A Pension Fund Freeze for the Winter Freeze

By Visiting Professor, John Clancy. Former leader of Birmingham City Council.

This winter's financial crisis has a short-term and then a long-term solution. It costs nothing and longer term could put the UK on a much more sound economic footing. The great Pension Fund Freeze can get us out of this mess.

All employers and employees should be given an immediate 12 months pension contributions holiday through an actual pension rebate through recalculation of the funds' and schemes' health statuses.

It might seem radical, but actually it really is simply there for the taking. It won't actually cost the Treasury a penny long term. In the circumstances it would be anti-inflationary as it would be relieving the pressure to raise wages.

It is targeted; but it will then also enable better targeting of the state's actual money to assist those without pensions or employers and businesses who for whatever reason aren'tpaying into pensions.

It would enable more to be targeted at pensioners themselves, as importantly. It will help individuals and households this winter in particular, and protect the wider economy by helping to prevent a sudden collapse in economic activity and a slide into deep recession

It will be paid for by literally a "refunding" process, in more ways than one.

Employers and employees alike have paid from their wages and payrolls what already have turned out to be significant ***overpayments to pension funds***, over the last decade at least. Over the next couple of years it will become even clearer how massive this overpayment has been. There will be surpluses developing in the schemes which will 'pay for' the break.

The re-calculation should be done now, not allowed eventually to come out in the wash over the next ten years, unnoticed. This will effectively then safely enable a pensions holiday for all employees and employers in the public and private sectors alike.

It can be done (as I shall explain later) initially by resetting the Discount Rate used for all public and private sector funds and schemes. The recalculation can be done in minutes, actually.

It should have been done in any event at least ten years ago by setting a floor in Pension Fund Discount Rates when central banks started printing money like crazy (a major departure from the workings of a free market) to fight the effects of the financial crash of 2008. And again when it started all over again to deal with Covid economic standstill.

This failure to set a floor in the first place caused the unnecessary overpayments and wrongly calculated deficit payments by employers, because pension funds used the same functioning markets calculations, when there wasn't a functioning market – these should have been suspended, at least. They weren't.

Employers and employees in the public and private sectors alike have already paid too much over the last few years, so there is no threat to the long (or short-term) viability of the funds or schemes. The Pension Funds/Schemes or the Treasury have actually asked for contribution rates from employers and employees at too high a level, so over time this money would have effectively refunded piecemeal and unnoticed over the next decade.

Let's just let it happen in one go this coming year – a big bang Pension Fund Freeze.

In the public sector a recalculation of the sums paid by local government can impact on local government bills this year. Similarly, the NHS, the civil service, army, schools, universities etc. set against a backdated revaluation of the overpayments of the last 10 years would work (the only area where the treasury may squeal short-term) and address their energy spending squeezes. The vast pension fund industry iceberg will simply cope. It will cope precisely because it is fast becoming clear that, since the interventions by centralbanks after the financial crash of 2008 and Covid, vastly too much money has been paid into pension funds in error by everyone.

As even auto-enrolled workplace pensions effectively mirror what has been happening in the larger funds and schemes, they, too, should have a pensions repayment holiday without harm to the scheme or future level of pensions.

Businesses should also see a repayment holiday on the now incorrectly calculated deficits on funds and schemes due to the wrongly applied Discount Rate. It will be an existential life-saver for many.

As I have pointed out repeatedly in my blogs here, illusory deficits in pension funds in the private sector, due to deficit calculations which simply don’t hold water, have been the cause of continual investment drag on well-run businesses and have caused widespread, unnecessary business failure.

Energy bills in homes and businesses can be offset by the holiday until this irons itself out or better planning than going bust can be given time to work.

The Discount Rate

Because the contribution rates of both employers and employees in the public sector over the last ten years have deliberately followed the private sector rates (through themechanism know as the Discount Rate), then so will have been the public sector’s. The Treasury’s ultra long-termforecasts for what they will have to pay in public sector pensions are based on those private sector pension funds’ practices and procedures. These public sector schemes are, after all, mostly unfunded, notional, pretend pension schemes.

