Written evidence from Samuel Pickford (PPF0049)

Introduction
I am a qualified Actuary and have been working in the pensions industry for 14 years, both in the UK and overseas. My current role is Global Benefits Manager for a large multinational corporation. I am making this submission to give the Committee a perspective from the plan sponsor's side of the fence, to balance against the views submitted to the Committee from within the consulting and advisory side of the industry. I am making this submission in a personal capacity and the views herein should not in any way be interpreted as the views of my employer.

Executive Summary
1. The key points from my submission are:

1.1. The Government should not allow companies to break their past pension promises since this unreasonably rewards those employers that have engaged in excessive risk taking, or failed to manage their pension plans prudently.

1.2. Government should recognise that defined benefit pensions earned in the past were part of an employee’s guaranteed remuneration package provided in exchange for work carried out by the employee in that past period.

1.3. The inter-generational fairness of pensions should not be viewed in isolation of an employee’s total remuneration and Government needs to consider that the composition of remuneration packages has changed over time in line with market trends and to support attraction and retention of employees.

1.4. The Government could take steps to address inter-generational fairness in pensions by a) maintaining the lifetime allowance, b) equalising annual allowance and lifetime allowance calculation terms for defined benefit and defined contribution members, c) removing the annual allowance taper for higher earners, d) equalising the amount that defined benefit and defined contribution members can recycle into the pension system after retirement.
2. Comment on whether the current wider environment, including very low interest rates, warrants an exceptional approach

2.1. Many companies find themselves with an obligation to manage defined benefit pension plans, not through the decisions of current management, but as a result of decisions made by past generations of management to implement such plans, or as a result of corporate restructuring, mergers or acquisitions.

2.2. For most employers, the financial risk and volatility of a defined benefit pension is an unwanted burden and this is supported by the realisation that (in many cases) the majority of plan members are no longer in active employment with the plan sponsor and therefore no longer contributing to the growth or profitability of the organisation.

2.3. These circumstances outlined in 2.1 and 2.2 have resulted in a rising sense of frustration amongst plan sponsors that they are being forced to commit significant management time, resources and costs to managing a problem that should have been dealt with by previous management.

2.4. Many prudent companies sponsoring defined benefit plans have taken steps to:

2.4.1. Close defined benefit pension plans to future accrual
2.4.2. Transfer obligations in full or in part to an insurance company, often at a significant premium to the net liability reported on the company balance sheet. A closed defined benefit plan is effectively an insurance policy in run-off and therefore an insurance company is naturally most suited to administering such an arrangement and managing the associated risks
2.4.3. Where step 2.4.2 cannot be implemented immediately due to the significant cost of insured buy-out, a conservative investment strategy has been adopted through the purchase of assets which closely match the profile of the liabilities (typically in the form of index-linked government bonds) as a key step to reduce risk until such time that step 2.4.2 becomes financially viable for the plan sponsor

2.5. While the above actions set out in 2.4 may not fully immunise all defined benefit plans against the risk of widening deficits, they do significantly reduce the risk that changing market conditions (e.g. falling interest rates) lead to a material increase in the funding shortfall.
2.6. The recent media speculation suggesting companies should be able to break past pension promises undermines the prudent approach taken by many employers to manage their defined benefit pension plans, as described in 2.4 above.

2.7. Those companies with large pension deficits have typically ended up in such a position as a direct result of the failure to understand or address the risks inherent in their pension plans, which has been demonstrated by their failure to adopt any or all of the prudent risk management steps described in 2.4 above.

2.8. Many companies have experienced rising pension deficits as a direct result of risk-taking on aggressive investment strategies based on the theory that equities will deliver higher longer-term returns, thus reducing the contributions that companies need to make to fund their pension promises. This gamble has not paid off, and these defined benefit plans have now been financially exposed as a result of the large mismatch between the profiles of the plan’s liabilities and its assets.

2.9. The difference between a well-managed and poorly-managed defined benefit plan has been magnified by recent economic conditions, which have rewarded the prudent plan sponsors and exposed those who have been aggressive or apathetic in the risk management of their pension plans.

