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Q&A – March 2009 – Myth Busting Special

New year, new Q&A and I'm starting with a myth busting special. Fed up with misleading and inaccurate pension reporting by the press, radio and TV? No, well I am so this edition is devoted to correcting some of the worst excesses of journalists and commentators' supposedly informed pronouncements.

Myth 1: The world is ending and we're all doomed
It is undeniably difficult to hold on to a decent occupational pension scheme when redundancies are occurring every ten minutes with other cut backs eating away at overtime, pay deals etc. However, companies who decide to hit the nuclear button when it comes to their remaining defined benefit pension schemes aren't going to solve all their financial problems overnight by destroying workers' retirement incomes. All pension funds, defined benefit or defined contribution, are reliant on investment returns (generally this means shares). At the moment share prices are extremely low but not even the worst pessimist thinks this will last for ever and when the recovery does happen, many of the problems will abate. Investment returns and dividends go up and down, the trick, obviously, is to be canny enough with the investments to make a profit and profits can be generated even with a stock market that appears to be in freefall.
The alternative is to invest entirely in predictable things like bonds and cash. The problem with that is the likelihood of generating a profit out of these sufficient to match the increase in living costs and the cost of buying an annuity is slim. That's why pensions should and do have a mixture of safe and riskier investments to generate higher returns. As an individual gets closer to retiring, their pension pot should move more into safe investments. Those of you in default or lifestyled defined contribution arrangements should find this happening automatically. This means that the nose dive in share values should affect you less than the press would lead you to believe.

Myth 2: The pensions industry is an innocent victim of economic circumstance
Given some of the commentary, you would be forgiven for thinking that no one involved in running pension schemes had any role to play in the current problems. So investment managers aren't responsible for the performance of investments they choose, actuaries aren't responsible for the assumptions they make about the cost of paying out pensions and no one is responsible for scrutinising fund activities. If they're all so innocent it does rather make you wonder what it is they do to justify their rather significant salaries.
In fact the culpability of the pension industry goes further than the unlucky or ill-judged investment strategies of individual pension schemes. Among the biggest shareholders in banks and therefore those with the greatest opportunity to block senior executives' remuneration packages (and pension arrangements) are pension funds – your pension funds. Whether you are in the LGPS, a private sector defined benefit scheme or a money purchase/defined contribution scheme, the money you contribute and that contributed by your employer is invested and I would bet a banker's pension on it being a fact that a proportion of that money is or was invested in UK banks.

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Myth 3: Immediate changes to the law are needed to save final salary pensions
Final salary and other defined benefit schemes need more 'quick fix' reform ideas like Fred Goodwin needs a Pension Credit application form. Almost without exception, any proposal to make schemes more attractive to employers means making it less valuable for members. The catalogue of changes that have been pushed through including reducing indexation and allowing employers to reduce benefits and walk away from good quality schemes have only succeeded in reducing the amount workers have saved for retirement, no one can point to any employer that has held on to a scheme because of these changes. Pensions are a long term concept; the objective is for schemes to have a lifetime spanning many, many decades. Crisis management is not only ineffectual in the pensions world, it's counter productive.

Myth 4: The Local Government Pension Scheme is unaffordable and will cause a massive increase in Council Tax
As I may have mentioned last time the LGPS is not unaffordable. Like all schemes the general fall in investment returns has an effect on the funding level of the scheme's 100 funds. However, unlike some private sector scheme sponsors, even the worst doom and gloom merchants don't believe that local government is in danger of going financially bankrupt anytime soon. The deficits being decried from broadcasting studios around the country are based on a view that funds should be 100% funded. Well that's a nice idea but not really the be all and end all. It's not as if all the four million scheme members are going to demand all their benefits tomorrow.
Properly managed there is no need for councillors (the people responsible for LGPS funds) to add excessively to Council Tax because of the LGPS. The 100% is a medium term target not an immediate necessity. Most councils should appreciate this, the Tory government in the late 1980s set a target of 75% funding in order to keep the Poll Tax down. Many would argue that has more to do with the current deficit than stock market problems but it does indicate that the world doesn't end if the LGPS isn't always 100% funded.

Myth 5: No one can afford occupational pensions at the moment; the money should be spent elsewhere
There are a number of understandable reasons why some individuals and companies decide not to spend money on pensions (the need to pay off debt, genuine financial precariousness of a company). However, these circumstances are rare and in many cases are temporary. The truth of the matter is that we, as individuals and as a nation, can't afford NOT to have occupational pensions. State pension benefits are already inadequate and with an ever increasing number of people claiming (the ageing population issue) the pressure on the taxpayer will increase. Oh and there won't be as many taxpayers in the future (for the same reason) even with people working well into their late 60s and beyond so the pressure will be even worse. The extra pressure on the NHS and local authority care services wont help the strain on the public purse either (see the last Q&A for more on this point).

That's it from me, usual wave in the direction of the website... www.gmb.org.uk/pensions

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