The regulatory politics of private pensions in the UK and Germany

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It is now well-established that privatisation brings with it re-regulation, not de-regulation. However, this does not mean that we should expect that the policies once pursued under public ownership will be reintroduced by regulatory means. On the contrary, privatisation can be understood as a way of institutionalising changes in policy. This is particularly evident when privatisation is accompanied by the delegation of powers to an independent regulatory authority, as has often happened when public utilities are privatised. Delegation can be a method for institutionalising the pursuit of distinct regulatory goals, generally weighted towards enhancing efficiency and promoting competition.

While pension privatisation has been accompanied by the announcement of new policy objectives, the regulatory approach has not developed along the lines found in other sectors where privatisation has occurred. Specifically, there has been little delegation. This chapter discusses the reasons why. The central argument is that private pension regulation is highly responsive to its interaction with the public pension system. This interaction produces regulatory goals or requirements, as policies aimed at reforming the public system are mirrored in demands on the private system. It also affects the regulatory policy process. The policy process of private pension regulation bears more resemblance to the policy process governing the tax code (indeed, pension provisions occupy a large part of the tax code) than to the regulation of a privatised utility.

This finding goes against the prescriptions put forward by early advocates of pension privatisation. The World Bank (1994, p.234) argued that the governance of the private funded pillar should be market-regulatory, while political attention to redistribution and poverty relief should focus on the pay-as-you-go system. The Bank’s ‘vision’ was that private defined contribution (DC) pensions would establish a clear relationship between contributions and benefits based on market performance, without political intermediation. Financial markets should determine the rate of return on the funds and the terms for converting the funds into pensions (annuitisation). So long as these terms are offered by competitive firms in a well-functioning market for financial services, policy-holders should accept the terms as legitimate. By determining pension amounts on a DC basis, the terms on which contributions are converted into benefits could change with changes in economic and demographic conditions, which gives private pensions a degree of flexibility and economic responsiveness which politically-managed public pensions lack. Furthermore, independent regulation would signal that the government would not interfere to adjust the terms of pension contracts, and this would create security of expectations for contributors. However, as things have turned out, the regulatory framework for private pensions has been subject to incessant political discussion and frequent revision, creating complexity and destabilising the relationship between contributions and benefits.

In both Germany and the UK, the development of a private funded pensions pillar is part of a wider pension reform process. Political scientists studying pension reform have shown how the promotion of private pensions is a ‘layering’ strategy (Thelen, 2003; Hacker, 2004) for overcoming the barriers to public pension reform. While the
‘pillar’ metaphor emphasises the separate and distinct modes of governance of public and private pensions, ‘layering’ draws attention to their interdependence. The idea of layering is that obstacles to direct reforms to the public pension system can be evaded by introducing new policy options in the private pension layer. The expansion of that layer can counterbalance and mitigate contraction of the public layer, both ‘economically’ by providing alternative mechanisms for income maintenance in retirement, and ‘politically’ by diverting opposition to reform.

The analysis advanced here suggests that layering is inimical to stable and politically-autonomous regulation. Political investment in the layering strategy produces a high degree of political interest in private pensions, because of the consequences for public pensions. But this implies that the private pension layer, while facilitating reform, is fated never to share the stability and autonomy of other regulatory spheres. For private funded pension provision to be governed by a regulatory logic, in which market values dominate, it would have to be released from serving the political agenda of public pension reform.

Public pension reform affects private pension regulation in two main ways: by shaping the goals of regulation and by involving different political constituencies in regulatory policy-making. For example, an important goal that pension-reforming governments add to the standard tasks of a market regulator is the goal of expanding coverage. The attention and resources that governments lavish on this goal reflects the desire to reduce the public pension layer relative to the private one. In both the UK and Germany, subsidies and tax incentives have been used to promote the take-up of private pensions. However, since the promotion of coverage has to be balanced against the control of public spending, these instruments are susceptible to frequent tinkering. Furthermore, there are tradeoffs between promoting increased coverage through flexible rules, and ensuring that the ultimate goal of reducing demands on public pensions is achieved. Policies are adjusted to find a balance, for example between providing incentives through subsidies and tax breaks and limiting their exploitation through the diversion of other savings.

The primary constituency of market-regulatory policy-making is normally the industry itself. Not only does it have both the interest and the resources to influence regulatory policy, but also it has the inside knowledge and expertise to provide necessary information to the regulator (Horn, 1995, p.42). However, we can expect a different pattern of political engagement to arise in private pension regulation when a layering reform strategy is in progress. The political actors that have engaged with public pension policy are likely to move their effort into the private pension regulatory domain, since they recognise that the private layer is planned partially to displace the public one. Thus political parties, trade unions and employers can all be expected to try to influence private pension policy, leaving the industry voice as just one among many, with the result that an autonomous regulatory policy space is not established.

