

January 2012 Savings Briefer

INTRODUCTION

This is typically the time of year when we look back on the past 12 months, and consider the likely developments in the coming year. At the risk of following in everyone else's footsteps, I shall take the opportunity to do the same. 2011 saw many initiatives in savings move forward or come to delivery, such as the abolition of the, effective, requirement to buy an annuity at retirement, whilst others were kicked into the "long grass", such as the proposals to allow early access to pension funds. We welcomed the arrival of the new Junior ISA and saw further progress on automatic enrolment into pension saving (of which more, later) and the building of the National Employment Savings Trust (NEST). All this was against a backdrop of the worst economic conditions in 100 years, with the Euro and banking crises far from resolved and ongoing as I write. Locally and globally, unemployment is on the rise, with individuals and governments straining to control debt. 2012 promises to be an extremely bumpy ride – at best.

2011

This year saw the Coalition Government in the UK settling down after a frenetic raft of policy proposals which emerged in 2010. However, there were some significant new statements of policy intent, notably towards provision of a new, flat-rate, Basic State Pension (BSP) as well as announced accelerations in the ages at which this can be claimed in future. As already alluded to, there was also progress in other areas and final implementation of earlier policy proposals.

AUTOMATIC ENROLMENT INTO PENSION SAVING

Late spring 2011 saw the publication of the final dates between 2012 and 2016 at which employers will be "staged" into enrolling their employees into pension saving, with further details of the process also emerging during the year.

No responsibility can be accepted, by the author or TISA, for loss occasioned to any person acting or refraining from action as a result of material in this document. It is intended for circulation only within member firms and under no circumstances should it be circulated more widely in the industry or to the public without the express written permission of TISA.

The Department for Work and Pensions (DWP) also consulted on the design of default funds for pensions. The “target date fund” approach being taken for its default fund by NEST, combined with this consultation, has prompted a spate of navel-gazing amongst Trustees and scheme providers, assessing whether their current approach is good enough.

Aside from this, there was an emerging consensus amongst the savings policy community that we really needed to get behind the automatic enrolment project in the light of ever declining numbers of employees saving anything into pensions and ever declining numbers of employers offering a scheme of any kind. The social policy implications of low, or no, saving for the long term are immense, with millions in the private sector apparently sleep-walking towards an impoverished old age. Still, we thought, at least the posts are now in the sand, and employers can turn to planning for the new regime, even if some reports suggested a possibly high level of employee opt-out.

Then in the autumn, rumours began to circulate of a report being prepared for No. 10 Downing Street suggesting possible policy approaches of a “business friendly” nature, one of which could be delaying the whole auto-enrolment project. Whether true or not, at the end of November an announcement made to the effect that the “staging dates” for “small employers” were indeed to be put back to give them more time and less employment cost in the short term. This was to apply to firms with 3000 employees or less, which doesn’t especially look small to me. DWP and the Pensions Regulator produced updates in mid-December, the latter headed “Government commits to automatic enrolment for all employers.....with extra time for some”, pointing out that half of all eligible employees would be enrolled “by the end of this parliament”. And half, of course, not. Elsewhere, statements to the effect that “all employers will be automatically enrolling by the end of the next parliament” suggest that micro-employers could be auto-enrolling for the first time in 2020! Whilst a welcome break for smaller businesses, we could be looking at a 16 year delivery period from when the policy first saw the light of day in 2004, which must be some kind of record. More confusion for employers will result and lower levels of saving for some employees, too, with the economic effects for the costs of the NEST build as yet unclear, but not likely to be favourable.

At the time of writing, the new “staging” regime is yet to be announced, promised “in the New Year” of 2012.

A FLAT-RATE BASIC STATE PENSION

The current regime of a low BSP, topped up by means-tested retirement income benefits is hugely complex and worse, fails to work for many who desperately need extra income, but don't, or won't, claim it. Means testing of income benefits in retirement also acts as a disincentive to save, as modest saving can simply deny the saver, pound for pound, benefits to which they would be entitled had they done nothing. This cannot be right, and especially so when we are about to enrol millions of modest earners into such saving - in many cases for the first time. The publication in summer 2011 of a Green Paper from DWP outlining possible approaches to provision of a flat rate BSP at or above the current "Guarantee Credit" level of £140 per person was therefore one of the most welcome developments of the year.

However, the paper had some potential flaws. First, the new, level, BSP would only apply to FUTURE pensioners, those retiring after a certain, as yet unspecified, date in the future, probably 2016. This means existing pensioners stay with the existing system, means testing and all, in a run-off that could last 40 years until the last eligible pensioner dies. It also means a "cliff edge"; someone retiring one day will be in a different regime to one who retires the next. Combined with the retention of a link to NI contributions, this makes the proposal less than the "universal" one we would have liked, and preserves complexity. None the less, it WOULD provide certainty for future pensioners and make it safe to save into a pension privately in the new regime.