Simply put, the funds and schemes work out how much they will owe to pensioners in the future based on this all-powerful always resetting Discount Rate. And this rate has now fundamentally changed due to the ending of money-printing by central banks resulting from the Crash in 2008 and then Covid in 2019-22.

As both interest rates increase and central bank money printing unwinds, so the discount rate rises. Deficits fall when the discount rate rises. So the funds will suddenly and inevitably find themselves in very rude health indeed. We will likely see widespread actual surpluses. The treasury will similarly recalculate what it will owe public sector pensioners, too.

The discount rate as used by pension funds should never have actually fallen. It created unnecessary, short-termist, illusory and (it turns out) incorrect long-term calculations of deficits. And so contributions, especially by employers on the payroll and payments down of wrongly calculated deficits, were unnecessarily hiked by funds (mirrored by unfunded schemes).

The USS Pension Fund – the U.K.’s biggest

This has become particularly clear this summer following the news from the biggest actual pension fund in Britain – the £82 billion Universities Superannuation Scheme. It’s an actual pot of money retained to pay out pensions now and in the future for academics. But over the last few years academics have been squealing as the fund has demanded ever-increasing contributions from them and their employers, the universities, due to an apparently increasing “Deficit”.

The (clearly now illusory) deficit, however, suddenly all but disappeared in one year when the accounts were publishedover the summer. Being the biggest in the UK, it is an indicator in macrocosm that actually the calculations of ALL pension funds, private, public and notional schemes which follow them have been way out (despite repeated warnings that they were based on figures which bear no relationship to reality).

The funds and schemes across the piece (not just the USS)miscalculated, but kept on making the same mistake year after year, because they literally had no idea what else to do. And the government and the treasury and the pensions regulator didn’t tell them what to do, which they should have.

Over the next few years, the main reason every pension fund and scheme in Britain will be mirroring the USS’s experience is because of the now apparently inescapable increase in interest rates. Bad for borrowers and households paying mortgages, but actually brilliant for pension funds.

The USS experience in suddenly mislaying its deficit, due to (they say) a particularly good year on the financial markets, will soon be compounded even further and will be in an even better position. This is because the way any pension fund calculates its present and future health is determined by interest rates.

If the USS was working with a recalculated, now continually increasing Discount Rate (which they have done slightly already) they would be moving into surplus. The funds have chased risky equity returns to cope with the wrongly set Discount Rate giving them illusory short-term deficits, so compounding the deficit when the markets fall.

Which is why a 12 month repayment holiday of some kind would not affect the pension funds’ or schemes’ liquidity or future health – it would not weaken them at all. It would at worst have a neutral effect. The state and the funds have been massively overpaid these last few years by employers and employees and they are due a rebate.

The second act should be for the government seriously to prepare to nationalise the unnecessary public sector pension funds out there in order to create a new U.K. Sovereign Wealth Fund, or SWFs for each nation in the UK. The USS and the Local Government Pension Scheme (actually a fund) now has assets worth almost $0.5 trillion – and they are failing Britain and are completely unnecessary. But that’s for another blog.

Politicians (not least an incoming PM and government) need to wise up and in times of crisis need to rebalance this part of the economy. It costs the taxpayer less than sudden fiscal or untargeted welfare intervention. Business and public sector institutions could breathe a sigh of relief as they approach this winter that there is help on the way.

And if likely incoming PM Truss wants a precedent, the last PM to bring in legislation to pave the way for pension payment holidays (then just by employers, and local councils) due to surpluses was her heroine – one Margaret Thatcher in the 1980s.

The pension fund industry will preach doom and gloom because things as they are mean a lot in terms of fees to them.

But let’s fight Putin’s attempt to cripple the UK economy through an energy war by radical acts of economic self-determination now. It can be done with the stroke of a pen, or a keystroke, by a regulator or in a fiscal event or emergency budget. In times of dire need, let's give Britain its money back.