The following discussion develops these arguments as follows. The first section gives a brief account of the regulatory history of pensions. Prior to the current wave of reforms, occupational defined-benefit (DB) schemes were the dominant form of private pension provision in both the UK and Germany. This section endeavours to explain why DB pensions have been eclipsed by DC schemes as the main focus for privatisation policy. The second section describes the personal DC schemes currently being promoted by governments in both countries and introduces the regulatory problems that have arisen. Section three examines the ways in which the regulation of private pensions is affected by policy goals derived from the reform of public pensions, and section four discusses the reasons why the financial services
industry has not been able to dominate the ‘policy space’ of private pension regulation.

While the account of developments in the UK and Germany shows a number of parallels between the two countries, there are also some significant differences. Comparative taxonomies of welfare states have highlighted their differences in public pension provision, contrasting Germany’s status-maintaining system with the low basic pension provided in the UK. If one accepts Esping-Andersen’s (1990) argument that these features reflect a wider pattern of contrasts between the political economy of ‘conservative corporatist’ Germany and ‘liberal’ (although occasionally social democratic) Britain, then one might expect to find corresponding differences in private pension regulation. Hippe (2009) outlines three ‘ideal types of funded pension regulation’ along these lines. The final section of this paper summarises the regulatory differences between Germany and the UK to see whether they correspond to different ideal types. Neither country fits into its expected box. The conclusion considers the implications for our understanding of regulatory politics.

[A] Layering and the decline of defined-benefit schemes

The current focus of policy effort to promote private pensions in both the UK and Germany is on DC or money-purchase schemes, but DB schemes have historically been the main form of private pension provision. The history of the UK’s experience with regulating DB pensions bears retelling, briefly, because it illustrates the regulatory difficulties introduced by a ‘layering’ reform. The British pension system in the 1960s displayed, with hindsight, a fairly clear allocation of public and private functions and risks. The government guaranteed a minimum level of welfare, through the basic state pension. While the National Insurance system also provided small additional ‘graduated’ (earnings-related) pensions, private schemes operated with a high degree of autonomy from public policy objectives. Contracted-out schemes had to guarantee benefits equal to the graduated elements in the state scheme, but since these were very low, this was not an onerous requirement (Whiteside, 2003, p.26). Treasury was concerned that burdensome regulations would dampen the growth of provision; it also held that problems with the schemes should be resolved by the contracting parties, i.e. workers (represented by their unions) and employers, rather than the government. The Department of Employment shared this view, arguing that occupational pension schemes should be left to manage their own affairs (Whiteside, 2003, p.30). Occupational pension schemes were backed by financial investments and often reinsured with and managed by insurance companies. There was no comprehensive scheme for guaranteeing employees’ and pensioners’ rights; instead, the funding of commitments was seen as providing the main form of security. In addition, the government guaranteed some benefits under contracting-out arrangements.

The evolution of this model to the present situation started with the government’s efforts to widen the coverage of earnings-related pension provision, culminating in the introduction of the state earnings-related pension scheme (SERPS) in 1975. At the time, SERPS had cross-party support, but this was withdrawn by the Conservative government headed by Margaret Thatcher, which introduced measures in the 1980s to encourage more people to contract out of SERPS. Contributors were allowed to contract into either occupational or personal DC schemes, whereas previously only DB schemes had been eligible for contracting-out because only DB schemes could provide guaranteed benefits comparable to the state scheme. The conditions for contracting-out were made more favourable by offering a special addition to the National Insurance rebate for the newly-eligible DC schemes (Marschallek, this volume). An implication of allowing contracting-out into DC schemes was that an employer sponsor was no longer required: contributors could
contract into a personal pension. The bypassing of sponsors might be thought to have increased the government’s exposure to risk, but the contingent liabilities of the government were apparently reduced by curtailing the benefits payable under the state scheme, SERPS.

The reform process at this point could be described as one of privatisation without layering, in that the state scheme still offered earnings-related benefits that were comparable to those provided by occupational schemes. The layering stage of the reform occurred through the reduction in benefits provided by SERPS, so that the state scheme retreated back towards the first pillar provision of a flat-rate benefit with means-tested supplements. This could be seen as a return to the status quo before the introduction of SERPS, but the path that had been travelled left a pronounced mark on the various private schemes in operation by the end of the 1980s. To a greater extent than in the 1960s, they were supported by tax incentives and national insurance rebates. They were also backed by an implicit government guarantee, created by the government’s insistent promotion of the desirability of private alternatives. The level of explicit guarantee, however, was eroded as SERPS was cut back, as the government was only committed to guaranteeing equivalent amounts to SERPS to those who had contracted-out into DB schemes. The so-called ‘protected rights’ of DC scheme participants were even more limited (Marschallek, this volume).

The gap between the explicit security provided by the government and the implicit promises imprinted in public expectations became apparent with the Maxwell scandal of 1991, when it emerged after the tycoon’s death that he had illegally borrowed from the company’s pension funds. The regulatory response was to tighten the rules governing the management of occupational pension funds in order to immunize funds from the fate of the sponsoring employer. However, inadequate provision for dealing with scheme failure continued to create problems, and in 2004 a Pension Protection Fund was established, funded by levies on schemes. This measure came too late for many pensioners who found that their occupational scheme was inadequately funded when the sponsoring employer’s business failed, and the government was also forced to provide the funds for a Financial Assistance Scheme to assist this group.

