

ROUNDTABLE

SPEAKERS PANEL



ANDY CHESELDINE
Senior consultant
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JAMES WALSH
Policy adviser,
workplace pensions
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“It is a fact of life that people have self-interest; if they see this is a good scheme they will do it for themselves”



MIKE SULLIVAN
President
Pensions
Management
Institute



JOHN-PAUL MARKS
Head of corporate
and international
relations
The Pensions
Regulator

“As we move from a DB market to a DC market, it is the individual who ultimately bears most of the risk”



PHILIP PERCIVAL
Senior consultant
Watson Wyatt



JONATHAN WATTS-LAY
Director
Wealth at Work

FLEXIBLE SAVINGS

The incentive to save must begin in the workplace



OWEN WALKER
DEPUTY EDITOR,
Pensions Management

What is meant by flexible savings?

MIKE SULLIVAN: Flexible workplace saving is around both what we would regard as structured pensions saving – and we need to have more flexibility in that to start with – and how else employers can encourage and facilitate savings for their employees. The question then is: what else out there is within savings? For example, are we looking at share plans or not?

JONATHAN WATTS-LAY: I would interpret it as providing flexible options for employees throughout their working lives. The way we would probably define that is between short, medium and long. On the basis of pensions, our long-term savings, it is what savings vehicles are available in the workplace. The shorter medium term could be share schemes of various descriptions, save-as-you-earn (SAYE) schemes, which cover short-term duration, whereas other types of share schemes, such as share incentive plans, could be interpreted per-

haps as more medium term because of the restrictions on selling them.

Equally, it could also go into either futures-to-shares schemes or maybe even things like ISAs and deposit accounts, which are deemed relatively safe and flexible in that they are accessible to employees in the shorter term.

PHILIP PERCIVAL: I would also add to that the flexibility to move between saving schemes; in other words, how the various savings vehicles interact with each other and the ability to roll money from one savings vehicle into another one. Generally speaking, during their working life, employees will want to roll money from shorter to longer-term savings, while at the point of retirement they may want to go back in the other direction, perhaps using the tax-free lump sum from the pension plan to invest in shorter and medium-term savings vehicles.

ANDY CHESELDINE: I would agree entirely with that point. It is very important that it should be as integrated as possible. One thing we all assume that I cannot remember someone actually saying is, ‘employer-facilitated and sponsored,’ so the employer takes responsibility for communication and, to a great extent, governance.

JAMES WALSH: Almost by definition, it is difficult to come up

with a single definition of flexible savings. Flexible savings should suit the circumstances of the individual as much as possible. That might be about how you put the money in – variable contribution rates, different forms of savings – and then flexibility in how the money is treated once it is invested.

JOHN-PAUL MARKS: In the end people face a choice every day: they have a marginal propensity to save and a marginal propensity to consume. That is partly always a function of the economy as much as the vehicles available to them. We know that seven million people are not currently saving in a pension. On the joining side, automatic enrolment will make a fundamental difference to that, but on the supply side clearly there is the potential for personal accounts to provide a low-cost, simple savings vehicle for people to use for pension provision, but then also everything that comes after that. Flexibility in that marketplace, where people have those bespoke solutions according to their needs, makes sense, but we must accept that flexibility also creates complexity sometimes, and there is a trade-off between giving people choice and ensuring there is adequate provision for retirement.

WALKER: Picking up on one of those points – there is a propensity to save and also a propensity to consume – but there is also a third one: a propensity to pay off debt. At the moment, we have record levels of personal debt. Should we be saving? If someone's got a credit card, a mortgage, a student loan, should they still be looking to save into a company scheme?

CHESELDINE: It depends. You cannot apply one criterion across everybody. If you have a credit card where you are paying 35% interest, then you almost certainly should pay that off before you put money into an ISA or a pension. If, on the other hand, it is a student debt on which you are effectively paying 0% interest in real terms, there is a strong argument for saying you should be in a pension or maybe saving in an ISA. If tuition fees go up to £7,000 a year, then lots of things change because at that point you are probably going to be in debt

to the order of £36,000 when you leave university and you are only going to pay it off at 43 if you are a typical graduate taxpayer – that is only two years before it gets written off anyway.

