

The Pensions Trust

Response to the White Paper “Personal accounts: a new way to save”

The Pensions Trust, established in 1946, is the leading multi-employer occupational pension fund in the UK for the charitable, social, educational, voluntary and not-for-profit sectors. We are directly accountable to our members – the employers who choose our pension schemes and the active members, pensioners and deferred members who belong to these schemes.

As a result, our motivation to provide a first-class service at all times is driven not by profit but by a close and real involvement with the people who use our services. This helps us to understand our customers’ needs and to adapt our product offerings accordingly.

We offer a range of pension arrangements including stand-alone final salary schemes, multi-employer final salary schemes, a money purchase plan and a career average revalued earnings (CARE) scheme, and have more than 160 staff serving over 4,000 employer organisations with over 120,000 members and pensioners, from offices in Edinburgh, Leeds and London.

The Board of Directors of Verity Trustees Limited, the corporate trustee of The Pensions Trust, has 16 members of whom 8 are elected by participating employers and 8 by pension scheme members.

This response to the White Paper proposals includes the views of Directors of Verity Trustees Ltd.

By the very nature of the sectors we serve, few of our members are highly paid – they are, in the main, middle-income earners.

Whilst naturally the effect of the proposals on the Pensions Trust as an organisation is of concern to us, we are primarily motivated to respond to this consultation by our concerns for the wellbeing of our members.

When we responded to the White Paper “Security in retirement: towards a new pensions system” we had concerns about how the proposed reforms would work, the greatest of which was the risk of levelling down in employer contributions following the introduction of personal accounts. We regret that this White Paper has not alleviated those concerns.

In our response we have used the chapter names and paragraph numbering used in the White Paper.

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General comments

We feel it necessary to repeat some of the general comments we made in our response to consultation in September 2006.

There have been many pension reform initiatives since the late 70s; each initiative was designed to resolve the perceived problems at those times. In practice, few have worked properly and much has been tampered with, and we now have one of the most complex pensions systems in Europe to contend with. As a result, the Government has not yet established confidence and trust in its policies on pension issues. **We urge Government to ensure that all-party support is secured otherwise pensions will continue to be a political football, as they have been for many decades. Furthermore, we urge that this support extends to the all-important detail of future changes where Government's track record does not inspire confidence.**

The introduction of personal accounts will hopefully facilitate a major increase in the number of people saving for retirement, but it could have significant detrimental effects on existing pension schemes and their existing and potential members. Government needs to be certain the new arrangements will work before it marginalises providers of the existing pensions system because, once marginalised, that system will not be able to provide and existing and potential members will be the losers. **We therefore urge Government to be absolutely sure that the implications for existing schemes have been thought through before finalising its proposals for personal accounts.**

The final and full removal of Advance Corporation Tax credits on U.K. equity dividends was imposed in 1997. In our view, the loss of ACT relief on a mixed portfolio costs about 17.5 basis points a year (0.175% of assets). This amounts to more than half of the proposed longer-term charge of 0.3% for personal accounts. **We recommend that if Government is serious about maintaining a high level of private pension provision, as a sign of good faith ACT relief should be reinstated.**

1 Individuals and automatic enrolment

1.3 - we note that means tested benefits were not listed as a barrier which stops the target group from saving enough for retirement. When we responded to the September 2006 consultation we expressed the view that means testing acts as a disincentive to private saving and its retention is almost certain to undermine the success of personal accounts. We stand by this and we agree with Steve Bee of Scottish Life that savers should be £1 better off for every £1 saved; the current system of means testing will not produce that end result. If means testing continues, then lower earners who remain opted-in to a personal account may find at retirement that they have replaced from their own savings an income they would otherwise have received from the State. People will feel cheated and their mistrust will extend to all forms of pension provision. **We again urge Government to be open and honest about the impact of means testing and to provide clear information to enable people to make appropriate choices, and in particular whether or not to opt out of the personal account system.**