DB schemes have declined sharply in importance in the UK in recent years. Many commentators blame the regulatory regime. Reports by both Myners (2001) and Pickering (2002) argued in particular that the funding rules for pensions were too burdensome. Other regulatory changes that reduced the attractiveness of DB schemes to employers concerned the ‘vesting’ of pension rights (whereby those leaving the scheme can preserve or transfer their rights, rather than losing them) and the indexation of deferred rights and pensions (annuities) in payment. The Pensions Commission concluded its analysis of recent trends by arguing that regulatory changes had produced an unplanned and unanticipated increase in the generosity of DB schemes, due to better treatment of leavers and extended indexation requirements, as well as to increased longevity. A reversal ‘was inevitable at some time. But the scale of the reversal, its sudden acceleration, and its uneven treatment of new versus existing employees, when combined with a state system planning to become less generous, has major adverse consequences’ (Pensions Commission, 2004, p.94). New employees have been losers as companies have closed schemes to new entrants, producing a sharp decline in the number of active (contributing) members of DB schemes. The implication of the Pension Commission’s diagnosis is that regulations introduced by government to shape DB provision towards public policy goals, by ensuring that pensions were adequate in retirement (through indexation) and fair to leavers as well as stayers (through vesting), contributed to the decline of DB schemes by making it unattractive to employers to offer them.
Not only did shaping voluntary pensions to public policy purposes reduce their attractiveness to sponsors; it also increased the government’s liabilities as implicit guarantor. In Germany, these hazards have been avoided because occupational DB pension provision has been of marginal interest for public policy. The comprehensiveness of the social insurance system, which provided, in its heyday, a net replacement rate of 70% for all but the highest earners, meant that both the policy objectives of providing minimum welfare and securing of income maintenance were integrated into a single pillar. No specific coordination of occupational with public pension provision was needed or sought, due to the monopoly of the statutory system in the provision of old age security (Berner, this volume).

In 1974, some steps were taken to improve the security of employers’ pension promises. Protection against employer insolvency was introduced, with the establishment of an Insolvency Protection Scheme, funded by employers’ contributions proportional to their pension obligations and managed by the Pensionssicherungsverein (PSVaG). In addition, there are regulations governing the vesting of pension rights: rights now accrue after five years’ service (previously 10), provided the employee has reached the age of 30 (previously 35). These rules are still not very favourable to leavers; but the German government has not shown much inclination to go further, as reflected in its rejection of a proposed EU Directive on pensions portability (Mabbett, 2009). German employers have been relatively successful in defending the workforce management features of DB schemes (i.e. their use to reward loyalty and structure workforce adjustment through retirement policy), but this makes them unsuitable as a substitute for the public scheme.

However, the workforce management function of pensions is on the decline, as indicated by moves to outsource DB pensions and offer DC rather than DB pensions to employees (Berner, 2009a). The Riester reform promoted DC provision because the principal policy goal was to reduce the share of pension costs borne by employers. German employers perceive non-wage labour costs to be a significant drag on their competitiveness, and they have insisted that the new layer of pension provision should be financed by workers’ savings, not employer contributions. Thus, even when pensions introduced under the Riester reform are adopted through collective agreements, the model is one of ‘salary sacrifice’ whereby potential increases in take-home pay are given up in exchange for contributions to a fund in which the worker holds personal rights.

In summary, occupational DB schemes are no longer the focus of pension privatisation policy, although they remain the main form of occupational pension provision. In the UK, layering politics could be said to have killed the goose that laid the golden egg of DB pensions, which are, after all, far superior in providing income maintenance in old age because they securely promise a pension related to previous earnings. However, their coverage was always limited and their effects on the labour market (tending to raise labour costs and support earlier retirement) were not always aligned with public policy objectives. In Germany, the social insurance system offered DB pensions, ensuring wide coverage, but the effects on labour costs have contributed to efforts to increase DC provision.

[A] Regulating personal defined contribution pensions
The regulation of voluntary, funded, DC pension schemes should, in theory, be a straightforward matter. In their simplest form, no promises are made about the value of the pension produced by such schemes in advance of the retirement date, when the fund is converted into an annuity. There are therefore no guarantees to honour until the annuity stage, which simplifies the regulatory task of ensuring financial soundness (solvency). The regulatory framework needs to ensure that contributions
are recorded and returns on investments attributed, so that the value of each contributor’s account can be determined. Proposals for private funded pensions generally attach a high value to transparency and flexibility, and the regulations for individual accounts must address this. To ensure that contributors make an informed choice between schemes, information about costs and charges needs to be given.

In practice, the regulatory task has proved to be rather difficult. Schemes are often complex and not well-understood by most people, while administration costs are high, eroding returns. Furthermore, households have proved to be resistant to the risks involved in a simple, transparent DC pension scheme. This section explains how these issues have been addressed in regulatory decisions in the UK and Germany.

[B] The UK

When personal pensions were first introduced under the Conservatives in the UK, regulations on administration required the disclosure of charges but did not set their level. The government’s assumption was that a competitive market would develop which would control administrative costs. This turned out not to be the case. Factors which have contributed to high charges include the sales costs of personal pensions (much higher than when schemes are provided through employers) and high rates of ‘lapsing’ (when investors stop making contributions). It has also been argued that UK providers competed through product differentiation rather than on price, and have offered excessively complex products.

