

WHAT I WOULD LIKE TO SEE IN THE GREEN PAPER

The Green Paper needs to announce radical changes to bring our retirement and pensions rules into the 21st Century and set out a sustainable framework for the future. The present system, devised in the 1950's, has not kept up with demographic and social changes. Pensions and retirement were never meant to last 30 years or more.

Government should try to get cross-party support for the radical changes that are needed and then ensure that a commitment from all parties is made that the new framework is inviolable for 10 or 20 years, to really enable pension planning to be safely done.

It's good news that we're living longer than before – but how can we achieve a decent standard of living in later life? Just saving more will not be enough, we must encourage people to work longer too. What changes do we need?

1. Concept of 'gradual' retirement:

Retirement was never meant to last for 30 years or more. As people are living longer, they also seem to be expecting to retire earlier – this is the case in the public sector as much as the private sector. The current situation is not financially sustainable. Even if you start pension contributions in your 20's, if you retire in your 50's, you would be trying to live on 30 years' worth of contributions for another 30 or even 40 years! The maths just don't stack up. It can't be done. The cost of providing decent pensions for such a long time is way too high to be realistically affordable.

I hope the Green Paper will introduce the idea of 'gradual retirement'. Move away from a 'one size fits all' approach and enable people to carry on working for longer, *but not necessarily full time*, to give them a better standard of living later. Retirement should be a 'process', rather than an 'event'. A whole new phase of life, which never existed before, in which people gradually withdraw from work. This is much healthier for everyone and would be a tangible benefit from the advances of recent decades. It would also be better for the economy as a whole since having so many people not working or contributing to society for so many years is a huge waste of valuable human resources!

Green Paper reforms required for this would include:

- allow part-time work with same employer, while drawing part pension
- Government take lead - introduce flexible band of retirement ages, rather than age 60 or less – for public sector workers
- age discrimination legislation
- end mandatory retirement ages, protecting older workers rights
- make State pension increases for delayed retirement financially worthwhile

2. Protect final salary schemes and/or provide proper risk warnings:

The Green Paper *must* address the 'wind-ups' problem. The current situation makes a mockery of our pensions laws and regulations. We have the most amazingly complex legislation, because of successive changes added to existing rules, rather than replacing the old ones each time. This is guided by the principle of 'no retrospection' - existing pension rights must not be damaged, even marginally. Member Nominated Trustees look after pensions, OPRA fines employers if every penny of contributions isn't paid on time.

But what is the point of all this, when members who have paid in loyally for over 30 years can actually lose their *whole* pension! Effectively, the law protects the pennies, while the pounds disappear out of the door. In focussing on tiny details, the regulations have lost sight of the big picture!

And this is not just when an employer goes bust. Even a solvent employer, complying fully with the law, can wind-up the scheme, leaving members with only 40% of promised pensions. The MFR was portrayed as 'protecting pensions', but the test has been weakened twice in recent years (most recently in March 2002) and it doesn't protect contributions at all.

Neither Myners', nor Pickering's proposals provide proper protection. But Government *must* accept some responsibility. There was no official recognition of the risks inherent in final salary schemes and no attempt to provide any risk warnings (which are standard practice in any other financial product and which the industry and the regulator spends enormous sums of money on providing and policing). Employers were allowed to describe their schemes as 'guaranteed pensions' and make pension promises, without clarifying that these promises may not be met. Even worse, Inland Revenue pension rules did not allow people contributing to an employer's scheme to put money into any other pension. So they could not even diversify their long term investments. Without protection, this is like financial advisers recommending clients to invest only in one share on the stock market (and also betting their job on this too!) If the company fails, they can lose their whole pension and their earnings and nobody ever warned them. In fact, successive Governments and the pensions industry in general has always encouraged people to put money into their employer's final salary scheme and always led everyone to believe that these were the best type of pension, but they never mentioned that you could lose all your contributions and end up with nothing! It's completely wrong. There is no such thing as a totally safe private sector pension scheme, just as there is no such thing as a safe share on the stock market. Nobody knows whether a particular company will collapse.

