THE LIFE INDUSTRY

IN THE SHADOW OF INCREASED LONGEVITY AND FALLING WORKING POPULATIONS, COUNTRIES ACROSS EUROPE ARE STRIVING TO FIND SUSTAINABLE SOLUTIONS FOR SUPPORTING THEIR CITIZENS IN RETIREMENT. **ALAN PICKERING** TALKS TO SHEELAGH KILLEN ABOUT THE PENSIONS CHALLENGE AT HOME AND IN EUROPE.

Collaboration is at the heart of Alan Pickering's vision for European pensions. As Chairman of the European Federation for Retirement Provision (EFRP), an EU-wide umbrella organisation for occupational pensions associations, Pickering is well-placed to encourage mutual debate and co-operation between European pensions groups and policy-makers. However, to deliver a truly effective and coherent framework for retirement provision, he believes that such collaboration is paramount, not only across borders but also between the providers of the three 'pillars'[1] of retirement income: the state, occupational pension schemes and private financial services companies. The often conflicting interactions between these sources of retirement income, according to Pickering, continue to dog both the UK model for pensions provision and the advancement of the pensions framework at the wider EU level.

STATE OF PLAY. Perhaps most prominent in the debate on optimising pensions policy is the question of the extent and nature of state involvement in the pensions arena. In the UK context, Pickering sees an increase in state retirement benefits as a "prerequisite of bigger private pension provision". He maintains that "inadequate state provision, increased reliance on means-tested benefits" is effectively turning private pension provision for those on low or medium incomes into "privatised welfare".

There is clearly little incentive to save when any additional income achieved in retirement will merely serve to reduce entitlement to state benefits. Therefore, Pickering argues that the current gap in pension savings for this income group cannot be closed without "a solid bedrock of state provision". He advocates a non-means-tested state pension of some 25%-35% of national average earnings which "would push us all above the poverty line".

In Europe, the problem of state pension levels is often the reverse. The generosity of these pensions in other EU countries such as France and Germany is such that few citizens on lower incomes are persuaded to contribute additional amounts to a private pension plan. Pickering does not recommend that these nations adopt the "parsimonious" level of UK state pensions but believes, realistically, with increased longevity and a smaller base of current employees to fund social security schemes, the retention of this level of provision in the long term is unlikely to be affordable.

The conclusion may therefore be that all EU governments must now start planning for a mixed public- and privately-funded pensions future. This would, in Pickering's view, most sensibly comprise an adequate subsistence element of state pension, funded

ALAN PICKERING

CAREER OVERVIEW

1967 Started work as a railway clerk

1969 Studied for a degree in Politics and Social Administration at Newcastle University

1972-1992 Worked in Membership Services for the Electrical Electronic Telecommunication and Plumbing Union (including work on developing convalescence and pensions benefits and related investment products, advising on negotiation of retirement benefits with employers)

1992 to date Joined Watson Wyatt, actuarial consultants as Partner

1991-1997 Member of the Occupational Pension Board

1997-1999 Vice Chairman of the National Association of Pensions Funds (NAPF)

1999-2001 Chairman of the NAPF

2000 Vice Chairman of the European Federation for Retirement Provision (EFRP)

2001-2002 Author of the Pickering Report, a Department of Work and Pensions sponsored study on the simplification and enhancement of UK pension provision

2001 to date Chairman of the EFRP

EUROPEAN FEDERATION FOR RETIREMENT PROVISION: ORGANISATION HIGHLIGHTS

- The EFRP represents the national associations and similar institutions for retirement provision across the EU, and has affiliates in a number of EU accession countries.
- Most EFRP members are concerned with occupational or 'second pillar' provision, although some members also operate purely individual schemes. The UK member organisation is the National Association of Pension Funds (NAPF).
- In Denmark, the Netherlands, Sweden and Poland, some 90%-95% of the workforce has their occupational pension funded through EFRP members. In Germany, Spain, the UK and Ireland, it is about 80%.
- In total, EFRP membership associations cover the occupational pension plans of around 93 million EU citizens and the management of some €2,819bn of assets for future occupational pension payments.

on a 'pay-as-you-go' basis, with private or occupational top-up elements providing the "icing on the pensions cake".

