



Research Workshop on Pension Guarantees

Panel Discussion Session

Watson Wyatt

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Dr. Ros Altmann



What's Gone Wrong?

- Government tried to offload pension provision to private sector – State pension only 20% of average earnings
- Government encouraged joining occupational schemes
- Members told they have secure, guaranteed rights, protected by law – relying fully on employer pension
- Many employers not taken these responsibilities seriously enough
- Contribution holidays, industrial restructuring, deficits
- Pensions used as 'financial tool' rather than vehicle to pay pensions!



UK System as it Stands

- Protection only if drawing pension – arbitrary and unfair
 - Variability of outcomes too wide (0 - 100% - too risky)
 - Even money transferred from other schemes not safe
 - Members contribute for 30–40 years but no pension
- Members are ‘betting’ their retirement income on shares of one company – but they don’t realise this
- No risk warning
- Poverty and long term economic decline



Employers' Open-ended Costs

- ORIGINAL IDEA OF PENSIONS:

Work:

several decades

Retire:

5-10 years

- TODAY'S SITUATION FOR EMPLOYERS:

Work:

5-10 years

Retire:

several decades



Problems of Final Salary Pensions

- 1. Asset values fallen – reliance on equities
- 2. Liabilities risen – falling interest rates
- 3. Longevity – unanticipated improvements

- Are final salary pensions affordable?

- Implications for public sector?



Arguments Against Protection

- 1. Extra costs of insurance will drive employers away from final salary schemes:
 - - this is already happening
 - - if employers can't afford insurance, how can they afford the pension promises?
- 2. Good employers will have to subsidise bad:
 - - there is no certainty about future of employer or assets
- 3. Moral hazard:
 - - we can learn from others' mistakes



How To Protect Pension Contributions - Alternatives

- Government backed mutual insurance – up to limit
- Change priority order – years from retirement age
- Move pension fund up ranking order on insolvency
- Directors' pensions last



Without Protection...

- Loss of confidence – why contribute?
- Wind-up makes a mockery of Section 67 (not even minor changes to accrued rights!)
- Recognise reality - UK schemes more mature and don't have enough to meet liabilities on wind-up
- Funding isn't working
 - today's contributions going to today's retirees
 - Not enough left for younger members' future pensions
- Final salary pensions become 'pray-as-you-go'!



Protection is Essential - Insurance or Compensation?

- Don't expect too much protection
- Only cover a relatively low amount of pension
 - E.g. £15,000 a year maximum
- Explain to everyone what they might get
- Similar to banks and investor compensation
- We compensate for fraud, why not for insolvency?
- Could Government put in initial sum to underpin?



Cost of Protection – Who Pays?

- Employer is making the promises
- Member benefits from insurance
- Trustees' role to protect scheme beneficiaries
- Flat-rate per member can be passed on
- Underfunding levy must be borne by trustees/employer
- Employer can choose to insure more if desired



Important Issues for PPF

- Power to examine corporate structure – companies may be waiting to dump pensions on PPF
- Don't be too ambitious – low level of cover
- In theory, cost of insurance should be:
each individual company shortfall x risk of default
- Premium related to:
 - 1. Shortfall – MUST have a penalty for under funding
 - 2. Credit risk of company (risk of default)
 - 3. Investment policy?
- Asset allocation of PPF funds, avoid correlated downside

Jumblies Pensions - UK Final Salary Schemes

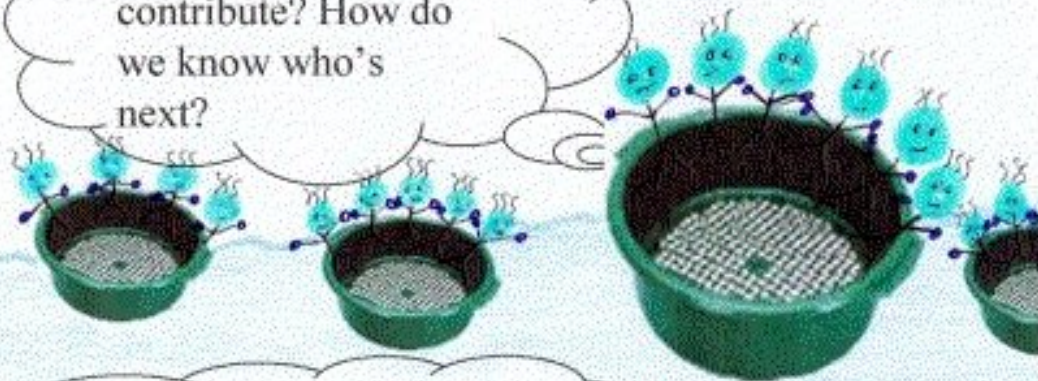
There is no crisis.
Pensions law
protects you.



Be confident.
Employer
schemes are best.
Look at us!



Help! Is it safe to
contribute? How do
we know who's
next?



We thought we had a
guaranteed pension.



Why didn't you warn
us? You said our
pensions were
protected.

