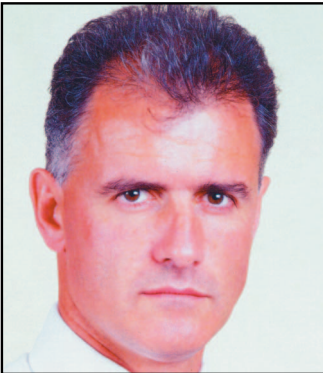


Time for a national debate on pension reform

Talking Point



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Pensions are an increasing issue of concern. Almost every day we see stories on the closure of defined-benefit pension schemes, the iniquity of public sector pensions, the outcries against increasing the retirement age and a host of other pensions-related problems.

Yet few commentators get to the heart of the matter: that these individual issues – big as they are – are symptoms of a wider malaise in the provision of pensions in this country.

What we have seen over the past couple of decades is pension risk being reorganised in an ad-hoc, unsystematic fashion, with little regard for the law of unintended consequences. The net effect of this reorganisation is that the long-established system of pooled risk in pensions is being broken down, with pension risk being pushed down on to the unwilling individual.

Today's occupational pension liabilities, whether unfunded or funded, public sector or private, are bigger than Britain's GDP. Add in state pensions, projected to be 6% of GDP every year over the next couple of decades, and the scale of the issue is immense.

As society feels the full effects of the ageing of the baby-boomers, increased longevity and the hang-over from the recent debt-fuelled economic party, it is possible to see social unrest, such as some European countries have experienced over this issue, and inter-generational dispute. We must therefore act to create a more equitable, efficient and sustainable system, one in

which pension risk is distributed across the board and is therefore manageable for all.

A good example of managing risk has been the pension insurance industry. To help maximise returns, pension insurers have been adopting more sophisticated investment techniques than those typically used by many corporate-sponsored pension funds.

The enhanced portfolios they employ seek to match the duration of the pension liabilities, incorporate greater inflation protection and more closely match cashflows with liabilities. These investment techniques include the use of reinsurance, swaps and more sophisticated asset management strategies.

If the move to individual provision continues with increasing numbers of people in defined contribution pensions, how many of them will be able to use these techniques to ensure a comfortable retirement?

Yet it is clearly not right for corporates to bear the pension risk. In many cases the sponsors of final salary schemes have themselves become enmeshed in a web of pension-related problems they are ill-suited to handle.

For example, British companies have been forced to increase by a factor of 30 the money they put into pension funds to plug deficits since the 1970s. In 2000, British companies were putting £9.2bn into their pension schemes; by 2007 that figure was £33.6bn.

There are many companies in the FTSE 100 facing liabilities that far outweigh their current stock mar-

ket value. The knock-on effects for the balance sheet and cashflow can be significant, potentially lowering profits, increasing leverage and ultimately, impacting their share price. For them, unloading pension risk is the logical solution.

A recent survey showed that three quarters of companies offering defined-benefit schemes were considering ending all future accruals for existing employees. Recent high-profile examples of this include Barclays and Wm Morrison. We could end up in this country with a system where the only benefits that are secured for the long-term are those of public sector workers.

Politicians of all parties must grasp the nettle and start thinking about the pension system today. In my view, it is essential that we have a national debate without pre-set boundaries around the shape of the provision for our old age: where the risks reside and the best solutions for spreading it equitably, efficiently and sustainably.

Without such a debate, taking full account of the role of the state and the interaction between state provision and occupational pensions, future generations will be left with an unmanageable burden – our old age. The answer is a review to create a system of pension provision fit for the modern age. This might well incorporate some of the features which made pension provision in the past so strong. After all, some of the challenges may be new, but the objective is the same. A good place to start is with a national debate.