing for retirement is their personal responsibility, this perception has not led to a more active and engaged approach towards saving. Most employees know they may not be saving enough, but fewer than half (48%) have reviewed their contribution levels within the last two years. Many are simply resigned to postponing their retirement, with 47% expecting to have to work longer than they anticipated five years ago.

AS THE POLITICIANS DEBATE HOW TO FINANCE THE WELL-BEING OF AN INCREASINGLY ELDERLY POPULATION WITH LONGER LIFESPANS, EVIDENCE IS STARTING TO EMERGE THAT EMPLOYEES AND EMPLOYERS ARE BOTH LOOKING TO TAKE CONTROL OF THE PENSION PROBLEM.

Box 1: Alternative pension vehicles

Large companies have little appetite for complicating their own schemes and systems by taking on responsibility for alternative financial or saving products, according to the CIPD/BlackRock research. However, there is a recognition that such savings vehicles may well be a more attractive way to encourage employee retirement planning. Research suggests there is corporate willingness to provide access to third-party products.

The research also suggested that the hardest to reach sections of employees are blue collar workers and retail-based young casual workers. Employees who do not contribute to pension schemes should, says the report, be helped by employers to track their journey towards retirement.

In terms of impending legislative changes, the report said that employers needed to feel confident that a change of government would not overturn or significantly amend the proposed legislation and consequently make redundant any action they undertook.

According to the research, affordability is a factor in the overall lack of engagement. Nearly a third of employees (31%) who are not saving with a pension scheme cite financial constraint as the reason. The pervasive scepticism towards pensions means that rather than putting money into a company scheme workers are looking to a wide range of other sources of funding, including inheritance (19%), downsizing or selling property (21%), the state (14%) and support from family and friends (6%). Many (the largest proportion of all, at 27%) expect they will have to find another job after they retire to supplement their income. As a risk management strategy, treasurers may spot one or two weaknesses in the approach.

Charles Cotton, CIPD's chief reward adviser, said: "This research shows that employees and employers alike are sleepwalking into a potential retirement disaster. Many employers will face the prospect of trying to motivate an older workforce, who are simply soldiering on because they cannot afford to retire. While employers are no longer responsible for the retirement planning of their employees, it makes sense for them to educate their staff on the importance of saving into a pension scheme, However, employers can't do this on their own. They need government support to help empower employees to make informed choices on the options available."

Even those currently saving into a pension scheme are looking for other ways to save, a trend that becomes more marked as age increases. One of the pension professionals quoted in the survey said that, despite his professional background, in terms of the broader business issue, he wanted pensions "off my agenda and looked after either by the state or through some compulsory system where everyone's the same, so that it's not part of a competitive package and I don't have to worry about it. I'd know that everyone's looked after in retirement and I'd be able to think about other ways of motivating and incentivising them."

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For the CIPD research report, go to **http://tinyurl.com/yjyaxho**

Box 2: Volatility gives way to new value norms

Research published last month by pensions company Aon suggested that pensions market indicators are returning to long-term norms, thus enabling companies to plan for the future.

Its figures suggested that the combined pension funding position shown in company accounts for the 200 largest privately sponsored pension schemes in the UK has improved by £16bn to show a deficit of £62bn and there are signs that this figure may be more stable than in the recent past. Previous difficulties with abnormal market conditions wreaking havoc on liabilities are clearing and now, said Aon, companies can plan for the future with a renewed sense of purpose.

One of the challenges for companies with final salary pension schemes is that the funding position is based on both the value of the assets and liabilities. The volatility in asset values during the credit crunch has been well documented, but the value of corresponding liabilities has been just as uncertain due to the movement of bond yields. Now that yields seem to be stabilising at what might be a new long-term norm, the volatility in the value of pension liabilities should reduce and companies can get on with confronting the real issue: facing and tackling the remaining pension debt.

Marcus Hurd, head of corporate solutions at Aon Consulting, said: "The era of uncertainty for final salary pension liabilities is coming to an end. The real issue of pensions deficit remains but if the goalposts are at least standing still, then there is an increased chance of hitting the target. Dealing with the remaining pensions deficits, whether accounting, funding or buyout, will have to be met by either strong asset performance or yet more pension contributions."

The claim for greater stability is based on the spreads between AA corporate bonds and gilt yields (one of the key factors underlying the values placed on company pensions accounting liabilities) stabilising between 0.5% and 0.7% from July 2003 to 2007 before ballooning to 2.8% in December 2008. They have now fallen back to around 1.4%, which most market commentators would agree is intuitively reasonable and could be a new long-term norm. At the same time, projected future levels of inflation and the yields available on government securities have also stabilised.

It should be remembered that the defined benefit scheme is now a minority sport among UK corporates. In August actuary Lane Clark & Peacock could find only three FTSE 100 companies that still had defined benefit schemes open to new employees. Many others have announced measures to reduce or freeze benefits completely for existing members.