PERSONAL AND PORTABLE PENSIONS - FOR ALL

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1. **Recommendations**

a) "There should be a fundamental review of pension legislation to remove the penalty on changing jobs, to aid mobility and to link individuals more closely with the wealth represented by their pension fund.

b) To these ends, pensions should, as far as possible become personal and portable, identifiable by the employee and attributable to him.

c) In certain circumstances, this would give individuals the opportunity to use part of their capital in constructive ways prior to retirement - As the self employed are able to do."

2. **General Background**

a) At present the law actually results in a continuing shift of capital from the personal to the corporate sector -- and for most people today ownership is ownership at second hand, and as such, is not ownership in the **motivational sense.**

b) We wish to see a policy that encourages "self employed pensions for all." This would allow those in employment to have the **option** to supervise their pensions through approved segregated S226 type funds as the self employed do. What is more, such a policy would encourage job mobility without pension penalty or **revenue costs** except insofar that people might save more.

c) Not least, it would give a new opportunity for twelve million people to have a real sense of involvement in the industrial success of this Country.

3. **Present Position - "The Early Leaver"**

a) There is currently deep concern at the grave injustice inflicted on those who change jobs -- the so called "early leaver." This injustice is indefensible; what is more it leads to ossification of employment patterns and harms the whole nation by inhibiting enterprise.

b) The problem arises from the traditional attitude (increasingly questioned) that pensions are an optional gift from the employer and thus the employee should not be entitled to more than return of his or her contributions, when leaving. Indeed, understandably, many employers have regarded the pension fund as a means of retaining and rewarding long service employees.

In reality the promise of two-thirds retirement pay is an illusion for most employees. In practice the trustees of pension funds have been able to take a gamble in the knowledge that this would be paid for by the excess contributions of early leavers.

c) As some 75% of those in employment change their jobs several times, i.e. the majority of employees are treated unfairly. Thus the Occupational Pensions Board (O.P.B.) Early Leavers Report, Cmmd 8271 para 5.16 "..... two changes of employment in a lifetime can reduce a person's pension rights by more than half, despite his having been a member of equally good occupational schemes."

4. A Double Solution

a) To rectify the injustice to early leavers, their rights should be improved and the changes that this requires presents the opportunity, if the political will is there, not only for pension benefits to be put on a far more equitable basis but also for people if they wish, to be given the chance to run their own personalised pensions as if they were self-employed, through segregrated funds.

b) (i) **In brief, we think it is desirable both from the point of view of this scheme and nationally, to encourage a gradual move to money purchase schemes with subsidisation of the non-leaver being progressively eliminated.**

b) (ii) The present system of funding for corporate pensions which promises a pension based on future salary carries risks* to both employer and employee.

*In a recent paper of admirable clarity Mr T.M. Ross, Chairman of the Pensions Schemes (Legislation) Sub-committee of the Association of Consulting Actuaries, described the risks as "ENORMOUS."

b) (iii) There is an argument that in equity citizens should be treated similarly and their pension not be dependent upon the companies in which they happened to have worked. Consequently state benefits should be increased, company benefits abolished and each individual given the option to top up his state pension by way of tax deductable additional voluntary contributions.

This view is perhaps ahead of its time.

c) Younger members of most schemes, given the opportunity to take their own and the employer's contributions out of a final salary scheme and invest them in a personal approved annuity would almost certainly do that, since the same level of investment in a money purchase scheme should bring a higher benefit in respect of that period of service than an occupational scheme would provide.

d) Having talked to individuals in the Inland Revenue, the Treasury, the O.P.B. senior fund managers and company directors, we see no overriding difficulties which make our suggestion impractical. Some of the changes proposed could be covered by changes in the O.P.B. regulations, <u>in particular if a condition be inserted that preserved pensions of early leavers be increased in line with pensions in payment.</u> This is likely to happen anyway* — but it is not a sufficient solution.

* Para 7.22 O.P.B. Cmnd P.8649.

