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Pensions Newsletter

The Pensions Commission's First Report

The Pensions Commission issued its first report earlier this week. The Commission's remit is:

“to keep under review the regime for UK private pensions and long-term savings, and to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach”

The report focuses on a detailed description of the current position and does not make policy recommendations. The Commission intend the report and its subsequent consultation phase to be used to develop a consensus approach which will be sustainable across parliaments and governments. The Commission's recommendations are due to be set out in its second report planned for autumn 2005.

The problem

Life expectancy is increasing rapidly and is expected to continue to do so. Birth rates are forecast to continue at low levels. Combined these factors are expected to lead to a doubling of the percentage of the population aged over 65 between now and 2050. This is happening at a time when the state plans to provide decreasing support for many pensioners in order to control expenditure and the private system is in decline.

The solutions

There are only 4 options:

- Pensioners will become poorer relative to the rest of society
- Taxes/National Insurance contributions devoted to pension must rise
- Savings must rise
- Average retirement ages must rise

The report comments that the first option is unattractive and that there are significant barriers to solving the problem through any of the other three options alone. It thus concludes that some mix of higher taxes/National Insurance contributions, higher savings and later average retirement is required.



Compulsory saving?

The report suggests 3 possible ways forward:

- A major revitalisation of the voluntary system and/or
- Significant changes to the state system and/or
- An increase level of compulsory private saving beyond that already implicit within the UK system

Analysis of these issues will be the key focus of the Commission between now and publication of the second report.

Decline of the defined benefit scheme

The report comments that the UK pensions system has appeared in the past to work well because one of the least generous state systems was complemented by the most developed system of voluntary private funded pensions. In fact the underlying trend in private sector employer pension contributions has been downwards since the early 1980's. But buoyant equity markets and a delayed appreciation of improved life expectancy allowed defined benefit schemes to avoid necessary contribution adjustments until the late 1990s. As the 'fool's paradise' has come to an end schemes have closed and there has been a shift to less generous defined contribution provision.

The report highlights that the public sector is the main residual defined benefit scheme provider. We believe that on current trends, even after the changes to the schemes following the current reviews, this is likely to remain so. It is possible that over-time the fiscal and economic environment in which schemes operate will change as a result of decisions taken following the completion of the review but there have been, and continue to be, such changes from a variety of causes during the lifetime of existing schemes.