Update: pensions

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By **Jennie Kreser**

With the pension pots of millions likely to be significantly reduced and fewer people than ever prepared for retirement, the future is looking bleak. Jennie Kreser considers how the D'Arcys and Bennetts of today will cope

It is a truth, universally acknowledged, that a single government in possession of a good policy must be in search of a strategy…

Well, I'm sure we would all like to believe that, but those of us who have been working within the pension industry in recent years must be wondering right now if that really is the case.

I remember when I first became a pension lawyer in the early 1990s, pension legislation filled two loose-leaf volumes of what was then called the NAPF Legislation Service. Even then, I was hearing complaints from the pension law pioneers that it was becoming unworkable and overly complex.

Things have only got much, much worse. We are now up to five volumes and things show no signs of abating. No government seems able to resist meddling just a little bit in pensions and, while I am sure it is all with the best of intentions, down here in the real world, the bloated mess that we have been left with seems to be doing no one much good, least of all the companies and employers who provide schemes for their employees or indeed for the poor employees themselves.

Pride and pensions

Come with me down the shadowed lanes of the pension law equivalent of the D'Arcys, Bennetts, Gardiners and Wickhams and see what they might be facing today.

For Mr D'Arcy, the rich entrepreneur and business owner, employer of repute and investor in the markets, he will have been facing the challenges of a large black hole in the defined benefit pension scheme he has always up to now provided for his staff amounting to several million pounds. This has been caused by increasing longevity of his workforce, excessive wage demands from a highly unionised workforce, a collapse in his Greek, Portuguese, Irish and Spanish bond holdings, general volatility in the marketplace and Pemberley being mortgaged to Lehman Brothers just before the crash in 2008.

All of this has meant that he has had to close several factories, and the once gold-plated pension scheme so dear to his paternalistic heart has instead been replaced with a defined contribution scheme whose costs can be more strictly controlled and managed. Yes, it means that his employees will now retire on incomes only about half what they would have got under the old DB scheme, but at least they have something.

The Bennetts and the Gardiners are small business owners and firmly rooted in middle England. They have only a small number of employees and up until now they have done little to provide any sort of pension provision other than designating a stakeholder scheme which they have had to do for a few years, but thankfully (for them at least) they have never had to actually make any contributions to it.

They have just had a meeting with their lawyers, however, and been introduced to a highly knowledgeable partner who specialises in pension law. She has told them that the government has recently introduced new legislation which will require them to actually pay some money on behalf of their employees into a pension arrangement of some sort. There is a government sponsored arrangement called NEST – the National Employment Savings Trust – which can be utilised by small business but which will not in reality provide anything close to a decent pension in retirement because of the low level of contributions going in (eight per cent of basic salary roughly split three per cent employer, four per cent employee and one per cent tax relief), a conservative investment policy, and a significant cost levy to pay for the thing to be set up in the first place.

They instead decide to establish their own qualifying pension scheme which will be far more valuable for their employees allowing a greater contribution rate, and, although the investment risk is still carried by their workers rather than by the company, everyone is happy and much more productive as a result. They've got a couple of years before their 'staging date' – it's just been put back a bit from the original date because the government seems to be having problems getting its computers and systems up to speed – but they want to be ahead of the game; unlike the government it seems.

And what of the Wickhams, who rely entirely on state benefits since Mr Wickham has never been in a job which provided any sort of pension scheme – indeed, he's never been in a job at all. How will he fare? For him, the government is consulting on the possibility that the old complex two-tier means-tested top up to the basic state pension should be simplified and replaced with a basic pension of £140 per week or more by the time he comes to retire.

But he is extremely unhappy to realise that since he's not due to 'retire' until 2020, he will now have to wait an extra year, until he's 66, before he can lay his paws on the prize. He's even more fed up that his wife Lydia will also now have to wait longer for her pension because women's pension ages are also increasing so as to be equal to men at 65 by 2018. She's considerably younger than he is so, for her, the pot of gold at the end of the rainbow is stretching further and further into the distance.

Coming unprepared

A recent report from MGM Advantage widely reported in the national press has suggested that around 2.4 million people aged 55 or over are simply not prepared for retirement. This figure is four times larger than last year, with only three per cent of working adults feeling ‘totally prepared’ and 40 per cent of people uncertain about the age at which they will retire – that’s up from 23 per cent in 2010. This is a worrying statistic and a wake-up call for government and the industry to improve the quality of communication that is currently being provided.

A further survey conducted by Baring Asset Management has revealed that 13.6 million working age adults have no pension, with 13 per cent relying on their property to provide income in retirement. Unfortunately bricks and mortar do not pay the grocery bill and equity release schemes are rarely good value in the end.

Those hardest hit are those already in receipt of their pensions through an annuity or other investments. According to the Financial Times of 13/14 August, the recent combined effect of tumbling share prices and the reduction in annuity rates by an average of two per cent means that the projected income in retirement of individuals with a DC or personal pension has fallen by nearly 19 per cent in just one month. In July 2011, a 65-year-old man with a pension fund of £100,000 would have had an income of approximately £6,400 pa. If his fund had tracked the FTSE 100 index since then, its value would have reduced to £83,000 giving an annual income of just £5,200.

PwC has estimated that the fall in stock markets may mean that the pension pots of millions may be worth no more than the contributions that have been put in as the value of any investment return is wiped out.

But remember that the value of any investment can go up as well as down, although the downward trend does feel somewhat entrenched at the moment. Ironically, the upside of the increasing longevity we are now enjoying is that we will have longer to fix the deficits and the financial weakness in our retirement planning. The secret as always is to seek advice early and save as much as you can reasonably afford.

I have spoken to many clients who are lucky enough to be working in the public sector about whether they should leave those schemes and take their chances in the real world following the changes that the government has announced to the rate of indexation and revaluation from RPI to CPI and other changes. I tell them this: be thankful you have what you have. It is still far better than many private sector schemes even (or perhaps especially) those who will have nothing better than the NEST scheme to rely on in their old age. The D’Arcys, Bennetts, Gardiners and Wickhams of today are all in it together. They are all in want of a decent pension system – let’s hope, one day, it’s provided for them.

Postscript:

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