Britain: Financial crisis threatens pensions and retirement plans

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A little discussed aspect of the global financial crisis is the devastating impact it is having on pensions. This is particularly acute in Britain. State provision is poor and successive governments have forced workers to rely on occupational pensions, on which half of all British workers depend, private pensions and annuities, and the value of their homes to finance their retirement.

In the last year, the London stock market has fallen by nearly 40 percent and deficits in UK occupational pensions in the top 100 corporations have leapt from £40 billion a year ago to more than £122 billion in October of this year if more realistic estimates of their liabilities are used.

The top 100 companies were trying to pull the wool over the public’s eyes by reporting pension surpluses of £22 billion in September in order to avoid increasing their pension contributions as a result of over-optimistic estimates based on financial sector bond yields. David Robbins, consulting partner at Deloitte, said, “From an audit perspective, using yields on financial bonds [to calculate liabilities] lacks credibility.”

The majority of final salary pension schemes did not have enough assets to cover their pension commitments in October, with 6,468 (84 percent of the total) in deficit and only 1,273 (16 percent) still in surplus. This contrasts with 3,121 in surplus a year ago. Their collective deficit stood at nearly £100 billion, an increase of nearly £20 billion on the month before. At the same time last year, the schemes had a surplus of £84 billion.

These deficits have not arisen just because of the stock market crash. Over the last 25 years, companies have taken pension holidays when the pension funds were in surplus and used the money to fund generous dividend payouts. Successive governments have done nothing to ensure that what was taken out was repaid.

While the Pensions Regulator has written to the trustees of all the UK pension schemes calling on them to be vigilant in these “unprecedented times”, he has not required a change in their valuation. If schemes are in deficit, employers have to make good the shortfall, typically over 10 years. However, the regulator acknowledged that to do so, even 10 years might be impossible under present circumstances.

Companies have sought to limit benefits to cut costs by closing schemes to new members, raising the retirement age and basing retirement income on career average rather than final salary. Even so, fears are now being expressed that they will take even more drastic action by stopping any future accrual for existing members. If, for example, someone whose pension was based on the annual accrual rate of 1/60th and had worked for 20 years, he or she would be entitled to 20/60—a third of their final salary—on retirement. But if a company stopped accrual after 10 years, the pension would be worth only half that amount.

Retirees face a further threat. As pension deficits soar and the economic slump forces companies into bankruptcy, the Pension Protection Fund (PPF), an insurance fund set up by the government to meet the pension bill of insolvent companies, will be wiped out.

The *Financial Times* reported that the PPF deficit has been updated to £155 billion as at end of November, an increase of £30 billon in one month and three times what it was last year. The companies with the largest deficits include BT, BA and BAe systems, former state owned enterprises which once had pension funds in surplus.

As it is, the PPF is very limited. It only pays out 90 percent of the promised pensions, up to a limit of £28,000, and does not provide indexation on most benefits in line with inflation. It is therefore deemed to cover only 70 percent of the average promised benefit and this is now under threat with the rising tide of corporate insolvencies. Furthermore, rather than increase the levy on corporations, it has the power to refuse to increase compensation payments in line with inflation.

The PPF has already rescued more than 66 schemes since it was set up in 2005. According to John Ralfe, an independent consultant, the 100-year-old high street chain, Woolworths, which recently collapsed, has a pension deficit of £250 million. This could mean that the PPF has to inject at least £100 million into the Woolworths’ pension pot, one of the largest payouts in its three years of existence. Ralfe has estimated that Woolworths’ workers face a cut in their pensions of 20 percent.

Woolworths reported a cumulative pension deficit of £81 million on an accounting basis in August, but is privately conceding that this figure is an underestimate. While this was initially estimated at £100 million, Ralfe believes the true deficit could be as much as £250 million. This is because the pension fund had liabilities of £384 million and assets of only £317 million last February, and these will have fallen considerably as 67 percent were held in shares.