5. Annual Disclosure

To achieve a full solution we suggest that; ALL PENSION SCHEMES SHOULD BE REQUIRED TO PUBLISH THEIR ANNUAL (DISCONTINUANCE) VALUATION, AND ATTRIBUTE TO EACH MEMBER HIS APPROPRIATE SHARE IN UNITS AT THAT POINT OF TIME.

This would open the way to a number of major policy changes.

a) Those who <u>leave</u> to go into alternative <u>employed</u> occupation should have the option to transfer their units into the new employers fund — in other words, bring their pension with them. We think most employees would opt, out of convenience, for this route.

b) Alternatively, they would have the **option** to withdraw their units from their old employer's fund and place them into an authorised S226 type scheme of their choice. To this scheme they would be able to add further contributions by AVC. (Additional Voluntary Contributions -- similar to the American Thrift Plan). i.e. their S226 scheme would run concurrently with their new employer's scheme unless he was prepared to pay into their scheme as (e) below.

c) Those who leave either to become <u>self-employed</u> or go into <u>non-pensionable employment</u>, would have the right to withdraw their units and put them into an authorised S226 scheme as above (b).

d) Those leavers who do not opt either to transfer to another scheme or for taking out an S226 scheme, as above, but wish to go for a preserved benefit in their existing employer's scheme will then see their units grow in line with the investment performance of that fund.

e) We have debated at length whether an existing employee should have the right to ask his employer to transfer his existing pension (units) into an S226 type scheme to be financed by joint contributions. This, though attractive, might at this stage put too great a strain on some pension funds or encourage employers to abandon the optional element of their funds.

So, our suggestion is -- at the employees request, **but only with the employers agreement** an employer may pay into a new employee's or existing employee's S226 type scheme contributions of an equal amount to those he would pay that employee had he remained in or joined the employers scheme.

Where such an employer has "contracted out" the appropriate scales of contributions would, we suggest, be published by the O.P. Board.

In other words, you would have to leave to start an S226 type scheme unless your employer agreed. The time might come to make, in the future, such requests mandatory.

f) In all cases where an individual has a S226 type scheme he should be granted the same loan-back facilities as are the self employed. i.e. The ability to use up to 25% of the assets as a loan-back for house purchase, investment in his own business, or employee buy out.

6) Objections

a) Some employers may worry that the removal of the disadvantage on early leavers may make it more expensive to finance pension schemes -- but they will need to remember that existing pension schemes will in future gain substantial inputs as a result of the transfer into them of units brought by new employees -- the majority of whom we believe will not opt for individual S226 type schemes. Equally they will not have the current problem of being morally obliged to give 2/3rds of retirement pension to those who, say, join them at 45 and stay with them for 20 years because in the future such people would either have their own S226 type scheme covering the early years or have, a better preserved pension or have brought with them an inflow of units when they joined.

b) (i) It will have to be accepted that the consequence of being **fair** to the early leaver may mean being **less generous** to the stayer. It is insupportable to argue that the current irrational funding of pension schemes which penalises up to seventy five percent of employees should be maintained, merely because change would put the burden of funding where it more properly belongs.

b) (ii) It is in fact worth bearing in mind in this context that both the state basic pension and the state earning related pensions are inflation proofed. Indeed a number of schemes recognise this fact and are **integrating** with those state benefits -- (i.e. deciding upon a total target income for their pensioners -- say 66% of final salary -- deducting from it the expected state pensions at retirement and paying the net result as an occupational pension). By this means it is then often deemed to be an acceptable risk to inflation proof the smaller occupational pension so that the whole of the pensioner's income keeps pace more or less with the cost of living.

c) Now is a good time for change; most pension funds are currently well funded because the period 1977 to 1982 has been one of strongly positive real return. This now coupled with the rapidly falling inflation means that benefit could be passed to early leavers without companies having to find additional funds for the remaining employees. In any case we only expect a gradual take-up of our scheme.

d) As to the extra administrative expense argument, we accept that there will initially be some additional burden (mostly on the computer) but eventually pension funds are likely to be free of the nightmare task of having to pay pensions to a myriad of ex-employees who left their employment many years earlier.

e) Some employers may argue that so long as their employees are, as a result of major contributions by employers, receiving pension rights, it is wrong to expect that employer to set up a scheme which encourages labour mobility. We attach little weight to that argument; we regard freedom for the individual as more important.