SULLIVAN: The other thing is when we have this discussion about paying off credit cards first or not, there is a natural assumption that, having paid it off, people will not then build it up again. The practicalities are that the majority of people who have high credit card debt only pay it off in order to be able to start borrowing again. If you are going to continually run that level of debt, you will never get to the point of getting to the stage where you can say, 'Now is the time to start saving for a pension,' so I would say you should be doing it contemporaneously.

WALSH: Is it possible that if you get someone into the saving habit early, even if only in a small way, they are more likely to pay off their debt and less likely to build it up again?

SULLIVAN: Yes, they will become more aware and they will start to notice just how much they are paying in charges each month, and think, 'Well, that is £85 that has gone nowhere. I could have put that in my savings account.' By encouraging saving into a short-term plan, even at modest levels, there is a much greater level of benefit that you cannot immediately see. It helps people to focus on the fact they need to make some provision for the future.

This has all got to start in schools really, and at home if possible.

WATTS-LAY: I see quite a polarisation around larger companies and smaller companies. Personal accounts are really the big event for smaller companies in terms of getting any sort of savings culture within their organisations. If you look at large companies, there seems to be a different dynamic, which is around providing benefits in savings contexts that are deemed to be more applicable for their workforce. There I can see it going the other way, where they might actually be quite happy to reduce the contributions that go into pensions, albeit not below the personal

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accounts level, and the money that was being spent on pensions might go into other savings vehicles, because their argument would be that it is much more meaningful for their staff, particularly where they employ younger staff.

SULLIVAN: There is a school that is pushing for greater flexibility within pension arrangements, to have drawdown during working life, etc. I think that will be difficult to get to, and I think there should be more focus on supplementing pension provision with shorter-term saving, which essentially gets you to the same point, where people can save and get their money out without tying it up for 40-odd years. Personally, I would like to see more focus on running longer and shorter-term savings side by side, rather than trying to change the pensions system yet again to facilitate some form of early drawdown.

WALSH: The evidence from the US's 401(k) plan is inconclusive as to whether it encourages more saving and particularly whether it encourages more people to save, including those who are not saving at the moment. Further careful thought is required.

PERCIVAL: There is a psychological aspect to this too. The 25-year-old committing to a pension scheme knows they cannot get at it for 40 years. If they know there is access to their savings at some stage in certain circumstances, that does break down one of the barriers for people doing nothing.

CHESELDINE: Yes, exactly right. I take Mike's point as well. Running two different schemes alongside each other is probably the way to do it. In the US, many commentators are not keen on the ability to drawdown from pensions because the benefits from 401(k)s are being ripped apart by people who have been made redundant or are ill, who then end up with nothing at retirement.

PERCIVAL: Coming back to the debt repayment issue, I almost see debt repayment as a form of savings in itself. What we are really saying to each individual is, 'You've got your own balance sheet. You've got assets and you've got liabilities. Essentially, when you get to retire-



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ment, we want the assets column to be significantly higher than the liabilities column, so that it can sustain you through retirement.'

WATTS-LAY: There is the thought that people are not as promiscuous with their debts as they should be. If they get a better rate, all other things being equal, that effectively frees up money, which they could invest in whatever savings vehicle is deemed to be appropriate. Some of that comes round to the opportunities that are available within the workplace, but some of it also comes back to Mike's point of school education.

WALKER: Do you not think there is room for debt management to be part of the workplace scheme, perhaps through education?

WATTS-LAY: I did read some US-based research a while ago. I think it is widely accepted that stress is one of the biggest reasons for absenteeism, and they found that the cause of stress in a relatively high percentage of cases was money worries within the family group. The argument was that this had a direct impact on the workplace, so employers should actually pay a bit more attention. In the current environment, however, where things are tough, I guess it is probably quite difficult for employers to make that leap.

