Our shrinking nest eggs: whose fault?

How much blame will be attached to Gordon Brown as the great British pensions collapse moves centre stage in the General Election battle? By Kenny Kemp

GORDON Brown intends that the imminent General Election will be fought on his piloting of the much-buffeted ship of state. Yet millions of UK pensioners and those approaching pension age in both the public and private sector are likely to blame him personally – as Chancellor and then Prime Minister – for sinking the nation's financial system, and taking down in its wake the era of decent retirement entitlements for the masses. If the opposition is wise, this disaster will feature front and centre in the campaign to come.

The UK pension industry – which gathered in Edinburgh last week for the National Association of Pension Funds (NAPF) conference – now calls it "The Lost Decade". The noughties in Britain were book-ended by two bubbles: the dotcom bubble at the beginning and the housing and credit bubble towards the end. In between was the debacle of Equitable Life, once a Rolls-Royce of a pension provider, with many of its beleaguered customers wondering if they might have been better off sticking their cash under the mattress. While the 500 delegates from pension houses, fund management firms, and fund trustees were acutely aware of the turmoil of Greece, Ireland and Iceland, there was no shortage of reminders that Britain itself was close to the brink.

The impact on the equity markets of these bubbles has been eviscerating. And this in turn has battered the future savings and pensions of our increasingly ageing population. Since 1900 there are only two other decades which produced negative real returns for the UK – the 1910s and the 1970s. Now the issue is how will the country be able to fund the pensions it requires for the next 25 years. Many of the UK's leading companies have significant pension fund deficits – a factor in the ongoing dispute between British Airways and its airline staff and the collapse of Reader's Digest UK – and the public sector's lucrative index-linked schemes are now under the beady eye of cost-cutting Treasury mandarins.

Britons are just not saving enough, and, no wonder, with interest rates at 0.5%, while more institutions are moving away from final-salary schemes – a DB (Defined Benefit) scheme – to a DC (Defined Contribution) scheme. In essence, this moves from a guarantee of income, supported by the company, to a much more risky situation where an individual's money purchase fund takes on the full risk, exposed to the freakish whims of the investment markets.

Ray Martin, chairman of the NAPF Investment Council, said: "The noughties were a tough time for pension funds in the UK and globally. I think the noughties were a lost decade for pensions. It is true that DB schemes are being replaced in many cases with good DC schemes but 10 years ago there were two million more people in private-sector DB schemes than there are today. And 10 years before that, we were at the high point of DB scheme membership, with 5.6 million members. Compare that with today's situation – barely three million people in open DB schemes. By anybody's standards, that's an astonishing rate of decline of what was not too long ago said to be the envy of the world."

Amid all this is the UK's consumer credit boom and subsequent banking collapse, the cosy system of regulation and the pillaging of pension funds by Chancellor Gordon Brown.

Roger Bootle, the prolific commentator and economist with research consultancy Capital Economics, says the failure was complex: it was a failure of markets, regulation and of ideas. But much of the failure was in the over-leveraged banking system, where there was "excessive emphasis on trading" in risky products that few – including board members – understood, and what he calls "trading option in the volatility of the dingbat."

There is a strong co-relation between the rescue of the banks, the creation of a massive debt mountain and the liability for future funding of the public sector.

Inevitably, a low-interest environment will continue to punish savers and pension fund returns. While China, as one of the super-saving countries, has a huge savings mountain, Mr Bootle says this debt-credit imbalance is dangerous for Britain and will take years to resolve. He even suggests that the whole edifice of capitalism is teetering because such global imbalances might lead to protectionism and trade wars.

But the pension industry also needs to take a sharp look at its own performance. NAPF members provide pensions to around 15 million people in the UK. They own assets of around £800 billion.

Every day NAPF members pay out about £80 million in pension benefits. Yet the pension fund managers and the trustees did little to discourage the short-term culture of profits, bonuses and rewards taken out at the expense of the future pensioner. Mr Bootle says: "Institutional investors have been weak in pursuing their members' best interests."

Lord Myners, the City minister, has been forthright in his condemnation of major pension funds. He insists that institutional investors must become more active and that they have a duty to protect the value of investments and rail against corporate bonuses that reward failure. They must also demand to know what are the lasting benefits – if any – of mergers and acquisitions which are driven by fee-chasing investment bankers and short-term bonuses.

Perhaps stronger investment fund managers might have halted RBS's takeover of ABN Amro, and objected louder to the merger of Lloyds TSB and HBOS.

For the pension industry, the difference between "utility" banks – solidly capitalised, well-regulated and looking after retail and business customers' money – and the so-called "casino" banks (the terminology was invented by the Scots economics writer John Kay) – unfettered and allowed to take risks for high rewards – remains a vital issue. Increasingly, the casino element is incompatible with the retail bank, if Government and the taxpayer are expected to step in as a "last resort" and save the casino gamblers when they over-extend themselves.