SAVING GRACE. In tandem with the difficulties of determining the optimum structure and level of state retirement benefits, governments also face the challenge of creating the cultural and fiscal environment in which the incentive for those who can save is maximised, while protection for those who cannot is maintained. In this regard, Pickering is concerned that the UK Treasury has a tendency to focus on the middle-class values of forgoing consumption and promoting thrift today in order to enjoy a secure tomorrow. "This is generally not appropriate for somebody who is struggling to make ends meet on a weekly basis," he comments. Quoting a recent KPMG survey, which points out that less than 50% of the electorate are in a pension scheme, Pickering notes that, while the survey is quick to point out the possible future consequences of this reluctance to save, for many people, the decision to forgo individual pensions planning may be "perfectly rational".

He goes on to explain: "If a 25-year-old had asked me about pensions a few years ago, I would have said 'join a scheme as early as you can. If one doesn't come with the job, set up a personal plan'. Now I would still say that if a scheme, either defined benefit or money purchase, comes with the job, grab it with both hands. But when it comes to a private scheme, it wouldn't be top of the shopping list." Pickering would, instead, advise young people to pay off debts, set up an accessible account for unexpected expenditure (to prevent them slipping back into debt) and then think about getting on the housing ladder. After that, medium-term monthly savings plans would still be higher on the list than long-term saving for retirement. The UK government is hopeful that the simplification of financial products and the promotion of greater financial awareness among UK citizens may have some impact on closing the current estimated £27bn savings gap. It continues a strategy of encouraging saving through the use of targeted tax incentives, such as the Individual Savings Account (Isa), and is looking at plans to introduce simple, low-cost financial products such as those suggested by the Sandler Report[2]. However, Pickering believes that the effects are unlikely to be dramatic. "Politicians should not try to design financial products," he says. "Incentives which are brought in to boost investment in certain products can be brought in swiftly, but are rarely withdrawn in such short order. The uninitiated are often lured into product areas and then left in them long after they cease to be appropriate, even if they were right for them in the first place."

He does, however, see that there is a place for a taxpayer-funded reward for those people who would not normally save, but who are prepared to put money aside in a bank or building society account. "I am more of a fan of John Major's Tessa than of Nigel Lawson's Pep," he confesses. "In terms of equity linked products, the tax incentives are rarely sufficient to compensate for volatility for lower income investors." Pickering also sees problems with the proposed 1% pricing cap on new CAT standard-type simplified products. Due to the fact that "most products still need to be sold", he feels that there is insufficient margin in such products to motivate providers to develop competitive offerings and promote them to consumers.

SCHOOL OF THOUGHT. As with the introduction of new products, consumer education, while a welcome development, should similarly not be regarded as a panacea. Pickering is sceptical that government interventions in this respect can compensate for positive action on the fundamental structure of UK pensions, claiming "government should not wash its hands of changing the infrastructure". He is wary of too much emphasis being placed on bringing consumers up to speed on the workings of financial products. "Citizens need to be made more financially aware, but I do not think citizens should be turned into do-it-yourself (DIY) financial experts. After all, we do not expect them to all become DIY electricians or DIY plumbers. Consumer awareness is not a substitute for government action. It cannot turn a nonsensical situation into a place where ordinary folk can save with confidence."

With this in mind, it seems that there will still be a need for professional financial advice for savers. Yet the provision of basic investment advice to savers should not be insurmountable, according to Pickering, as most are not wealthy enough to need sophisticated inheritance tax planning or detailed product comparisons. "For most people of modest means, it is the most appropriate product type which is important, not the choice of a 'best in class' performer within that product type," he says. In most instances, Pickering points out, clear and straightforward advice on the relative risks and returns of a deposit account, a medium-term mutual fund or a long-term pension plan would be sufficient.

RULES AND REGULATIONS. The third aspect in which the role of government is essential to the development of the pensions infrastructure of the future is in the regulation of pensions providers, be they in the occupational or financial services market. This again, is an area which Pickering regards as fraught with the danger of costly mistakes. "There is a tendency for over-regulation of the private pensions sector," he maintains and lends support to the view that the protection of pension benefits has to be carefully weighed with the costs of regulation and other financial guarantees. "Pensions regulation should be designed to root out fraud, rather than inefficiency. Otherwise pensions provision becomes so expensive that it strangles itself. Politicians need to appreciate that there is no such thing as a meaningful no-cost guarantee." For this reason, Pickering has reservations about the Pension Protection Fund and the "fund to buy-out level" requirement proposed for occupational pensions schemes by the UK government in June this year. While agreeing that the inherent guarantee of the UK state pension by the taxpayer is both desirable and necessary, in terms of occupational and private pensions, Pickering sees "absolute security" as "absolutely unaffordable".