WALSH: All the evidence suggests that people have a good deal of confidence in information provided about pensions and savings through the workplace. Presumably the same would apply to information provided about debt management. We do not want to overdo it; we want them to be able to get on with their work, but certainly providing some sort of employer-endorsed information in the workplace would be met with interest and confidence by employees. Whether it should be done at school or not, I am not sure.

MARKS: It is definitely the case that employees look to employers for guidance and trust them as a source of information. It is true people do find it stressful when they are unsure about their future retirement provision and savings. If employer engagement in this area can reduce absenteeism by encouraging people to feel more secure about their income over their lifetime, that can be a good thing for employers. I think there is a lot to be done between now and 2012 in

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talking to all UK employers about pension provision and enabling them to have that conversation with their workforce.

CHESELDINE: There is anecdotal evidence that if you announce you are running a staff presentation on wealth management or pension investment, you might get 20%-50% of the workforce turning up for it. If you talk about debt management, you will get closer to 70%-80% interest. There is a caveat though: you have to make it clear that the employer does not get access to any of the information. Employees are quite reticent about employers finding out about wealth information and personal debt.

MARKS: That evidence flags up one of the major behavioural failures that you have with retirement provision. People are rightly and understandably focused on their immediate short-term and medium-term risks. And rightly, there should be incentives and vehicles in place to manage those concerns, but at the same time we need to get the right incentives and vehicles in place to tackle that longer-term problem.

WATTS-LAY: There is an element of 'carrot and stick' with this, isn't there? To a degree personal accounts are the stick, but in certain environments there is the carrot, which can be seen as very appealing. Phil, you mentioned earlier about the linking of things like share schemes and pensions; we have clients at the moment that are creating pension pots with effectively less than nothing because they are getting two lots of tax relief and they have rising share prices. It

is a question of how we create carrots in this environment; flexible savings is quite an interesting area because it is trying to create more carrots to get people engaged.

PERCIVAL: It doesn't necessarily need a radical change in approach to benefit provision; lots of employers already have good quality pension arrangements and have been running share plans for years. What has often happened is that they have been running down two parallel tracks, often driven by different departments, ie pensions and reward, and nobody has considered how to actually bring them together. When the share plan matures, there is an opportunity to create a sensible onward delivery vehicle for those savings and actually get people thinking about where it might go in the longer term. It doesn't have to be radical in the thinking; it is just taking a logical and integrated approach to benefit design.

WATTS-LAY: One of the things that interests me is this whole notion that in the workplace a lot of people have not got to invest a single penny to take advantage of their annual ISA allowance because they can do it with stock they may already hold. What you are effectively doing is enhancing value that ultimately can still be transferred into pensions at some point in the future. In some ways these are the hidden gems within the workplace. It is saying that actually there are things you can do to increase value which is good for you as an individual employee; it is good for the employer because they can offer it and it doesn't really cost them any-

thing because it is using the tax system; and actually we get a bit nearer to that whole savings culture and flexibility in the short term, which ultimately hopefully will help enhance pensions as well.

PERCIVAL: Share plan maturity is one of the obvious entry points into the workplace savings culture as the employer can easily demonstrate the value that they can bring without having to go to really radical solutions. It is just common sense really.

CHESELDINE: What I would say, however, is that we shouldn't rely on rollover and double tax relief for the long term. In an environment where we talk about limiting pension contributions to £20,000 or you get hit with punitive taxation, I can't see any government permitting that for very long. That doesn't mean the product is a bad idea, but we need to think about the incentives.

SULLIVAN: I don't want to bang this same drum again, but the people who will be most interested in these sorts of schemes are the higher paid and are the ones that have now had that opportunity closed to them. It is a fact of life, like it or not, that people have self-interest; if they see this is a good scheme they will do it for themselves and they will then hopefully make it available to their employees. If they can get nothing out of it themselves, then why should they bother? I think it is another aspect of the Budget changes this year that is hidden behind the scenes, and there are lots of very good ways of encouraging saving other than just pensions that are being closed off through lack of incentives for the decision makers.