It might be thought that a DC scheme would always be based on an individual account, making it easy to determine the fund value and therefore also easy to transfer between schemes. However, providers of British personal pensions offered other arrangements, based on existing products developed by the insurance industry. These included ‘endowment’ and ‘with profits’ funds. Endowment policies offer a guaranteed value at maturity (e.g. at retirement). They are therefore an insurance product, although the guarantee may be very limited (e.g. that the money value at maturity will not be less than the money amount paid in). With-profits policies supplement this guarantee with annual and terminal bonuses. The insurance company declares bonuses on the basis of its judgment of past and prospective investment performance. The company’s appointed actuary is accountable for ensuring that it meets ‘policy-holders’ reasonable expectations’ (PRE), which is treated as a matter of professional judgement. Companies can adopt very different bonus policies. Some might aim to distribute most returns in the form of annual bonuses, while others wait until maturity to declare a large terminal bonus (annual bonuses are ‘reversionary’, i.e. they cannot be retrieved from policy-holders if the value of the fund’s assets subsequently falls).

The insurance industry argued that with-profits policies were a valuable instrument in personal pension provision, because they reduce the retirement date risk faced by the contributor by smoothing returns. However, the tide of opinion moved against these approaches, and in favour of other strategies such as shifting funds into lower-volatility assets as the account-holder approaches retirement (called ‘lifestage switching’). There was a particular problem with calculating the transfer values of with-profits policies for those wishing to leave early or move to another provider: even if a fund committed to providing a ‘fair’ transfer value (and many imposed penalties), there are different ways of determining the value of the contributor’s asset share. While the insurance industry defended its practices as providing some of the risk reduction that consumers wanted, critics took the view that the industry marketed its complex policies vigorously because they were profitable. They argued that pensions, in the
marketing jargon, are ‘sold not bought’; in other words, the volume of business transacted depends on the effort of the seller, not the preferences of the buyer.

In its preliminary report in 2004, the Pensions Commission noted a substantial decline in with-profits investments. While accepting that these products had been ‘rightly criticised’ for poor transparency and high charges, it also remarked that ‘the effect of the decline… is to remove from many people of modest savings the option of investing in equities in a risk-mitigated fashion’ (Pensions Commission, 2004, p.112). This meant that contributors were having to choose between volatile equity investments with the risk that entailed, or less risky investments which, due to their lower rates of return, required a higher level of contributions to produce an adequate income.

When the new Labour government came to power in 1997, the tide of opinion was running against complex products with guarantees and in favour of transparency and simplicity. The government’s response was to create a highly regulated product, the ‘stakeholder pension’ which was supposed to have a simpler structure than most personal pensions, lower administrative costs, and more straightforward rules on transferring benefits. Stakeholder pensions can be understood as a sort of product franchise, whereby the government gave its stamp of approval to a pension contract which the private sector could then sell. This ‘partnership’ between the state’s supervision of contracts and the marketing effort and contractual commitment of the private sector would, the government hoped, promote pension saving. The government thought that setting standards ‘will give a minimum level of protection and reassurance to potential scheme members that a stakeholder pension will provide them with a good basic deal’ (Department of Social Security, 1998, ch 7, para 18).

However, the take-up of stakeholder pensions was modest. The Pensions Commission (2004, p.92) reported that ‘[t]here is little evidence of a net increase in ongoing pension contributions as a result of the introduction of Stakeholder pensions’ although some contributions previously being made to personal pensions had been converted to the stakeholder product. Nor did the requirement that employers designate a stakeholder scheme for their workers (if they do not run an occupational scheme) have much impact: many schemes are inactive. To overcome this, the Pensions Act 2008 provides that employers must automatically enrol employees into ‘a qualifying workplace pension scheme’ from 2012. Participation is not compulsory, but employees will have to take a decision to opt out; the passive option is to remain enrolled. Employers will be required to contribute 3% of salary, with contributions from workers and tax relief taking the overall minimum contribution to 8%. The government has established a new agency, the Personal Accounts Delivery Authority (PADA) which will provide and manage personal accounts for those who do not belong to another scheme.

[B] Germany
There are several counterparts in Germany to the issues raised above, although, given that Riester pensions are relatively new, some issues have yet to become politically salient. Costs and charges have presented problems, but with the opposite pressure to that found in the UK, with providers successfully pressing for more favourable terms. By contrast with the UK, the question of guarantees was addressed by a political decision that contributors should be protected against losses in the nominal value of their funds.

In the initial regulations for the Riester pensions, the problem that high initial administrative charges could absorb contributions in the first phase of investment was addressed by requiring providers to spread the costs over ten years. However, this rule came under scrutiny in the face of low initial take-up of Riester pensions. Providers argued that the rule made pensions unattractive to sell due to the long
period for recovery of setup costs (Berner, this volume). This argument was successful in bringing about reform in 2004; since 2005 the charges are spread over five years instead of ten. However, this raises the converse problem that returns on investments will be low in the early stages. Furthermore, it is not easy for savers to assess and compare charges. A critical analysis by Uwe Wystup has drawn attention to the multiple charges imposed and the difficulty of comparing costs across schemes (Zydra, 2008).