1.13 – when we responded to the September 2006 consultation we expressed our reservations that the minimum contribution of 8% of the personal accounts earnings band ('PAEB') is unlikely to deliver a meaningful benefit until personal accounts have been running for many years. It is also not clear what impact the proposed changes to the state second pension (in the Pensions Bill 2007) may have on individuals' total retirement income. People must not be lulled into a false sense of security. **If combined benefit statements, showing individuals' projected total retirement income from state pensions and personal accounts, were to be issued this would go some way to allaying our concerns in this area. (See also 3.29)**

1.14 – we note that it is proposed that employees with earnings below the PAEB lower threshold may opt in to personal accounts, but there will be no requirement for an employer contribution. We are concerned that this will constitute indirect sex discrimination, as women will be affected to a far greater extent than men. The absence of an employer contribution will make it very difficult to encourage individuals with two or three part-time jobs, with combined earnings that place them firmly in the target group, to save in a personal account.

1.21 – We do not understand why the cohort of employees approaching state pension age when personal accounts are launched should not be automatically enrolled. If Government truly believes the vast majority would benefit from saving in a personal account, why should such a group be excluded from automatic enrolment? If individuals do not wish to save, they can opt out.

1.24 – We agree that three years appears to be a reasonable interval for automatic re-enrolment, given that individuals' circumstances can change quickly and inertia may prevent them from actively seeking to enrol in a personal account. However, automatic re-enrolment will place an administrative burden on employers as they will need to set up and maintain a reminder system to record details of employees who have opted out and the date when they must be re-enrolled.

3 Delivering personal accounts

We are encouraged that Government intends to draw on private sector expertise in setting up and running personal accounts.

3.25 We believe members interests would best be represented in the governance of personal accounts by an appointed or elected trustee body. Elections will add to the cost of running personal accounts, so initially a system of appointments may be more cost-effective.

3.29 We believe members should receive the same information that must be provided by occupational pension schemes and contract-based arrangements. Annually, members should receive a statutory money purchase illustration and a combined benefit statement including their state pension projection. **Given the DWP's ongoing efforts to persuade occupational schemes to provide, at their own expense, a combined benefit statement to all members it would be a serious omission if personal accounts were not to provide this information.**

If the administrative burden on employers is truly to be minimised, then general and member-specific information to support personal accounts should be disseminated by the Board or by the various service providers direct to members and not via employers. In the interests of transparency the cost of providing information should be factored in to the cost of running personal accounts, just as it has to be for private schemes.

4 Charges and financing

Box 4b We have read that the US Thrift Savings Plan and the Swedish PPM are subsidised by employers or by government, and so question whether it is appropriate to use these as examples of systems where costs have been driven down?

4.13 We believe that a fair charging structure would be achieved by charging the greater of a percentage of contributions and a percentage of the member's fund value. A charging structure of 4% of contributions or 0.3% of assets, whichever is greater, would seem appropriate.

The delivery authority or board should have flexibility to decide the charging structure within set parameters.

It would appear reasonable to make additional charges for investing in higher cost asset classes, or switching asset classes more than once in a given period.

5 Investment and accessing saving

5.16 We believe that it would be reasonable to restrict the number of investment options and to pass on to the individuals concerned any higher charges associated with their choice of investment options.

6 Employers and private pension reform

6.15 – 6.21 We note the exemption criteria for different types of occupational scheme and agree that these are largely reasonable. We do retain our concerns (first expressed in our response to consultation in September 2006) that the requirement to auto-enrol into a more costly arrangement as a condition of gaining exemption will deter a great many employers from seeking exemption. **We believe very many of our participating employers will consider offering personal accounts as a cheaper alternative to their current arrangements.**

This will lead to personal accounts competing with and driving out occupational schemes that are, in fact, better for their members than personal accounts. The stated intention that personal accounts should ‘complement and not replace’ will not be realised.

6.27 We note that government is not proposing a waiting period for personal accounts, though it ‘recognises there will be a short period before the automatic enrolment process is completed’.

If there is no other workplace pension scheme available, then we would recommend that a limit is placed on this ‘short period’ to discourage employers from delaying, but that this time limit should be long enough to reduce enrolments where the employment turns out to be very short-lived. We propose that employers should be encouraged to complete their part of the auto-enrolment process perhaps no later than four to six weeks after a weekly-paid employee starts work, by the third payroll run after a fortnightly-paid employee starts work, and by the second payroll run to be processed after a 4-weekly or monthly paid employee starts work.