WALKER: Would you say that the Budget has had that much of an effect on these types of schemes?

PERCIVAL: The Budget is a double-edged sword when it comes to other forms of workplace saving. The negative side is that, as you say, if senior employees can't benefit from rolling over shares into pensions then that opportunity becomes less appealing to them and we will probably see less of that happening. On the other hand, what we are seeing is increased interest from senior executives in looking at alternatives to pensions.

WATTS-LAY: What worries me about the issue of changes in tax-

ation for the higher earners is the fact that it is just another bad news story in the press and so it just confirms everyone's worst fears that pensions aren't great and they are taxing them again. I have even had people say to me that, under the new rules, pensions won't be worth having as they are taking away the tax benefits. If you analyse that, they may be reducing the tax relief that you are actually getting but there is still a tax benefit there. Again, the perception that is created in the market and the reality are really two different things; it is just another dampener on pensions.

CHESELDINE: Part of the problem is complexity; John-Paul made the point that you have got to try to keep things as simple as possible. I would argue that the most successful financial product in the UK at the moment is ISAs, which are about as simple as you can get. There were 13 million new ISAs set up last year and £275bn in total is in ISAs; that makes the personal pensions market look quite sick really, considering how long it has been going. If you give someone a simple product with reasonable tax reliefs – okay, you are not getting tax relief going in but you know it is growing tax free – that works for a lot of people. Let's keep things a bit simpler.

WALSH: I agree with that; the success of ISAs is a powerful argument for the simplification of pensions that so many in the industry have been urging for so long now. But we have only made pretty modest progress.

MARKS: Simplicity was at the heart of Pensions Act 2008 in terms of providing a very simple, low-cost, low-charging savings vehicle in the form of personal accounts for those who are auto-enrolled and those employers who currently offer no pension provision. In terms of the communications to both groups who will come into pension savings – six to nine million individuals from 2012 and 1.3 million employers – the critical issue is that simplicity. There has to be a clear message about what it means, how they need to do it, how they need to register with the regulator, what the call to duty and registration means, how they should make their contributions, and why pension saving does make sense for the very large majority of people who need

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to provide for themselves in retirement. I think simplicity is very important. The challenge for us will be to put some more confidence back into the pensions market and that needs to come from better standards of governance.

WATTS-LAY: My worst fear in all of this is that it actually ends up where both employers and employees see personal accounts as some sort of tax, effectively, because they see no value in it. I can't help thinking that it is a bit like some of the campaigns in the past where, if done well, they do change public opinion and public attitude. In some ways I see pensions a bit like that, but it is almost that it is so big and it affects everyone in one way or another that it needs some of that real public policy to change people's understanding and therefore actions.

SULLIVAN: You are right; with the campaigns of the early privatisations like 'Tell Sid'; a huge proportion of the ordinary British people did become shareholders. Rightly or wrongly I think is another debate, but it did change people's perceptions around becoming a shareholder. You are right in that we need to have that same sort of mindset change of the man in the street around saving for the future. Let's not call it 'retirement' because that's a really scary word and let's not call it 'long term' necessarily; it is just around saving for a day more than today or tomorrow or next week.

PERCIVAL: One of the things the personal accounts rules will do is overcome one of the objections about workplace saving, which is if you give people choice they will choose to save in short-term vehicles, spend it, and it will never end up actually building towards retire-



ment. I think with personal accounts in the background, however, there is always that reminder that there has to be a certain amount going into a pension and if you don't do that the employer will have to re-enrol you back there.

WALKER: We talked a bit about personal accounts; the Conservatives have said they would look to incorporate more workplace savings with the 2012 reforms. Is that something that should be encouraged? Or should a nationalised pension scheme be something very different from the company saving schemes?