Paul McGlone, an actuary at Aon, explained, “The PPF collects a levy of £675 million a year to fund itself, which means that it only takes another seven Woolworths to eat up those funds”.

The *Financial Times* revealed that Lehman Brothers, which collapsed in September with a widely reported £100 million pension fund deficit, contributed as little as £100,000 a year to the PPF because it had the highest possible credit score with credit ratings agency Dun & Bradstreet. Some advisors in the industry believe that the cost to the PPF could be as low as £10 million, in which case it is the work force who will bear the loss.

The PPF has refused to increase the levy more than inflation to protect workers’ pensions, despite the increased risk of corporate pension collapses. It announced that the levy for 2009-10 would be £700 million, instead of the maximum £863 million permitted. The government has rejected calls to guarantee the PPF.

More than 18 million workers have no occupational pension. Of these, some seven million have some form of personal pension plan whose funds are invested in the stock market. The commissions charged by the insurance companies always ate up most of the gains, but now these pension plans are almost worthless as a result of the downturn in the markets.

Fully 41 percent, or 11 million workers, have no pension plan at all because their wages are too low to allow them to save.

For years, working people have been told that their home will provide them with a nest egg for the future. Seven million homeowners, one quarter of the total, intend to use the equity in their property to pay for their retirement. The downturn in the property market has already wiped 18 percent of the value of their homes, and this is set to continue for the foreseeable future. They will be unable to sell their homes without incurring a loss, if they can sell them at all.

Many people who bought their homes late in their working life are stuck in debt with a never-ending mortgage. More than two million pensioners have mortgage debt of more than £100,000. The average mortgage debt of pensioners is about £50,000. One debt organisation reported that amongst those seeking advice, the over 60s had bigger liabilities than any other age group. When pensioners become ill, half will need to sell their home to pay for nursing home care.

According to Charlotte Black, Corporate Affairs Director of Brewin Dolphin, the view of property as a gilt edged investment is false: equities gained 470 percent over the last two decades whereas property gained only 270 percent, as of mid October.

The *Economist* reported that for American and European savers with personal pension plans, it has been a lost decade. Markets have gone through two booms and two busts and bonds and bank deposits have yielded little in the way of interest. Were it not for tax relief they receive, savers in pension plans would have been better off keeping their money under their mattresses.

Pensioners are facing further cuts in their living standards as the income from their meagre savings fall. The Bank of England cut lending rates to 3.5 percent last month and then to 2 percent week. As a result savings rates were slashed, while inflation is running at 4.5 percent a year. By way of contrast, lending rates fell only slightly as banks sought to shore up their profits. Saga, which specialises in savings plans for the elderly, said it would replace its one year fixed rate bond paying 5.75 percent with a one worth 4.75 percent.

Retirees have also seen the value of their pension pot fall as a result of the stock market crash. Annuity rates, which give income for life, are pegged to bonds linked to interest rates—bonds that have fallen to their lowest level in 30 years.

According to research from Lincoln Financial Group, 41 percent of workers in the UK doubt whether they will have enough to live on once they reach pensionable age. More than a third of people expect to work full or part time during their retirement to avoid poverty. Older workers are even more worried. Of those aged 55 or more, one in 10 already plan to work full time during retirement and 47 percent say they will work part time. Some doubt whether they will ever be able to retire.

More than 1.2 million men and women over retirement age are already working today.

Sections of the media are presently engaged in a sustained campaign to denounce the occupational pensions provided for civil servants, health workers, teachers, local authority workers and the police as unaffordable. Estimated by the Treasury at about £650 billion, payable over 50 years, public sector pensions are similar to the average private sector final salary scheme. There are numerous calls for the retirement age for existing members to be increased, ending final salary schemes in favour of average salary schemes to reduce the value of pensions from 21 percent of salary to just 7 percent, and for public sector pensions to be “properly funded”—meaning invested in the stock market.

Millions of people who have been forced by successive governments to rely on the market not the state to provide their pensions will now find themselves dependent upon the meagre state pension they had sought to augment. As it is, more than a third of pensioners live in poverty.