Private Third-Party Pension Sponsorship in the UK: A Chance for Better Outcomes

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Summary

• Many in the pension industry have identified that there is a huge savings gap in the UK. However for the last 20+ years the industry has not managed to solve the problems and, if anything, things have become progressively worse.

• For most pension specialists, the main issues are not really about which pension provider to choose, the investment management charges or even the investment style. Yet this is exactly the area on which the industry seems to concentrate all its collective expertise.

• The problem is that the industry have been complicit in transferring the risk from employers to employees without ensuring they understand that risk. Those half way through their working lives are woefully short of retirement savings and worse still have lost faith in the industry. Auto-enrolment may help, but it brings a double-edged sword that could mislead people into believing that an 8% contribution level is enough.

• One solution may be Private Third-Party Sponsorship. This is the addition of an extra party willing to help fund for an individual to reach retirement aspirations in addition to traditional sources. It is a new form of private sector partnership to help public/society needs.

• In its simplest form it is a strategy rather than a packaged product, that involves:
  1. Access to a new source private capital from a sponsor;
  2. A registered pensions scheme that meets the sponsors approval;
  3. Transference of risk to the sponsor rather than the individual; and
  4. Flexibility to repay sponsor through a range of options if successful outcomes are achieved.

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CII Introduction: the debate about an appropriate pension system to suit the current social and economic realities facing the public still wages, even though automatic enrolment will start to enter force later this year. One concern is that those people in the middle of their working lives face a risk of not earning enough. In this article, Pierre Coussey, Chartered Financial Planner offers his own view, exploring the options open, including a new prospect known as Third-Party Sponsorships. He provides a background and case study demonstrate what can be made possible with new thinking and innovation to create potential outcomes that are affordable and 2-4 times greater.

Many in the pension industry have identified that there is a huge savings gap in the UK. However for the last 20+ years the industry has not managed to solve the problems and if anything things have become progressively worse.

On 4 October 2010, the BBC’s Panorama programme delivered a damning verdict on the pensions industry. Although it took stance against the industry, the programme stopped short of describing two of the biggest problems in the sector:

- the cost of delay; and
- the impact of insufficient funding.

For most pension specialists, the main issues are not really about which pension provider to choose, the investment management charges or even the investment style. Yet these are exactly the areas on which the industry concentrates all its collective expertise. Whilst charges and investment returns do clearly influence the outcome of any investment, they will always remain just a sideshow to the biggest influencer in any long-term savings strategy i.e. how much is actually paid in and how long it remains invested.

Whatever the case, consumers have become disillusioned with investment returns. They have seen more than a decade of horrendous volatility. For many, it has left a deep scar on their experience of investing for over a quarter of their working life. As Lord McFall, former chair of the Treasury Select Committee puts it:

People need to get more bang for their buck, or they’re not going to bother with a Pension. Instead they’ll end up spending today, ignoring tomorrow, and scraping by in poverty on the State pension. We cannot stand by and let that happen. The complacency of many in the pensions industry is alarming.¹

The problem is that the industry have been complicit in slowly changing the game and transferring the risk from employers to employees without really striving to make sure that they understand the risk.

Who has the deficit today?

The UK has been experiencing the gradual shifting of a “hidden deficit” arising from:

- In the late 1970s, SERPS was hailed as a long-term solution but the benefit has eroded to a level well below that originally envisaged;
- In 1988 people were encouraged to ‘contract-out’ on a wider scale to move some of the problem away from the State;
- 1997 Chancellor Brown commences taxation of pension fund investment income;
- Since followed by the abandonment of Defined Benefit pensions as huge deficits have arisen and spiralling costs made them unaffordable;
- Research shows that far more by way of contributions was being set aside for Defined Benefit schemes than those for the Defined Contribution replacements; and
- Demographics clearly demonstrate that the ratio of retired individuals to those in employment is changing more rapidly than envisaged.