WALSH: One way of assessing this is to consider what approach will get us where we want to be in the long term, which is as many people as possible having as high a level of retirement income as possible. If the route to that is non-pensions flexible saving maybe alongside pensions, then there might be some merit in that. It won't necessarily be the case that one size will fit all and one model will suit everyone, but it might be something worth discussing.

CHESELDINE: We have to differentiate as well between strategic and tactical decisions. Tactical being how to actually get more bang from my buck from tax relief or short-term financial gain by investing in something other than a pension. The strategic question is, why are we putting 21-year-olds who have yet to build a career, buy a house and start a family, into a pension, when later on in your working life it makes much more sense.

For two reasons I would say that approach works because, from a strategic point of view, I would argue that 21-year-olds probably shouldn't be putting large portions of their money into pensions; yes, get a savings habit but not necessarily into pensions. Secondly, from the perspective of student debt and other debt for young people, they are better off clearing that as soon as possible and making sure they have a strategy for the future in terms of where they're putting savings and how they are paying off debt. If you can actually integrate these things together into one plan – albeit this goes exactly against the point I just made about simplicity – that is clearly to people's advantage.

WATTS-LAY: That is why the workplace is quite interesting,

because the workplace is the one place where you have got a fighting chance of bringing some of this together just by the fact it is where you get paid.

SULLIVAN: Part of the problem is that we are where we are, we all have a general consensus on where to get to and it is a very big step, and big steps are always easier if they can be broken down into smaller steps. Rather than personal accounts, maybe what we should be having is a compulsory short-term savings vehicle on very much the same lines except that it has an end, let's say three years. Particularly for the less well-off and younger people, that is quite a long time. At the end of that you would set it so that at younger ages they can take 75% of it out as cash and 25% of it has to be rolled over into some other form of savings vehicle that is not necessarily a pension, but it could be. You have always got to have an element of withdrawal in order to encourage it, but I think this would go a long way towards encouraging people to actually participate in it rather than opt out and to get them into the culture of savings.

WALSH: Would that be in addition to the existing ISA system or some sort of replacement for it? My concern is that people will say that sounds slightly more complicated than this very simple ISA that I can just put my money into and then I am the complete master as to whether I get it out or not.

SULLIVAN: I think ISAs are absolutely brilliant; the figures that Andy quoted to us show how successful they have been and it would be great if you could just build on that system to then say if you are aged under 30, for example, you can get 75% of it back, but 25% has to be rolled over into something else. Of course the other thing with ISAs is that they haven't got an end time. At the end of the day you are always going to have to make some compromises and accept the point that the more complex it is, the less people will understand it, the less they will put into and feel a part of it. I do feel that there is a need to develop some steps to get them where we want to be, and at the moment we are trying to do it in one leap and I'm not sure that that leap is going to be successful.

WALKER: Is there a danger here that, if there is not enough advice and education, we will see mis-sell-

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ing or misuse of products?

MARKS: The whole discussion about flexibility highlights the importance of transparency, information, generic advice and, where appropriate, regulated advice, because in the end, as we move from a defined benefit (DB) market to a market where defined contribution (DC) is a much bigger part of the landscape, it is the individual who ultimately bears most of the risk. Therefore, they have to have a better understanding of what those risks are, what they mean and how they can mitigate some of them. Clearly, the employer is a critical part of that contract. I agree, also, that the psychological contract is very important, which is why there has to be trust in that interaction.

PERCIVAL: I suspect the risk of mis-selling is lower in the sense that these are regulated products, generally speaking, and the sorts of employers who want to go to the trouble of setting these up will want to ensure they are fully compliant with those regulations. Personally, I think the greater danger is the misuse of products by individuals. If you offer more choice, you give more scope to go off the rails in terms of those choices. That is where the education, advice and design of these programmes become important. On an ongoing basis with the employer, we should not forget the ongoing governance of those arrangements to help identify potential misuse.