The risks to savers are mitigated by the *Nominalwertgarantie*: the requirement that, at closure or retirement, the value of the fund should be at least equal to the nominal value of contributions. The *Nominalwertgarantie* was the subject of a vigorous debate. While its advocates defended the guarantee as providing an essential minimum of security for investors, critics have pointed out the costs, in reduced returns, of providing this form of risk reduction (Maurer and Schlag, 2002; Kling et al, 2005). Different types of Riester-compliant fund are available, and they use different methods for meeting the *Nominalwertgarantie*. These different methods are likely to produce wide variations in performance, but this has not, so far, produced political pressure for further regulation.

As Berner (this volume) explains, the initial take-up of personal Riester pensions disappointed the expectations of providers. The take-up of the occupational variants was, however, strong from the start. Trade unions negotiated participation in collective agreements, thereby expanding take-up by acting on behalf of groups of workers, rather than relying on a worker’s individual initiative. In effect the pension became compulsory for the employee group by being incorporated into a collective agreement. Occupational promotion of DC pensions thereby surmounted some of the problems with personal take-up, as sales costs and administrative charges could be restrained while individual inertia was overcome. In this aspect, occupational DC pensions in Germany work in a similar way to the proposal for automatic enrolment in the UK, but their impact is limited to areas of employment where there is a collective agreement (with a pension element) in force.

More recently, there has been an increase in the take-up of Riester pensions as personal pensions, whereby individuals choose a fund and contribute to it. This take-up has partly been spurred by increases in subsidies (particularly for parents and low earners) and changes to the regulations governing the accumulation and use of Riester funds, including the creation of an option which allows the fund to be used to purchase a home. This change was criticised by the Sozialbeirat (2008, pp.10-11) as open to abuse. The Sozialbeirat acknowledged that the promotion of home ownership was popular, but argued that it was an inappropriate adaptation of a programme to provide income security in old age. The wider implication of this episode is that pressure to increase take-up contributes to the complexity of the regulatory regime.

[A] Public pension policy goals in private pension regulation

It was suggested in the introduction to this paper that the adoption of a ‘layering’ reform strategy lay at the root of the difficulties with regulating private pensions. The government’s reform goals for public pensions engender a high degree of political interest in private pensions, and this means that the private pension layer cannot become autonomous and depoliticized. We can look for autonomy, or lack of it, through different lenses. One lens focuses on policy goals, asking whether the policy goals assigned to each layer are distinct. Intermixing of goals will lead to ongoing political intervention in private pension regulation. An alternative lens, used in the
next section, focuses on the actors involved in the different policy domains, in particular on the influence of the financial services industry over pensions policy.

An obvious process whereby goal interdependence between the public and private systems will arise is if an overall target for pensioners’ incomes is set in the public policy debate. In Germany, the Riester reforms were framed in the context of maintaining the ‘overall provision level’ (Gesamtversorgungsniveau) of a 67% replacement rate. Cuts in the public scheme would be matched by the expansion of private provision. Berner (2009b and this volume) notes that this concept has been quietly dropped from the political debate, but it is not yet completely clear that the government can release itself from commitments about the overall replacement rate.

Hegelich (2006) has questioned whether, looking at the underlying political dynamics of the pension reform, there can really be said to have been a shift to a DC scheme in Germany, in the sense that the parties accept that the pensions payable should be defined by market conditions. One possibility is that the political investments of successive governments in promoting private pensions may draw them into propping up the sector. Investors (insured people) are at least guarded against cash losses through the Nominalwertgarantie, but issues may arise in the future about honouring this guarantee. For example, the rules currently state that the guarantee cannot be financed by pooling between investors, but this rule might become impossible to sustain if providers get into financial difficulties. Ultimately, the government might have to honour defaults on the Nominalwertgarantie.

In the UK, governments have made no commitments about the overall level of pension adequacy, but this does not mean that no goals about adequacy exist. The framing of policy goals may not be completely in the gift or control of the government. The overall level of pensioners’ incomes will stay in the frame if policy analysts and advocates keep it there. In the UK, pension policy analysts have developed a wealth of information about the joint operation of the public and private systems. Furthermore, this information is often presented to the public by government agencies which have an ‘educational’ remit, to persuade people that they need to enhance their private provision because the public pension will be inadequate. Thus, while the government has avoided defining a target for pensioner incomes, it is inescapable that pension reforms will be evaluated by reference to all sources of pensioner income. The private pension layer may appear to create space to retrench public pensions, but, if it fails to thrive, it may also create a constraint on retrenchment.