Despite all this, the shame on our industry is that those half way through their working lives are woefully short of retirement savings and worse still have lost faith in the industry. Those very same individuals are effectively the biggest future strain on society.

Having transferred the dual problem of investment risk and funding deficits from employer to employee, without a change in the way we deal with this, there is every chance that it will land back on society and the State.

¹ Lord McFall of Alcluith, the former Treasury Select Committee chair who led the Workplace Retirement, Income Commission, 1 Aug 2011
**Having a simple target to aim for**

Most UK individuals have not been educated about the sum they need to save and the industry has not looked at affordability in any real depth. Lord McFall is so correct in saying that many will blindly end up “scraping by in poverty on the State pension”. But, even more dangerous, is the assumption that a reasonable State pension will be afforded to all! The demographics do not bode well. If we look forward 20 years, will there be a need in the long term for means testing of a State safety net? Research by Aviva in 2010 revealed:

*A majority in each country surveyed are worried that they will not have enough in retirement to fund an adequate standard of living. Two thirds of people surveyed estimated that they would need at least half of their pre retirement income just to get by, and the majority would prefer to have at least three quarters.*

The problem is that the vast majority of individuals have no idea of what sort of capital sum is needed. Furthermore they have no way of checking where they are currently relative to where they need to be. A question for industry is why have we failed to effectively tell the public what they need?

The Aviva report showed that in the UK, on average, the extra annual savings needed, on top of existing savings, was a further 10,000 euro per annum. It also acknowledged for the first time that traditional pension’s savings alone could not provide the entire solution. Neither would options like ‘trading down’ or home equity release be sufficient to close the gap either.

If we couple this with extremely high levels of personal debt, estimated to be in excess of £10,000 per household on top of mortgages, we create even more pressure on household incomes. The very incomes that need to provide even greater savings for the future. This further highlights the dynamics of ‘cost of delay’. As the CII explains in its 2011 pensions report:

*Savings more, paying down debts and above all else planning for the costs of retirement will be crucial if people want to be sure to avoid having to sell off a large proportion of their accumulated wealth during retirement in the future.*

So, who is going to be most at risk? The introduction of automatic enrolment is a form of soft compulsion that will affect the lower earner; the very people the State safety net should be seeking to assist. It also brings with it a double-edged sword that could mislead the wider population into believing that an 8% contribution level is enough.

Those most at risk may actually be higher up the earnings curve, the so called ‘middle England’. In simple terms they are the ones who may suffer the largest drop in income at retirement yet potentially need to rely on self provision alone.

**Case study**

George is typical of the scenario above, aged 42 and married with two children of school age. He earns well at £75,000 p.a. but still finds things can be tough providing for his family. On the horizon George is thinking about how to set aside enough for potential higher education costs. And, the family also aspire to one more ‘trade up’ to their dream home at some point. Lastly, George is thinking seriously about how he will afford to retire comfortably in the future.

Long gone are the days when colleagues retired at 55 or even considered early retirement at 50; they had a generously funded Defined Benefit company scheme back then. George has come to realise that early retirement is no longer be an option and 65 is more realistic.

He is disillusioned with pensions: high charges, poor performance, and lack of access to his savings if needed. And, that credit card debt sitting at £10,000 is costing him £1,800 p.a. to service in interest alone. It’s no wonder that adequate funding of his pension plan is not a top priority.

**Figure 1: Targeted Retirement Fund through conventional retirement savings**

| Existing Fund Value in Year 20 | £319,080 |
| Pension Fund Shortfall | £305,920 |

Immediate lump sum set aside: £104,302; £720 per month

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*Aviva European “Mind the Gap” survey of 2010
Chartered Insurance Institute, An Age Old Problem: Developing Solutions for Funding Retirement, May 2011.*
George’s company offers a 3%+3% matched contribution scheme at present. He has recently considered opting out completely to concentrate on clearing his personal debt.