7) Costs of self administration

The cost of these proposals are very small in terms of the extra work burden to companies and there will be a minor Inland Revenue requirement for pursuing the additional seggregated investment. Additionally there may be the cost to the Exchequer of extra savings through AVC's. It is not, however, visualised that more than a minority of the work force will opt for S226 type schemes as most will probably transfer their units into their new employer's fund.

8) **To argue for the present status quo is to argue for the perpetuation of a gross injustice on most future pensioners. We believe our proposals would rectify this, and at the same time bring all the benefits that come from having a wider capital owning society.**

Figure 2: Effect of The Rate of Earnings Growth on the Pension rights of Early Leavers in Final Salary Schemes

Assumptions: (a) Pension calculated at the rate of 1/80th of pay at time of leaving for each year of service.
(b) Early leavers take deferred pensions which are not increased.
(c) Rate of earnings growth constant over 40 years.

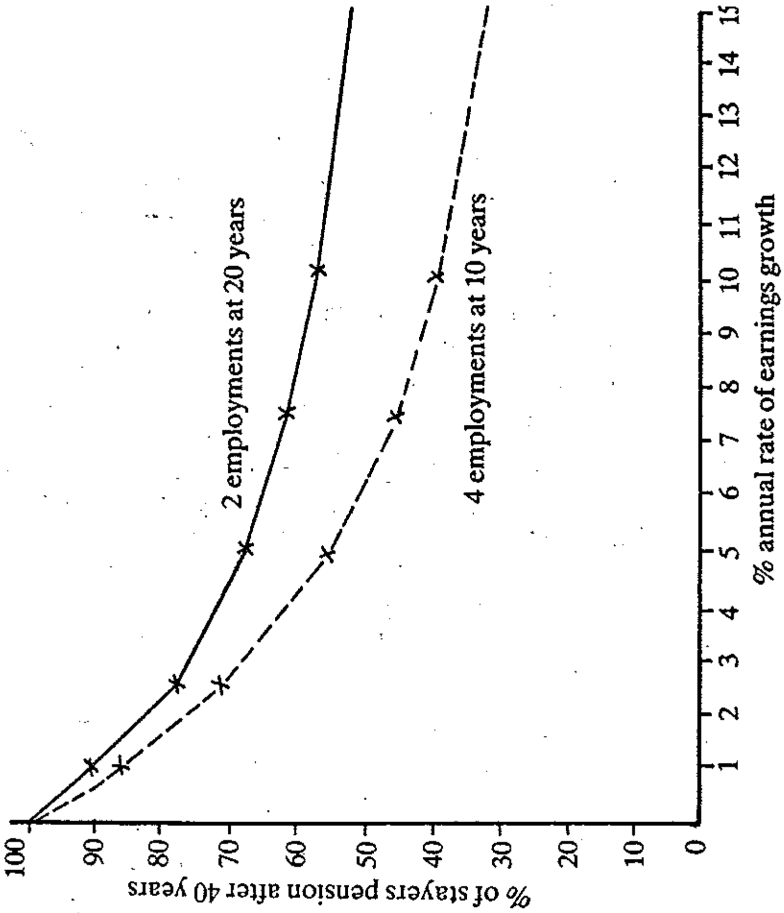

Figure 3: Build up of Pension Rights for Stayers and Early Leavers at 7½% Per Annum Earnings Growth

Assumptions: Pension calculated at 1/80th final salary. Stayer remains in same employment for 40 years
Leaver changes jobs every 10 years, and takes deferred pension which is not increased.
Starting pay one unit per year.