However, if there is a good workplace pension scheme available, meeting the criteria for exemption (with the exception of auto-enrolment), we propose that a slightly extended waiting period for personal accounts should be permitted for the reasons set out below.

The Pensions Trust remains concerned for good existing schemes, in particular defined benefit schemes, which want (for now, at least) to remain open to new members and with existing or near to existing high quality benefit structures. These schemes would probably find it impossibly costly to operate auto-enrolment because of the much higher membership take-up that is likely to result.

As mentioned above, if a good existing scheme seeks exemption from personal accounts, the employer is exposed to the cost impact of more of its employees joining the scheme as a result of auto-enrolment. We believe many good schemes are therefore unlikely to apply for exemption.

The following proposal might provide a means whereby the existing 'good' scheme can continue to enrol successfully without auto-enrolment, but with auto-enrolment into personal accounts retained as the second stage option for employees. From our reading of chapters 6 and 7 of the White Paper, Government's present proposals do not permit this, so we would ask that our proposal be given serious consideration.

- The existing scheme must have the standards to qualify for exemption from personal accounts, however ultimately defined, although it would not seek exemption.
- **Whether or not the existing scheme has a waiting period, our key proposal is that a slightly extended waiting period should be allowed before auto-enrolment into a personal account, in order to allow the existing scheme to offer voluntary enrolment to all new staff. We would suggest no longer than three months to help meet the Government's objection in 6.26 that a longer waiting period would mean significant loss of pension (under personal accounts) for frequent job movers.**
- At the end of the agreed waiting period, new staff who have not chosen to join the existing scheme would be auto-enrolled into a personal account.
- At the commencement of personal accounts in 2012, existing staff would be auto-enrolled into a personal account (rather than into the employer's scheme).
- For schemes that operate a waiting period, the situation might need to depend on what is decided under 6.31. If such schemes are permitted to operate a waiting period before auto-enrolling, then if they had opted to take the Personal Accounts route as above perhaps they could be required during the waiting period to obtain a non-binding commitment from eligible staff to sign up to the existing scheme at the end of the waiting period. All other new staff would be auto-enrolled into personal accounts at the end of the agreed period as above. If any staff member who had indicated the wish to join the existing scheme when eligible failed to do so, they would at that point be auto-enrolled into personal accounts.

6.31 We support the use of waiting periods in existing superior schemes seeking full exemption. The length of the waiting period should be linked to the quality of the existing scheme – a six month waiting period would not be unreasonable for a 60ths Final Salary scheme, but would be too long for a DC scheme offering contributions very close to those payable to a personal account.

6.33 Regarding re-enrolment into exempt occupational schemes, some protection for Trustees/employers will be required where the scheme includes death benefits and enhanced terms on retirement due to ill-health. An employee who had opted out of such a scheme and then became ill would be most unlikely to be allowed to join the scheme at a later date. Even if the Trustee did allow this then they might restrict or refuse life assurance cover and access to ill health benefits. **Schemes should be permitted to protect themselves against 'selection against' instances like this. If not, employers may be further discouraged from seeking exemption.**

6.40 Phasing in the minimum employer contribution to an exempted occupational DC scheme over a three year period is workable, though there may be pressure from employees or their representatives for employers to pay the full normal employer contribution straight away.

Phasing in a minimum level of DB accrual over a period of time is going to involve additional actuarial and other professional advice, and may require new, lower-accrual sections to be added to an existing scheme. Employers are unlikely to have an appetite for the complexity and cost of phasing in the minimum accrual rate.

Phasing in membership of an exempt DB scheme by groups of employees is workable, but the employer will have to agree with employees and their representatives the order in which sections of the workforce will be enrolled and when. Employers may feel obliged to take legal advice if they fear their proposals might be perceived as giving rise to indirect discrimination on grounds of gender or age depending on which groups are given priority.

The regulations should give employers sufficient comfort and protection to minimise or, preferably, remove the need for expensive professional advice on their ‘phasing in’ proposals.