In isolation the existing scheme would attract total contributions of £5,000 each year. That amounts to just £25,000 over the next 5 years. Unfortunately will be insufficient to achieve his goal. To target his deficit the required combined contribution would be just over 11% of earnings going forward, an unaffordable increase of 5% p.a. for George.

George has been offered access to a sponsorship solution that would allow him to make a contribution of £75,000 this year and a further £50,000 for each of the following 4 years.

After taking professional advice and following successful negotiations with George’s employer, he has been allowed to initially divert his member contribution to pay down debt and then pay into the company’s Corporate ISA whilst the sponsorship solution is in place without losing the benefit of his employer’s contribution.

One solution for George may be a Private Third-Party Sponsorship (3PPS). This is the addition of an extra party willing to help fund for an individual to reach retirement aspirations in addition to traditional sources. It is a new form of private sector partnership to help public/society needs. In its simplest form it is a strategy rather than a packaged product, that involves:

- access to a new source private capital from a sponsor;
- a registered pensions scheme that meets the sponsors approval;
- transference of risk to the sponsor rather than the individual; and
- flexibility to repay sponsor through a range of options if successful outcomes are achieved.

The sponsorship solution secures a total of £275,000 in contributions to underpin the existing scheme option of £25,000 of funding over the next 5 years.

The cost of saving towards repayment of the sponsorship capital would amount to just over 3% of his salary which he can ring fence in an investment of his own choice. George likes the idea of only having to pay for something if fixed returns agreed at outset have been achieved and is happy to save towards this.

Various forms of 3PPS will evolve in the market through time, this it is hard to know in advance the shape of all offerings. The primary focus when selecting a 3PPS strategy for a corporate or individual may be to focus on a solution with reduced consumer risks.

Negatives factors to look for:

Taxation rules changed retrospectively and member cannot access the benefits as intended:

- unforeseen adjustment to a tax return resulting in an unexpected bill and no spare money to pay it;
Schemes that fail to ensure HMRC balance their books in the short term;
• Schemes which do not invest in genuine investment opportunities;
• Schemes that deduct investment charges before delivering stated investment objectives;
• Other unexpected failure;
• Expectations not being met in the future;
• Client over reliance, failure to take responsibility to save to pay back sponsor meaning lower benefits if repayable sponsorship;
• Aggressive investment schemes that may throw extra risk back at the consumer; and
• Member does not control investment flexibility of the sponsored element of their retirement strategy.
Positive aspects to look for:
The main benefit is limited to no capital exposure for the investor:
• Sponsorship on Consumer Credit Directive-compliant risk-free capital finance terms if repayable;
• Savings requirement below or close to auto enrolment member affordability;
• Low or zero interest rate;
• No monthly loan repayments during the investment term;
• Investment charges that only apply when results are delivered;
• Repayment of sponsorship capital only if agreed outcomes are achieved; and
• Freedom to save regular amounts into a savings account, ISA, Share Save etc.

To be most tax-efficient from an HMRC perspective, strategies must deliver wider social benefits. Examples could be as follows:

• Solutions that commit to invest with a target that allows Treasury tax receipts to balance in the short term as well as the long term.
• Solutions that commit to invest in areas that meet wider society needs such as environmental and sustainable infrastructure.
• Investment commitment to supporting Small/Medium Enterprise sectors, that in-turn help meet economic recovery objectives.

The outcome of combining a 3PPS strategy with existing arrangements could be 2-3 times more effective. The possibilities if fully embraced by the employer and combined with all the tools commonly used in the employee benefits arena the return ultimately could be more than four times the outcome of his existing typical scheme.

The use of 3PPS provides a genuine solution to the problems faced with cost of delay. It is also capable of addressing many of the negative issues frequently raised by irate consumers on popular award winning blog sites. As with most pension planning solutions, the generous tax incentives provided by government are a key factor; this may, of course, change in the future. A 3PPS solution may be suitable to individuals as an addition to existing pensions provision not a replacement of responsibility to save. They may help people meet a defined aspiration which they may have been either unwilling or unable to reach with conventional solutions in isolation.