On the other hand, the layering of pension provision may dilute political attention to adequacy by increasing inequality among pensioners. Some will fare well and, with the aid of tax concessions and subsidies, retire on a high income, while others remain primarily reliant on the state system. Taylor-Gooby (2005, Table 6.2, p.118) documents the vast gap between the best-off and worst-off pensioners in the UK and the contribution of private pensions to this inequality. In the two decades from 1979 to 1999, the top quintile of pensioners saw their real incomes increase by 80%, while those of the bottom quintile increased only 34%. One might expect that the relative unimportance of the public pension to higher income pensioners would erode support for public provision. At first sight, evidence for this is lacking. The national insurance (NI) pension remains a popular part of the welfare state, with strong majority support for a basic pension payable to all (Hills and Lelkes, 1999). However, the value of the basic pension relative to wages was allowed to fall during the Conservative era (1979-1997), and subsequent Labour governments have only stabilised, not increased, the NI pension.
In the UK, pensioners whose combined NI and private incomes are inadequate are helped by a wage-indexed means-tested safety net (currently called Pension Credit). This has expanded greatly in the last decade: about a quarter of pensioners receive the Pension Credit. If contribution rates to private schemes were high and the prospects for these schemes were good, this percentage might be expected to fall. However, contributors should rationally take into account the effect of private pension income on their means-tested entitlement. Furthermore, financial advisers selling private pensions should also consider possible effects on eligibility for means-tested benefits in giving pension advice. The introduction of ‘auto-enrolment’ from 2012 will be accompanied by a simplification of the rules governing financial advice, but it may also see workers accepting the default option and contributing to private pensions when they have little prospect of achieving an income above the means-tested level (Age Concern, 2007). In sum, pension adequacy is a public policy goal, but it is pursued with incompatible instruments.

Regulations concerning the annuitization of pension funds also reflect goal interdependence between the public and private layers. In both Germany and the UK, pension funds must be converted into a flow of income that can be drawn on in retirement, either by buying an annuity (in effect, insurance against the risk of a long life) or by other types of ‘income draw-down’ arrangement. Without annuitization or draw-down rules, people could use up their funds early in retirement and then become dependent on public provision. A similar logic applies to requirements for married contributors to purchase a joint annuity for both partners, and to ensure that the surviving partner has a pension. Compulsory annuitization reflects goal interdependence: to reduce claims on the public layer, restrictions are put on the form of private provision. The payoff for accepting these restrictions takes the form of tax concessions and subsidies. Thus public funds are engaged, albeit in an opaque way, in producing the desired outcome. However, annuitization requirements are not popular. To promote the take-up of private pensions, governments in both the UK and Germany allow 25-30% of the value of the pension fund to be taken as a lump sum. In Germany, it is permissible but not compulsory to purchase survivors’ benefits with the Riester fund. In the UK, the requirement to purchase a survivor’s pension will be abolished from 2012.

The regulation of the annuities market could also be affected by concerns about adequacy. This market is heavily dependent on financial instruments issued by the government, as insurance companies hedge interest rate and inflation risks with government bonds. The thinness of the annuity market has led to several proposals in the UK for the government to issue a wider range of instruments. For example, some commentators have proposed that the government issue ‘survivor’ or ‘longevity’ bonds whose future coupon payments depend on the percentage of the population of retirement age on the issue date of each bond who are still alive on the date of each future coupon payment. As Blake (2004, p.41) explains, ‘[t]he insurance company which buys such a security bears no aggregate mortality risk and, as a consequence, cost loadings fall’. In other words, the issue of such bonds would transfer longevity risk (the risk of the population living longer than expected) onto the future working-age population (future taxpayers). This idea was taken up by the Conservatives’ social security spokesman, David Willetts (2004). Willetts located the causes of the unpopularity of annuities in people’s incorrect expectations of their risk of living a long life, which, compounded by low inflation, made annuities look like poor value. In Willetts’ analysis, government could reduce the cost of longevity risk and make annuities more attractive by issuing bonds, thereby creating another implicit subsidy to the private pensions sector.
Hinrichs (2005, p.62) has argued that the Riester pension creates a ‘new politics of retirement income policy’ in which previously marginal actors have gained a stake, including ‘the various branches of the financial service industry offering the certified defined contribution schemes, the Ministry of Finance, which is involved with considerably more tax money than before, authorities regulating the emerging “welfare market” and its products, organizations protecting consumers’ interests, and the social partners in a new role as they enter collective agreements on occupational pensions.’ Inevitably, any account of the configuration of German regulatory politics after the Riester reform must be speculative, but the British experience yields some insight into how pension politics might be reshaped by privatization.

It was argued in the introduction to this chapter that the politics of regulatory policy processes are normally characterised by industry dominance. The financial services sector is of central importance to the establishment of private pension regulation as a separate policy ‘space’. By contrast, the Ministry of Finance/ Treasury will not be a promoter of regulatory autonomy. Its concern for achieving maximum public policy ‘leverage’ for minimum cost in tax concessions and subsidies is one of the main drivers of government intervention and policy change in private pensions regulation. For their part, consumer organizations and the social partners tend to link and bridge public and private provision, rather than focusing on the private pillar. The main exception arises when schemes fail. In these circumstances, contributors and pensioners have been vocal and well-organised, forcing the government to provide bailouts.