So the Green Paper reforms needed include:

- introduce mutual insurance to protect final salary schemes (at least to protect a certain amount of pension for all scheme members, depending on their contributions)
- change the priority order which governs how assets are distributed when pension schemes wind up, so that assets are divided more fairly
- perhaps make the Directors' pensions the last to be met, once the assets have provided all other members' pensions (this should ensure the Directors fund the schemes better!)
- provide proper risk warnings, if pensions can't be fully protected
- allow everyone to invest in other pension schemes apart from their employer's scheme and encourage them to diversify
- legislate maximum time for wind ups – it usually takes 5 years or more, but should be kept to maximum, say, 2 years and allow members to challenge the costs.

3. Slow the move away from DB schemes

We are witnessing a far too rapid shift from final salary to money purchase pensions. The law currently allows employers to switch with no notice and no consultation. This is

extremely dangerous and detrimental to future pension provision. The pensions industry is not yet geared up properly to provide DC pensions and workers are generally not fully aware of all the implications of the change. Employers should properly explain to their workforce what they are doing, what other benefits they will be losing, how much less the employer will be contributing and also help them plan how to replace the benefits they will be losing in the new type of scheme. If employers are required to give notice to the workforce of the intention to change and are required to consult them, this would help delay the movement away from final salary schemes (although it is probably inevitable that most employers will switch to DC arrangements). It is very expensive to provide final salary pensions and workers do not always appreciate this. In the public sector, for example, a guaranteed final salary pension of just £10,000, paid from age 60, with cover for a spouse and index-linked would cost around £270,000. This is an enormous sum of money and it is not clear that public sector workers appreciate the value of their pensions.

So the Green Paper reforms needed would include:

- Require employers to give at least 12 months notice of intention to change pension arrangements
- Require employers to consult workforce and explain full implications of these changes
- require (or perhaps provide incentives for) employers to give their workers independent financial advice, to help plan how to make up for any lost benefits

4. Simplification is essential – both of pension regimes and industry forms/procedures

The Green Paper must simplify the current pension regimes. We have at least 4 different regimes for money purchase pensions and 6 for defined benefit pensions – how is anyone seriously supposed to be able to understand all this? The key to real simplification will be to make any changes retrospective. This *can* be done. It can be done for money purchase schemes with virtually no-one ending up worse off and it needs to be done for defined benefit schemes because they are just too costly and cumbersome to administer as they are. Part of the reason for the complications and for many of the rules we have, is that it was always thought to be wrong to change the rights which people had already accumulated in their pension, even tiny changes. So each new piece of legislation (including those designed to simplify the system) was just bolted on to the existing rules, which left the overall position more complex, since everyone had to cope with the older rules *and* the new ones! But we have learnt that this has not worked. With all the complications of the current system and all the old systems in place so as not to damage previous rights, people have still been left potentially losing all their contributions and pension rights. The wind-up fiasco should pave the way to allow small changes in retrospective rights, in the interest of proper simplification going forward.

But simplification should not just apply to the rules governing pensions, it should also apply to the procedures, forms and processes used by the financial services industry too. At the moment, the forms that need to be filled in for both pensions and annuities are so complicated and differ so much from company to company, that most people find it really hard to understand what they mean. Standardisation of forms and procedures should be discussed in the Green Paper, to encourage providers to make it easier for people to buy pensions and make advisers jobs quicker too. The ABI should make this mandatory, rather than voluntary as at present.

So, the policy changes required are:

- Simplify tax, contribution and investment rules for pensions
- Have just one regime for DB and one for DC
- Make any simpler regime retrospective
- Require financial services firms to simplify their forms and procedures too

5. Clarify and simplify State pensions

It would be really useful if the Green Paper actually set out the thinking behind the State pension policy. What should the State provide? Should it be a flat rate pension or should there be earnings linking as well? I think the Green Paper should completely overhaul the State scheme, removing many of the current complexities. People should be able to know what they can expect from the State (some basic minimum provision, to take people above the poverty line and then anything extra that people want to provide for themselves could be left up to them.