2.10. In my personal view, it is imperative that Government does not allow companies to break their past pension promises. Companies that have invested time, money and resources to understand pension risk and to manage their pension plans in a prudent manner should not be undermined or indirectly penalised whilst those companies that have chosen not to make this investment, that have engaged in excessive risk taking, or that have simply brushed the issue of pension risk management under the carpet are rewarded or given special concessions.

3. **Comment on whether the current framework is generating inter-generationally fair outcomes**

3.1. Private sector companies in the UK typically provide their employees with a remuneration package that consists of pay, pensions and benefits. The value and terms of the package are set at a level that, overall, ensures the company is able to attract, retain and motivate the employees that they need to successfully operate their business.
3.2. Companies may provide a different balance between pay, pensions and benefits components depending on the culture of the organisation, the types of roles they need to fill, and the preferences of their current and prospective employees.

3.3. The relative value of the pension in the remuneration package may therefore be different across companies and within companies; however it is important that the pension component is not considered in isolation, but rather as one element of a wider remuneration package.

3.4. The recent media speculation suggesting companies should be able to break past pension promises directly challenges the notion of the remuneration package. For companies providing defined benefit pensions, the pension promise amounted to a guaranteed commitment to pay deferred remuneration to the employee, in exchange for the services provided by the employee under the terms of their employment during that past period.

3.5. Breaking or reducing past promises would effectively be the same as asking an equivalent employee who did not have a defined benefit pension as part of their remuneration package, to refund to their employer, say, 10% of the salary they received in their pay cheque many years ago. Clawing back salaries earned in the past would be inconceivable, and therefore so should the idea of reducing or scaling back the accrued pension that was earned by employees as deferred remuneration in the same period.

3.6. The inter-generational fairness of pensions is a topic that the media has given much attention; however it fails to address pensions in the context of wider remuneration.

3.7. An employee in the private sector today may expect to receive, say, 90% of their remuneration in the form of direct compensation (e.g. salary, bonus) and 10% in the form of defined contribution pension contributions and benefits. This may contrast with previous practice where a larger share of the package was delivered in the form of defined benefit pensions accrual and benefits, and a lower share as direct compensation. The remuneration mix has changed and evolved over time.

3.8. Employees today have the flexibility to save any additional compensation into a retirement plan, or make other provision for long-term savings. However, the choice is theirs and will depend on their personal objectives, as well as the relative importance they give to their standard of living today versus in retirement.
3.9. The idea that younger people are not saving enough for retirement is built on a view carried over from a time when defined benefit plans were prevalent that people should expect to retire at age 60 or 65 with a pension of two-thirds of their final salary. Rather than trying to meet those fixed and obsolete objectives, this should be addressed by resetting expectations. In future, the majority of people will still be healthy and fit to work beyond 65 and most (at least those on middle to high incomes) will be able to have a comfortable retirement on an income significantly less than two-thirds of final salary.

3.10. Retirement planning should be based on realistic expectations and goals, which may evolve over an individual’s lifetime, rather than those fixed expectations carried over from defined benefit plans that were established a generation ago.

3.11. The Government can, however, support intergenerational fairness in pensions through a number of measures:

3.11.1. Maintaining the lifetime allowance, to restrict the additional tax relief given to those people fortunate enough to have benefitted from a lifetime of generous tax relief awarded by previous Governments

3.11.2. Equalising the lifetime allowance and annual allowance calculation basis for defined benefit and defined contribution plans, since under the current terms, defined benefit members, who are typically older, are able to accrue significantly more pension on a tax efficient basis than defined contribution members, who are on average younger

3.11.3. Removing the annual allowance taper for the highest earners, which is administratively burdensome and makes financial planning for affected individuals almost impossible

3.11.4. Equalising the restrictions on recycling of pensions for “retired” persons (“money purchase annual allowance”), which are currently set at £30,000 for defined benefit members and £10,000 for defined contribution members. This discrepancy provides an unjustifiable subsidy to defined benefit members, who are typically older than defined contribution members. I suggest the amounts be equalised at £10,000.

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