Since the financial services sector has a strong interest in promoting private pensions, one might expect that it would play a key role in defining an autonomous and depoliticized regulatory sphere for private pensions, which it could dominate. However, in the UK it has singularly failed to achieve this. Indeed, the evidence suggests that the industry has not been particularly influential in pensions regulation. This can be illustrated in several ways. The industry’s preferences regarding public pensions have been ignored, and its resistance to aspects of the government’s plans for widening private coverage overridden. Furthermore, it has lost status as a supplier of technical expertise to the regulatory process. The following discussion expands on each of these points in turn.

Some members of the financial services industry were quick to recognise that the government’s agenda of promoting private pensions contained threats as well as opportunities. The fastening of public policy objectives onto the private sector could easily produce regulation that was undesirable from the industry’s point of view. In particular, if private pensions were to become the main source of many pensioners’ income, issues about how to achieve adequate security for people of modest means could mean that regulation of investment decisions would become very risk-averse, lowering overall returns. Thus several of the large companies that contributed to the first consultations done by the new Labour government in the late 1990s argued that the state should provide a basic pension that would secure an adequate living standard. Subsequently, industry opinion moved wholeheartedly towards an improved basic pension as the adverse effects of rising dependency on means-tested benefits (see above) became more apparent. However, the financial services industry is just one voice among many in public pension policy, and this reform to public provision has not been forthcoming.

Pension privatisation called for a considerable widening of the financial services industry’s customer base. This could present opportunities: linked products could be sold, and financial literacy generally would presumably rise. However, as Taylor-
Gooby (2005, pp.121-2) reports, the initial response of the financial services sector to government proposals to create a DC pension layer was unenthusiastic. Providers recognized that administrative costs would be a problem in handling small accounts, and some also rightly predicted that households would prove resistant to the risks involved. One result was that, by the time the Labour government came to promote its stakeholder pension proposal, it was reliant on new entrants into the sector for positive endorsements and promises to engage as providers. When providers were asked for their views in a major consultation in 1997-98, one of the most enthusiastic responses came from the supermarket group Tesco, which advocated a low-cost scheme for investing pension contributions in tracker funds (Tesco and London Economics, 1998, section 2.1.7., p.14). (Tesco did launch a stakeholder pension in 1999, but soon abandoned it.)

The financial services sector can lay claim to distinctive expertise in two main areas: investment decision-making (fund management) and actuarial estimation and assessment of risks. However, as the Labour government’s attention focused on trying to reduce the charges levied by financial service providers, the industry’s fund management expertise was challenged. Analysis by the Treasury (1999) concluded that funds under active management did not outperform tracker funds (where funds are invested in a basket of shares - or an index of that basket - which tracks the stock market). However, the industry succeeded in retaining the option of active fund management in stakeholder pensions.

In the meantime, the actuarial profession suffered a severe blow to its prestige with the failure of the insurer Equitable Life. Equitable Life turned out to have made inadequate provision for guarantees that it offered on endowment policies. The focus of attention for this failure fell on the self-regulating actuarial profession. Actuaries had a central role in the old regulatory regime for insurance, where the ‘appointed actuary’ of an insurance company had responsibility for judging the adequacy of the company’s provision against the risks it had taken on. As Collins et al (2009, p.257) note, ‘[s]ince the appointed actuary was often a senior employee of the insurer, and typically a board member, the role relied on the individual integrity and professional judgment of the actuary.’ As one of the reports into the Equitable Life failure noted, the appointed actuary faced conflicts of interest between endorsing policies that were profitable in a competitive market, and ensuring that guarantees were not offered without adequate provisioning (Penrose, 2004). This structure of self-regulation proved to be inadequate to the competitive strains of the 1990s.

The prestige of the financial services sector was also dented by the mis-selling scandal, which arose when sales agents seeking to maximize their earnings from commissions persuaded savers to leave occupational schemes and enter personal pension arrangements where they were clearly worse off. Mis-selling was a failure of corporate governance by the large insurance providers, which should have recognized that their incentive schemes were producing perverse behaviour. Not only was mis-selling costly for providers (compensation for mis-selling totalled some £13.5bn (Blake, 2004, p.25)), but also the government inevitably responded with further regulation. Providers became subject to a detailed ‘advice regime’ that shifted some of the responsibility for households’ poor financial decision-making onto the sellers of financial products. Far from setting the regulatory agenda, the industry was placed under tighter and tighter control.

Why did the mighty UK financial sector so manifestly fail to dominate policy-making over private pensions and profit from the government’s privatisation plans? Writing after the financial crisis of 2007-09, it is tempting to accuse the sector of wholesale greed and short-termism. Certainly, competition seemed to contribute to short-run
strategies and failures of self-regulation, by contrast with the long era of stable provision of DB pensions (above, section 1). However, the government’s desire to promote private provision has also played a role in the sector’s difficulties. In particular, the widening of the customer base was not sought by the industry, and it predictably failed to deliver a good service.

[A] Conclusion: Worlds of welfare and regulatory politics
This chapter has shown how hard it is to reconcile regulatory autonomy for private pensions with the political strategy of layering. In Germany, the linkage between Riester pension expansion and social insurance contraction is very explicit. Despite the government’s efforts to free itself from the concept of a Gesamtversorgungsniveau, the frame of the political debate still encompasses the overall level of earnings replacement achieved by both pillars of pension provision.