7 Personal accounts and existing pension provision

7.15 We agree there is a strong case for prohibiting transfers between personal accounts and other pension products and schemes, in order to protect existing schemes while personal accounts are established and ‘bed in’. However, the Pensions Act 2004 requires leavers from occupational schemes with 3 to 24 months’ service to be offered a transfer value option; if the option to transfer is not taken up then a refund of contributions may be paid. As refunds of contributions benefit occupational DB schemes (by generating a small surplus which remains in the schemes), we will be happy for no such transfers to be paid to personal accounts. However the proposal would seem to be at odds with the intention behind the PA2004 provision to encourage pension saving and reduce the number of refunds being paid.

7.19 If transfers are prohibited, a review in 2020 seems sensible.

7.24 A normal annual contribution limit of £5000 appears to be high enough to put personal accounts into competition with occupational schemes so **we would not be in favour of a higher limit being considered until the personal accounts initiative is reviewed in 2020 when the impact on existing schemes should be assessed.** We note this annual limit would be kept under review. We note also the proposals for higher contributions in year one.

7.26 The proposal to allow higher contributions in the first year only is perplexing. Is it wise to give a one-year window of opportunity on day one, when a huge new system goes live? Is the intention to encourage individuals to join in the first year to boost membership and funds under management, so that personal accounts can appear to be a success? Individuals may be wary of investing other savings in an untried, untested new initiative, so it may be preferable to allow additional savings to be transferred over a longer introductory period of, say, 3 to 5 years. We hope that information would be made available to highlight the pros and cons of transferring other savings into a pension arrangement.

Concluding comments

The Pensions Trust spent a lot of time on its response to the September 2006 consultation and we were very disappointed that none of our concerns appear to have been addressed. In closing, The Pensions Trust's key concerns remain:

Auto-enrolment

We urge government to consider very carefully how personal accounts are to be offered in workplaces where the employer offers a comparable or better scheme (whether after a waiting period or not) but cannot seek exemption as it cannot afford to auto-enrol all employees into the existing scheme. As the proposals stand, auto-enrolment is a pre-requisite for exemption. If a scheme is not exempt then the employer must auto-enrol into personal accounts which have no waiting period. These measures will not protect existing schemes and employees as a whole will be disadvantaged. **We believe that our proposals in 6.27 would reduce the potential for competition between existing good schemes and personal accounts, allow personal accounts to more truly complement existing provision and, most importantly, be in the best interests of employees generally.**

If auto-enrolment reduces the number of members in more beneficial occupational pension schemes, then we cannot accept the harm that auto-enrolment could cause to these schemes and their potential members as a worthwhile trade-off to achieve higher numbers saving for retirement

Levelling down

We still have grave reservations that personal accounts will lead to a levelling down in employer contributions; and as such do not go far enough to protect existing workplace pension provision.

If the current proposals are implemented, we foresee that many employers will not complain as their payroll costs may reduce (due to lower pension contributions and wage restraints); the taxpayer will not complain as less social security will be paid; and Government will not complain as more people will be saving.

The wealthy will look after themselves; middle income earners will lose out as pension pots will be lower; and those on the lowest earnings may save while working only to find they have replaced Pension Credit that the State would otherwise have provided.

We cannot support personal accounts unless measures are put in place to protect existing workplace pension provision. We urge Government to ensure that “complement, and not replace” is not just fine words but also the end result. Otherwise there is a significant risk that the concept of personal accounts will turn out to be yet another example of tinkering - it will solve one problem (not enough people saving) and create another (the final destruction of our current system of workplace pension provision) with the result that middle income earners will be worse off in retirement due to the levelling down effect personal accounts will have on existing provision. If middle income earners will not save enough, then is it worth putting the new system in place?

We urge government to learn lessons from the levelling down that took place following the introduction of Stakeholder pensions in October 2001 and to ensure that “complement, and not replace” is the end result.

Confidence, trust and consensus

Government has not yet established confidence and trust in its policies on pension issues. **We urge Government to ensure that all-party support is secured on both the principles and the all-important detail of the proposals; otherwise pensions will continue to be a political football, as they have been for many decades.**