If you have any questions or comments about this Thinkpiece, and/or would like to be added to a mailing list to receive new articles by email, please contact us: thinkpiece@cii.co.uk or by telephone: +44 (0)20 7417 4783.

Pierre P. Coussey has over 23 years experience in financial services both within the largest providers in the UK and at the coal face within private practice, being both a Chartered Financial Planner of the Personal Finance Society and Chartered Wealth Manager of the Chartered Institute of Securities & Investment. Currently he is involved as a panel member of the CISI in shaping their new Private Client diploma examination standard as well as being a contributor to the Pensions Management Institute and regular attendee to events of the Centre for Study of Financial Innovation involving pensions and investment.
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Recent and relevant articles in the series:


A long-standing review led by the FSA of how investment advice is given to consumers in the UK is reaching its conclusion with a number of major reforms around adviser professionalism, how their services are labelled and how advisers are remunerated coming into force at the end of this year. There has been much debate over whether these reforms would restrict access to all but the wealthiest consumers, and the very people who will most need assistance with how to best save will only be able to afford non-advised solutions.

No.77: The Money Myth?, by Alex Davidson (18 May).

With technological advances and ever more complicated investment vehicles, it is easy to forget that financial markets are driven by humans and human nature. The author offers up examples from classical mythology that show human nature has changed little in 2,500 years and provides five rules to help would-be investors bear this in mind.


The European Insurance & Occupational Pensions Authority (EIOPA) was formed in January 2011, at a time when many in the industry were still wondering how a pan-European insurance “supervisor-of-supervisors” could operate in practice without compromising the work of the national authorities. In this article, Gabriel Bernadino, Chair of EIOPA provides a perspective on the Authority’s first year of operation.

No.74: From Brussels with Love: A Perspective on Developing Insurance Regulation at the EU Level, by Karel van Hulle (4 May).

With EU insurance regulation landscape more relevant to individual firms than ever before, Karel van Hulle, the European Commission’s lead official on insurance & occupational pensions, and author of many of the proposals under discussion in these areas, offers his own strictly personal view on insurance regulation in the post-financial crisis world.

No.71: The Challenge of Age: Global Longevity Trends and Economic and Social Implications, by George Magnus (23 March).

George Magnus (“the man who predicted the financial crisis”) argues that the current economic turmoil is colluding with rising longevity to severely depress returns for the elderly. Governments, societies and industries must take robust action now in order to ensure that rising longevity is celebrated rather than feared over the decades to come.


James Lloyd of the Strategic Society Centre and Tim Fassam of the Prudential summarise the results of an extensive survey exploring public attitudes driving pension saving, and draw conclusions in the context of the Government’s new workplace pension auto-enrollment system starting this October.
CPD Reflective Questions

Reading this Thinkpiece with respect to the learning outcomes below can count towards Structured CPD under the CII CPD Scheme. The questions are designed to help you reflect on the issues raised in the article in relation to these learning outcomes. Please note that the answers to the questions are not meant for CPD records purposes.

Learning Outcomes

• To gain an understanding of the implications of the savings in the UK, and the steps that might be taken to address it.

• To be able to appreciate the issues about transferring of risk from employers to employees, and the extent to which policy responses such as auto-enrolment, and industry solutions such as Private Third-Party Sponsorships might make a difference.

• To be able to summarise the pros and cons of Private Third-Party Sponsorships as one approach to dealing with an individual's savings situation.

1. How could public and regulatory policy frame developments based on a more detailed statement of policy for the savings, engagement and advice gap issues?

2. What is needed to expand the development of focused advice services, particularly as a significant activity for larger brands?

3. What are Private Third-Party Sponsorships? Explain their pros and cons of these solutions and how they could help the customer meet savings targets.

4. How could new mainstream products designed around end-consumer preferences be safely partnered with simplified advice models?