In the UK, there is no focal concept of an overall level of adequate provision. Furthermore, the level of the basic state pension fell precipitously during the first phase of the reform process (up to 1997). This might be taken to signal a more favourable environment for the promotion of private pensions than in Germany, and certainly the rate of contribution to private schemes is higher (OECD, 2009, Pension fund contributions as a percentage of GDP). However, regulatory autonomy has not been established in the UK either.

The regulatory problems that arise in the course of reforming public pensions by adding a private pension layer differ with the structure of the public system. In particular, heavy reliance on means-tested benefits in the UK has created a ‘better off?’ problem in giving advice on private pensions, and has probably discouraged take-up. The financial services industry and others have argued that private provision would thrive if the government put in place an adequate universal public pension. Pension providers see an improved basic pension as a way of reducing regulatory intervention and enabling contributors to bear more risk in their funded pensions, instead of seeking security through low-risk, low-return investment strategies. Restoration of the basic state pension or the introduction of a ‘citizen’s pension’ was also advocated by the UK’s Pensions Commission, but it was rebuffed by the government on the grounds of excessive cost. While the Conservative opposition has expressed its disapproval of means-testing, it has made no commitment to increasing the basic state pension.

Esping-Andersen (1990) argued that residual provision in the liberal ‘world of welfare’ was unstable, because of the adverse effect of means-testing on market incentives. The paradoxical implication is that a so-called ‘liberal’ welfare state might not adopt a ‘liberal’ approach to market regulation. This can be illustrated by testing the British case against Hippe’s (2009) classification of neo-liberal regulatory policies. According to Hippe, these should include voluntary participation, reliance on competition to control costs, competitive fund management by private firms and use of individual solutions (such as ‘lifestage switching’) rather than pooling of risks to address market volatility in investment returns.

The measures introduced by the Thatcher government broadly fitted this pattern. The industry initially operated forms of interpersonal risk pooling (through with-profit funds) but this was not encouraged by the regulatory regime. However, since the late 1990s, the regulatory pattern has moved away from Hippe’s neoliberal ideal type. Automatic enrolment will soon take the place of voluntary participation. Stakeholder pensions were an attempt to push charges below the level achieved by market competition; the administration of individual accounts by PADA will use competitive
contracting-out, in which the government uses its power as monopsony purchaser to keep costs down. While active fund management is still available for stakeholder pensions, tracker options were encouraged, and again PADA will operate a more tightly-controlled approach to fund management. There is still no explicit risk-sharing mechanism to deal with market volatility, but the track record of bail-outs in DB pensions and the episodic policy discussions about how to support the annuities market suggest that further regulation on this front is possible, even likely.

In the rhetoric of reform in the UK, there has been a sustained attempt to establish a distinct set of values around private pension provision in support of the idea that individuals and households have personal responsibility for their well-being in retirement. Individual autonomy and control over one’s own fate is a primary market value. But attempts to entrench this value in the regulatory norms of private pension provision have encountered a great deal of resistance. As shown in the first section, the public response to the failure of DB schemes in the UK was that the government had a social responsibility for remediying the harm that had befallen individuals. This claim was directly derived from the government’s ‘layering’ reform strategy, as the government had actively promoted the shift into private pensions. For many commentators, it was self-evident that, by sponsoring the takeup of private schemes as substitutes for SERPS, the government had to guarantee a comparable level of security. For example, Casey (1998, p.58) argued that ‘where a function of the State is “subcontracted”, there is normally felt to be a need for the State to take some responsibility for those to whom it delegates its tasks.’ The usage of ‘subcontracting’ is telling, as it implies that public policy goals are being pursued by private means, rather than that an autonomous private sphere is created.

The regulatory policies adopted in Germany are also hard to fit into any of Hippe’s ideal types. On one hand, insurers are required to guarantee at least a zero nominal rate of return (the Nominalwertgarantie) and rules were made from the outset about the allocation of charges. However, there is no regulation of the overall level of charges, and the Nominalwertgarantie is explicitly not to be achieved by interpersonal pooling. Participation is largely voluntary, although participation through collective agreements introduces a less voluntaristic, more collective aspect to private pensions. It is perhaps the one clear instance where regulatory differences arise that reflect the more organised and regulated German labour market compared with its British counterpart.

In summary, we see different ‘worlds of welfare’ in public provision, but not in private pension regulation. The liberal welfare state does not produce a liberal approach to regulation, because of the perverse effects of means-testing. Similarly, there is not much that is ‘conservative-corporatist’ about German private pension regulation beyond the use of collective agreements to extend take-up. This suggests that we cannot understand the regulatory politics of private pensions by applying schemes based on worlds of welfare. Instead, we have to look at the specific features of regulatory politics: the goals of regulation and the political constituencies engaged in the regulatory policy process. The central finding of this chapter is that, in private pension regulation, goals and constituencies are strongly affected by the public pension reform agenda. Because governments have adopted a layering strategy for public pension reform, private pensions are highly salient politically. This is the fundamental reason why the model of autonomous market regulation found in utilities sectors has not developed in pensions.
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