In addition, he sees the measures as potentially undermining the role of the pensions trustee. With the relationship between the employer and the pension fund member becoming more direct, there is a movement away from the traditional trust principle which could leave "trustees as more bystanders rather than key players". This may not only have the result of marginalising trustees, but will also lead to tensions in relation to investment strategies of pension funds as companies, which will ultimately underwrite the fund, demand greater influence on the risk/reward decisions of pension investments.

CALLED TO ACCOUNT. The obligation on the employer to provide this added layer of security may also contribute to the perceived high cost of corporate pensions and fuel the well-publicised shift from defined benefit to defined contribution schemes. Pickering quotes a number of factors which have already contributed to this move, including increased risk aversion among corporates, growing awareness of the implications of longevity and a generation of finance directors who had never before been required to contribute to the pensions pot. He is less keen to lay the blame at the door of the controversial pensions accounting standard FRS 17. "You can't blame FRS 17 for everything. In many cases, it may just give legitimisation to a decision that has already been made."

That said, Pickering is not satisfied that the FRS 17 approach for reflecting the cost to companies of pensions liabilities is beneficial. "I can understand people searching for increased shareholder transparency," he says. "But one has to be careful not to be too clever by half. One can't have accounting purity if the cost of that is social strife and shareholder misery in the long term." His main issue with the standard is the fear that the need to manage volatility and to safeguard capital on an annual basis will actually increase the long-term costs of providing pensions and discourage the continuation of occupational pensions provision – a spectacular "own goal". He believes that the accounting profession should have more faith in investors to "see through the snapshot to get a feel for the long-term liability associated with the pensions promise", rather than insisting on delivering short-term performance data.

FINAL ANALYSIS. Pickering remains committed to the concept of occupational defined benefit schemes, although he is open to the possibility that the sharing of risks between employers and employees should be flexible. Defined benefit schemes need not necessarily be full final salary schemes but could, instead, for example, be linked to average pay to prevent large shocks to schemes caused by significant promotions late in an employee's career. Mix-and-match schemes made up of a lower level defined benefit element, with a money purchase tranche on top, might also be a solution or, potentially, the risk of post-retirement increases to take account of inflation could be transferred to employees. Pickering, however, points out that, at the end of the day (or, indeed, of our working lives), the transfer of risks from a collective to an individual basis is likely to increase the overall cost of our pensions. "With a narrower base of risk [as would apply to an individual employee, rather than to a pension scheme as a whole], the more sense it makes to be risk averse. Each pound of pension would cost more than if risks were shared with the employer."

DIRECTING PROGRESS. It is the balance between greater protection and higher cost that has coloured much of the debate on the EU Pensions Directive[3], in which Pickering and the EFRP have been closely involved. There have been heated discussions on the role of regulation in the EU pension industry and the acceptable risks for EU pensioners, including the range of assets in which pension funds should be permitted to invest.

Again, Pickering has been opposed to overly prescriptive regulation or designation of pension fund assets, supporting the 'prudent person' approach to asset allocation, rather than the imposition of quantitative restrictions on a particular class or classes of assets. This has, at times, cut across the views of some EU campaigners who were pushing for significant compulsory allocations to assets perceived as lower risk, such as cash deposits and government bonds. The discussion on asset allocation illustrates the gulf between the concept of a cast-iron pensions promise at all levels of provision and the tiered approach (broadly favoured by Pickering) of a secure minimum state-sponsored retirement income, supplemented by additional funded sources which are subject to 'light touch' regulation. "It is a feather in the cap of the EFRP that we have a Pensions Directive at all," explains Pickering, who admits that it has not been easy to persuade EU representatives "to acknowledge that the Pensions Directive is a financial services framework and not an instrument of social policy." It is hoped that the Directive, which has been "more than a decade in the coming", will be implemented in the next two years.