THERE are also growing question marks over the bancassurance model, with its increasing conflict of interests in delivering long-term return for investors. Five years ago Edinburgh-based Scottish Widows was at the vanguard of highlighting the UK's pension timebomb, with a series of hard-hitting adverts about old people slaving away into their dotage in inappropriately youthful jobs.

Now its parent, Lloyds Banking Group, requires a massive bailing out from the taxpayer. And Lloyds Banking Group chief executive Eric Daniels and Scotland director Archie Kane have been battling to keep the business solvent. Yet the unanswered question remains: how much of Scottish Widows' pension pot money is set aside to shore up the short-term toxic debts of HBOS? Increasingly, it appears to be sleight of hand on the balance sheet raising ethical questions about short-term or long-term benefits.

Professor Amin Rajan is the CEO of Create-Research, a UK think-tank on global investment management which has undertaken massive research with over 225 global fund managers and pension funds in 30 countries with $24 trillion under management.

"Clients will be demanding simplicity, quality and safety which may well accentuate the funding crisis," he predicts.

He says that, without decent returns, a DC scheme will remain a death plan and fund managers need a new narrative about what they stand for and what they deliver. Most alarmingly, his research found that 66% of fund managers expect one or more systemic crisis in the next 10 years. That would be bad news for the UK, which is already on the ropes.

His view is that wisdom and leadership remain at the heart of a strong future. But this requires leaders to stand up and protect the pension provision of the majority of hard-working people, not pander to the money-makers.

Professor Rajan mocked Gordon Brown for his Mansion House speech in 2007 when, as Chancellor, he congratulated the City of London "at the beginning of a golden age." Less than a year later, as Prime Minister, he was blaming the City for ushering in "an age of irresponsibility".

Of course, there is not yet any indication that a Conservative government will treat the UK pensions industry any differently. Addressing the conference in Edinburgh, David Willets, a former Shadow Secretary of State for Work and Pensions, attempted to reassure the industry that his party would be more benign, and do more to encourage pensions and protect the interests of pensioners.

However, Ray Martin of the NAPF says: "Politicians from all the main parties tell us they value workplace pensions and want to support them. But what we want to see now are their plans for action."

HE wants more simplicity in compliance with the 2012 reforms that will help employers. He wants to modify the objectives of the Pensions Regulator so that its priority is not just to protect the PPF (Pension Protection Fund), but so it has an equal duty to encourage the creation of an environment in which pension provision can flourish. He also hit out at accounting standards that currently favour short-termism and don't recognise that assets and liabilities are long-term in nature. He is also pleading for a clearer pension policy.

"The complications in both the UK state and workplace pension environments are second to none. Even in the US – where bureaucracy is an art form – retirement provision is simple compared to here," he said.

Professor Avinash Persaud, chairman of Intelligent Capital and former MD of State Street Bank, talks about the ethical gap which led to the collapse.

"Ethics is about personal responsibility but we need to realise the franchise value of reputations. We need to find a mechanism that raises the value of ethical behaviour."

Professor Persaud says too many of the City's financial heavyweights believe that the law of the jungle must prevail, and maintains that trust and ethics are the only way a system can properly work. "A high level of ethical behaviour is good for the economy. It makes doing business easier and less bound up by regulation and box ticking. It is inherently more productive."

In all, massive damage has been done to the reputation of the UK's pensions industry throughout the lost decade, and much needs to be done to restore public confidence and faith in a battered system. At its most fundamental is the question: why should I bother with a pension? Whoever wins the General Election will need to articulate what they will do for the nation's ageing population. They must ensure that pension providers curb their charges, stop raking off extra fees, reduce their reliance on boom-and-bust equities, and build genuine flexibility and transparency into savings and personal contributions. The future wealth of our nation depends on it.

Photograph: Rex

WALKER ON PENSIONS

THE UK pension industry has recently been reviewed by Sir David Walker, a senior adviser to Morgan Stanley and former assistant secretary at HM Treasury.

The key areas of his review related to the engagement between boardrooms and institutional fund managers, who hold large stakes in major listed companies. Walker argues for more effective engagement between boardroom and the pension funds. He wants tougher chairmen and women, better trained non-executive directors and more demanding institutional shareholders.

He says that behavioural change is required in the interests of companies, owners, pension fund trustees and those with pensions.

He also examined the relationship between bonuses and "high-end remuneration" and the performance of companies. He says it is vital that failure and short-termism are not rewarded.

The FSA and the Financial Reporting Council is currently in consultation over Walker's recommendation which will be drafted in due course by Government into new regulations.