This would mean that the Green Paper reforms would need to:

- end contracting out, giving a clear distinction between State pension and private provision.
- merge Basic State Pension and SERPS/S2P, giving people a proper base on which to build private provision and clarify what the State will provide
- address the pension needs of self-employed better (currently only entitled to Basic State Pension)

6. Change Pension Credit

Government's recent Pension Credit policy is great for today's pensioners but is dreadful for future pensioners. Pension Credit has been billed as an incentive to save and ensuring that 'it always pays to save'. This is completely untrue. It is less of a *disincentive* than the current Minimum Income Guarantee for most people, but it is still a major disincentive for most people to put money into pensions, because they may lose 40% of their pension, or even all of their savings, if they become entitled to Pension Credit when they retire. In fact, next year 57% of pensioners will be entitled to means tested benefits as will 75% of single older women! If we really want people to put money into pensions, we have to remove this disincentive.

So the Green Paper should:

- announce Pension Credit is temporary or disregard perhaps the first £20 per week, to end the major savings disincentive it entails.

7. Bigger and fairer incentives for pensions and savings

We should give basic rate taxpayers more incentive to make pension contributions. Higher rate taxpayers (the top 10%) get much more incentive than lower rate taxpayers. For every £3 they put into their pension, Government gives them £2. But for every £3 a basic rate taxpayer puts in, Government gives them less than £1. Tax relief is unfair and illogical (giving most incentive to highest earners, who can afford to save more anyway);

it's inflexible -the amount of incentive you can give depends on tax rates – just 22% or 40%; it's also hard to understand – people don't know how much they receive from Government for their contributions. I believe we should give basic rate taxpayers more incentive to contribute to their pensions and give everyone the same incentive for the same contributions, to make it fairer.

My recommendations are:

- separate savings incentives from the tax system
- introduce a simpler system, giving more people better incentives. Perhaps £1 for every £1 contributed up to a certain limit, or perhaps give everyone the equivalent of higher rate tax relief i.e. £2 for every £3 they put into their pension.
- introduce better incentives for employers who contribute generously to their schemes.
- allow pensions to offer prizes, like premium bonds, to encourage people to contribute more. There could even be a bit of fun in pensions at last.

8. Improve working of DC.

The pension schemes of the future are likely to be defined contribution, but none of the three elements of DC, which are crucial to ensuring a decent pension, is working well.

The Green Paper needs to address them:

- Contributions: When switching from DB to DC employers usually cut contributions, often substantially. We should make this harder for employers to do and also explain to people how much they may need to actually contribute in order to provide a decent income in later life.
- Investment profile: DC schemes often fail to offer sufficient investment options. The financial services industry should be encouraged to provide products designed specifically for DC – wider choice and perhaps guaranteed funds, to help provide some certainty about final pension fund size.
- Annuities: Reform is urgently needed. People just don't understand annuities.

9. Annuity Reform:

Buying an annuity is mandatory and, once bought, it can never be changed. Surely, then, Government has an obligation to ensure that people make the right choice before buying.

My recommendations are as follows:

- Make OMO work properly. Since the annuity can never be changed, it should be mandatory for people to receive basic specialist annuity advice, going through the few fundamental questions they need to consider, to find the right type of annuity *before* buying. People are charged 'commission' anyway, whether they use an adviser or not. The advice should help people to find the best type of annuity for them and also to find one of the top rates for the annuity.
- Allow money back guarantees. People will feel annuities are fairer, if they can pass on any balance of their original fund not received in pension income, if they die unexpectedly early.

10. Make financial advice more widely available:

The Green Paper should address financial advice by proposing:

- incentives for employers to provide workplace financial advice
- a new class of 'specialist' advisers, FSA approved, to help people plan their finances and choose 'suitable' products. Not Sandler's simple products, without advice, but a more economical type of advice that will check suitability for particular products only. However cheap and simple a product is, if it's not suitable, it's not suitable. If an ISA is more suitable than a pension (perhaps if the person might lose means tested benefits or might need money in an emergency before retirement) will the check-out lady at Tesco's tell them this?