Where will we be in 2017?

The trends set in the past five years are likely to set the pace for the next five but, **Mark Homer** warns, we need to factor in a great deal of uncertainty if we are to make the right long-term decisions

An awful lot can happen in five years. The introduction of auto-enrolment, an ongoing uncertain economic outlook and changing trends in investment may mean private sector pensions becomes a very different world in a relatively short time.

The decline of final salary schemes is well publicised. 2011 Pensions Regulator figures show only 16% of defined benefit schemes remained open to new members and 24% were closed to future accrual. Add the continuing pressure on scheme funding and the shift towards defined contribution, and it is perfectly conceivable that **by 2017 at least 95% of final salary schemes will be closed to future accrual, with fewer than 100 remaining open.**

Following negative press and progressively closer regulatory scrutiny, enhanced transfer values are likely to become less common. So, while active membership decreases, the 'deferred member problem' grows. However, we may be able to better manage pensioner liabilities. **By 2017, an ongoing low interest environment could see a rise in pension increase exchange exercises.**

In an attempt to limit future pension liabilities, it has become increasingly popular to move from a final salary scheme to a career-average revalued earnings (CARE) one without switching to DC. However, generally, moving to CARE only makes a difference if salaries increase at a rate greater than inflation. In the current environment, where average salaries are not keeping pace with inflation, CARE may be just as expensive as final salary with the same accrual rate. **By 2017, will employers have found that CARE has not been the solution they thought it would be?**

In the rush to move to CARE or DC, it seems cash balance schemes have often been overlooked. These offer members a defined amount of money for their pension pots, for example 15% of salary, and each year's payment is revalued up to the date they retire. At this point the member uses their pot to secure a retirement income by purchasing an annuity, sometimes at rates guaranteed by the employer, or by using drawdown, etc.

Cash balance started to be seen in the UK in the 1990s but, in an era of final salary scheme surpluses, the balance of risk in a pension scheme was not at the forefront of people's minds. **By 2017, we may have realised that cash balance was the solution we missed as we made the move to DC.**

The fact that the vast majority of open private sector schemes will be DC seems to be assured. Between now and 2017 all but the smallest and newest UK employers will have implemented auto-enrolment. This alone is accelerating the move to DC, with the National Employment Savings Trust and other specialist providers joining insurance companies in the group pensions market. **By 2017, 80% of DC schemes could be contract based and the flurry of activity around mastertrusts may have fallen away.**

According to the Office for National Statistics, the average total contribution rate in DC schemes in 2011 was 9.4%. This is simply not enough. With relatively low contributions and possibly poor investment returns, **by 2017 pension pots may be too small and everyone may accept that they cannot retire until they are at least 70.**

Setting aside the biggest economic uncertainty – the eurozone crisis – inflation is already challenging and could rise significantly. If gilt yields also rise, a small improvement in annuity rates may lead to a rapid increase in pension buyouts as trustees and sponsoring employers look to de-risk their schemes. **By 2017, will the buyout capacity in the insurance market be saturated?**

Trends in scheme investments always occur as prevailing economic conditions change. Will the fashion for liability driven investment continue or will there be another new 'big idea'? **By 2017, will pension fund assets be more heavily invested in infrastructure, alternatives and social housing bonds?**

The popularity of delegated investment mandates and fiduciary management, which are typically used to ensure trustees do not miss opportunities to lock in investment gains when working to a set de-risking plan, is increasing. **By 2017, with more plans on a flight path to full funding, delegated investment could be in place in the majority of DB schemes.**

The concept of lifestyling, developed as a response to the October 1987 equity market meltdown, is now commonly used in DC schemes as the default. However, it is still early days to know whether it works, particularly for individuals with significant DC savings. **By 2017 will we have realised that lifestyling doesn't work?**

Whatever the future holds, including the chancellor's continuing changes to the tax efficiency of pensions, there will certainly be ongoing challenges for employers, employees and the pensions industry. Perhaps the biggest question in 2017 will be 'what happens to pensions in the public sector?' ■

Mark Homer is Scheme Manager at PS Independent Trustees.

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