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MARKS: The governance structures that are put in place are critical. We have a learning programme which trustees can complete to help increase their knowledge and understanding, and are shortly starting a campaign on governance which specifically looks at improving the management of risk and the internal controls within pension schemes. The extent to which that is multiplied across the industry to achieve best practice is something that will create confidence in the marketplace and enable consumers to feel confident about the choices they make.

WALKER: What would you like to see in next year’s Budget to make workplace saving more attractive?

PERCIVAL: The obvious one is to think again about the Budget changes on tax relief for high earners. Not only does it break the traditional deal on pensions, it is disrupting a new tax regime that lasted only three years when it was meant to be a long-term settlement.

CHESELDINE: Get back to some simplicity. Going back to Phil’s point, the reason that we built the consensus around pensions is to try to make them simpler. In one fell swoop, they have managed to totally stuff that up, and for what kind of benefit? Probably very little. I recognise that we are in a very hard place from the point of view of the economy, but it does not seem to move us any further forward and just creates more and more problems.

SULLIVAN: I suppose my concern is more around what else is going to be in there. Is the next step to remove tax-free lump sums, or

maybe just for the people with total income over £150,000? Who knows? I think it is very dangerous attacking specific parts of the population in that way, for some of the reasons we have already discussed about the bigger implications of that. I would like to see possibly some other tax incentives for wider savings. That is a very generic statement, I know, and there are incentives inasmuch as an ISA, which is building up in a tax-free environment, but I think we have to do something to encourage more people to save more. We can worry about whether this is short term or long term at the next stage, but it is getting them committing to save in the short term that is the most important thing. I would like to see more to encourage that.

WALSH: It looks like it will be a very constrained Budget, so I do not think we can expect much in the way of attractive giveaways to encourage pensions and savings. Realistically, the best we can hope for, given that the government is unlikely to unravel its changes announced in the last Budget, is for some certainty on how the new system will work from 2011 onwards. There are still many unanswered questions about exactly how it will work, how they will go about ensuring it does not catch the wrong people, who currently look likely to be caught, such as people who earn less than £150,000 but are made redundant and get pushed above the threshold. There are a lot of important questions to be answered, so we want some clear answers on that.

MARKS: With apologies, I am not going to answer this question. I

genuinely cannot comment on the pre-Budget report or Budget measures. The only thing I would say is that our experience of the DB pensions market through the downturn, especially with regards to scheme funding, and also our experience of the DC market, shows how critical the economy clearly is to pension saving and to pension provision. Economic stability and a return to growth are critical for the economy, but also critical for pensions and clearly that is the focus.

WATTS-LAY: If it is accepted that there is a need to create more of a savings culture in this country again, and if it is also accepted that while pensions and personal accounts will help, it is not the whole story and flexible savings are a more attractive notion for a lot of people, then I wonder whether the government could look at something to further encourage saving. They encourage share ownership right now through the tax reliefs they give to SAYE schemes and share incentives plans. I wonder whether in the workplace they incentivise that further by saying, ‘If you transfer those share schemes into an ISA, for example, we will increase the allowance we give you,’ so it is a special workplace-based incentive, so rather than £10,200 you get £15,000 or whatever the number may be.

In turn, once it is in the ISA, which gives them the flexibility of that short-term accessibility to the money if they needed it, if they roll that ISA into a pension in due course, then there is an additional incentive to do that. Perhaps then you would create an environment where people actually feel a little more secure and there is more of a carrot for them in terms of going through that short, medium and long-term savings cycle. Yes, giving more allowances clearly costs money, but there is an ultimate saving in the sense that, with an ageing population, if people do have more savings, it will save the country money.

CHESELDINE: The only problem with all of these comments is that they are predicated on the government looking at the long-term view and it is clear that they are desperate to stop us just paying off debt. They need to keep expenditure up because otherwise the economy crashes. Realistically, I do not think we can expect an awful lot. **PM**