INSURING SUCCESS. Even so, some compromise has been called upon to ensure that the text of the Directive would be acceptable. One particular issue Pickering highlights is the fact that insurers and asset managers do not enjoy a level playing field, in terms of the provision of pensions services. Pickering sees pension provision as the result of two separate phases – the accumulation phase, when a pool of assets is amassed, and the output phase, when this pool is utilised to purchase an income for the remaining life of the pensioner. While asset managers could meaningfully contribute to the accumulation phase, although not offering annuity products in the output phase, their access to this pan-European market is restricted under the Directive.

This dichotomy has sprung from a strong insurance lobby in the EU which, along with left-wing political and social groups, has pushed for a stronger emphasis on the 'guarantee' elements in pensions. As Pickering comments: "Some unholy alliances have arisen from the fact that the more guarantees are involved, the more the insurers would enshrine their position in the market." In his eyes, the limited supply of guarantees that the market can underwrite should be centred on the output or annuity purchase phase, rather than on guaranteed rates of return at the accumulation phase. In this case, there should be no bar to increased competition at the accumulation phase driven by the endorsement of offerings from asset managers.

However, such issues are more "fine-tuning rather than major surgery" and Pickering still sees the Pensions Directive as a significant step forward. He views the Directive as an "enabling" rather than an "enforcing" piece of legislation for companies and financial services companies wishing to offer pan-European pension plans to an increasingly mobile EU workforce.

He hopes that governments will echo this attitude when introducing its provisions into domestic legislation in EU member states. In this process, he does not, unlike some commentators, see national tax authorities as the main threat to timely and effective adoption. Pickering feels the tax authorities are already responding to European Court of Justice decisions on the non-discriminatory treatment of pension contributions across borders in the EU and that they will continue to take this pragmatic approach. However, he does harbour some concerns about the risks of "prudential competition", whereby regulatory bodies in the EU seek to establish themselves as either the 'tough guys' or 'the soft touch' of the EU pensions regime in the quest to maximise EU pensions-related investment activity in their jurisdiction.

PERSONAL PENSIONS. Pickering clearly derive personal satisfaction from contributing to the progress of a pensions industry for which he has had a lifetime's passion, and seems to relish the opportunity of leading the EFRP on to new challenges. Indeed, he has come quite some way, in both career and pension terms, from his early days on the railways, when his parents advised him "to take any job you like as long as it comes with a pension". Unlike "cobblers who don't have very smart shoes," he says, "I'm quite well-provided for on the pensions front – which is just as well, as I'm planning to live to 95."

Pickering is especially enthused by the opportunity to influence the fledgling pensions panorama in central and eastern Europe. Poland and Hungary are already affiliated to the EFRP family and Pickering is attracted by the fact that these nations have not got "the baggage" of more developed pensions systems. "They can tack and trim as they need and can fine-tune their infrastructure without having to eat platefuls of humble pie. They are open to ideas. They have been let down by state and financial markets alike and so have no starry-eyed allegiance to one or the other."

Pickering sees the EFRP as a chance to learn from each other's mistakes and to share expertise and experience. "The EFRP is about subsidiarity and diversity. We are not trying to impose ideas on anybody." This international dimension to his work has brought its own demands for Pickering, who acknowledges that "an EFRP chairman may not always be able to be quite as robust in his views as, say, the chairman of the NAPF. EFRP membership is more heterogeneous. I now have to think at least twice before making one of my pronouncements."

Pickering describes his EFRP role as "diplomatic, not evangelical or technical", although he is clearly not entirely at ease with the thought that he might be now regarded as some kind of "elder statesman" of the pensions world, rather than the outspoken author of the Pickering Report. Still, a role as a European pensions 'ambassador' cannot be too much of a disappointment, considering his claim that his firm only took him on because they wanted to hire his personal assistant, Jenny, and he came as part of the package.

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Notes

[1] *In planning the structure of retirement provision, three pillars or tiers of provision are often referred to. The first pillar is public, earnings- related pension provision; the second pillar is private occupational provision; and the third private, individually-funded provision.*

[2] *Sandler Report on Medium- and Long-term Retail Savings.*

[3] *EU Directive on Institutions of Retirement Provision, adopted by the European Council on 13 May 2003.*