To help pay for it, means tested retirement income benefits would be scrapped for the new cohort and contracting-out would be abolished entirely. It is in this second area that problems are starting to emerge. Some people have accrued State Second Pension rights which would take them above the new BSP level in terms of weekly income. If contracting-out is abolished, they will lose the extra money. There are probably not that many of them, but many will be the public sector, and they are restive. A solution needs to be found for this if the plans are not to derail. Equally, persistent rumours emerge (equally persistently denied) that the Treasury are balking at the cost of the whole exercise, particularly the fixed, "on balance sheet", cost of the new BSP. Certainly, the "triple lock" increase introduced by the coalition for the current BSP (at least 2.5% per annum, more than 5% this year!) probably looks unsustainable in its current form when applied to the proposed new regime. Then again, the UK spends the least of the EU 25 on state retirement income benefits.....

PUBLIC SECTOR PENSIONS

A few years ago, whoever would have thought that we would see national industrial action over pensions? Yet that's exactly what we saw in 2011 over the Hutton proposals to reform the pension regime in the public sector. Matters now seem to have been concluded, with low earners actually better off with regard to pension income in many cases and an apparent guarantee that those within 10 years of retirement will see no change at all to their current arrangements. The only element of the Hutton package (which he warned had to be taken as a package, or not at all, and was the bare minimum that needed to be done) remaining unchanged is a fairly modest increase in personal contribution levels and a general move to "career average" as a basis for accrual. Wild promises were made about not re-visiting the settlement for 25 years, when to this commentator, the present savings look like nil and long-term future savings (if they ever materialise) modest indeed. It's my view that we'll be looking at this topic again very soon, probably in the next parliament. We have certainly witnessed some astonishing things this time round, but two inescapable facts remain. First, Defined Benefit (DB) pensions have become rare and frequently unsustainable in the private sector. They are almost universal in the public sector, but are also unsustainable there and worse, in many cases are unfunded to boot. Second, the private sector is moving to Defined Contribution (DC-NEST, after all, is DC, not DB) for very good reasons. So a pension apartheid is developing along with social divisions between the two groups of workers. Additionally, the effect of Solvency 2, the EU initiative targeted at Insurance Companies, could be to radically increase the actual (in the private sector) and notional (in much of the public sector) funding costs of DB, such that a wholesale flight out of remaining private sector DB could be anticipated. Where then for public sector DB?

SIMPLIFIED PRODUCTS

HM Treasury indicated its interest in this concept in 2011. Although not directly impacting the savings space, with the focus initially on bank savings accounts and life insurance protection, it is one of those initiatives with the potential to grow like topsy into other areas. Essentially, the belief is that if products were stripped down to basics, with extraneous features removed, it might make them more attractive to consumers, who could more easily compare prices. Whilst echoes of the Stakeholder product range of 2002 ring in one's head (we have

been here before), a working party under Carol Sergeant, formerly a Director at Lloyd's Bank, has been established to investigate further. Watch this space.

2012

This year seems likely to be dominated by sovereign debt, banking debt and the Euro crisis, probably to an even greater extent than 2011, in which the problems started to become apparent, even if the solutions did not. The suspicion is that some of the solutions will be as unpalatable as they are necessary and unavoidable. Stock markets remain lower in value than they were 13 long years ago and are still displaying extreme intra-day volatility. However, here are my positive predictions for 2012.

1. THE FLAT RATE BASIC STATE PENSION GETS THE "GREEN LIGHT" – the problems are overcome and, after a White paper is published by DWP in Q1, legislation is prepared.
2. AUTOMATIC ENROLMENT INTO PENSION SAVING – starts on time in October, with the new "staging" schedules delaying enrolment for all by no more than 18 months. "Opt out" rates turn out to be less than 20% in early cases, indicating a likely policy success. Employers, after a difficult start, get used to the administration as "business as usual".
3. THE JUNIOR ISA IS A SUCCESS – those providers who have entered the market report steadily building sales as people start to put money away for their children as part of the overall recovery in savings ratios. More providers enter the market.
4. THE ISA SAVINGS SUCCESS STORY CONTINUES – the ISA is the biggest single savings success story in recent financial services history. 2012 sees the number of open accounts pass 20 million and a total of nearly £500bn invested by the year end, as domestic UK repairs its balance sheets.
5. PENSION AND OTHER PRODUCT TRANSFERS GET EASIER FOR ALL – led by the platform re-registration project and the cash ISA transfer project, pension transfers are made quicker, more reliable, cheaper for

providers and easier for consumers. TISA will have made a central contribution to this.

6. NO NEW MISSELLING SCANDALS IN 2012 – or any other year going forward. Gradually, consumer confidence rebuilds.

Is that a pig I just saw flying past my window?
Happy New Year!

MALCOLM SMALL
DIRECTOR OF POLICY
[Correspondence is welcome. Contact malcolm.small@tisa.uk.com]

12 January 2012