



The Pensions Trust

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Response to the White Paper “Security in retirement: towards a new pensions system”

11 September 2006

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The Pensions Trust, established in 1946, is one of the leading multi-employer occupational pension funds in the UK for the charitable, social, educational, voluntary and not-for-profit sectors. We are a unique ‘mutual’ organisation and, as such, 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, or the need to provide returns for shareholders, but by a close and real involvement with the people who use our services. This helps us to understand our customers needs and allows us 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 the Directors of Verity Trustees Ltd.

By the very nature of the sectors we serve, many of our members are not 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.

We recognise that much of the detail is not available yet, but at this stage we have concerns about how the proposed reforms will work, the greatest of which is the risk of levelling down.

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

For further information please contact:

Richard Stroud
Chief Executive
The Pensions Trust
In Tuition House
4th Floor
210-212 Borough High Street
London
SE1 1JX
Tel: 020 7788 0100
Fax: 020 7788 0129

General comments

There have been many pension reform initiatives since the late 70s; each initiative was designed to resolve the perceived problems. 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.**

Simplicity is one of the key tests for pensions reform. **If simplification is really desired then somebody or some organisation needs to be appointed with very significant authority to ensure that simplicity is delivered.**

The proposed personal accounts scheme 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, such as The Pensions Trust (see pp3-4). Whilst this may not be Government's problem, 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. **We therefore urge Government to be absolutely sure that the implications for existing schemes have been thought through before going down the personal accounts route.**

The final and full removal of Advance Corporation Tax credits on U.K. equity dividends was imposed in 1997. Since then stock market valuations have been poor and pension schemes are struggling. 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 Encouraging and enabling private pension saving - Personal Accounts

1.1 Adequacy

The proposed personal accounts scheme (1.46) will hopefully facilitate a major increase in the number of people saving for retirement, but we have reservations that the minimum contribution (1.106/7) is unlikely to deliver a meaningful benefit. **We recommend that a 'health warning' be attached to minimum contributions; people must not be lulled into a false sense of security.**

1.2 Auto-enrolment

We understand the rationale for auto-enrolment into personal accounts (1.85) to achieve higher participation and lower charges, but we have concerns that auto-enrolment will result in personal accounts competing against existing workplace schemes.

- 1.2.1 Very few of The Pensions Trust's 4100 employers operate auto-enrolment into the schemes they run with us; some have contemplated this, but have shied away on the grounds of cost. Auto-enrolment into existing arrangements would lead to greatly increased employer costs and it is therefore highly unlikely to be voluntarily adopted by charities and not-for-profit organisations with regard to their current pension arrangements unless they are paying contributions very close to the levels anticipated for personal accounts.
- 1.2.2 If an employer's existing 'good' scheme has a waiting period of, say, 12 months before an employee can join and in the meantime they are auto-enrolled into a personal account, these employees may stay in the personal account rather than join a superior arrangement, to their detriment.
- 1.2.3 Where the existing workplace scheme is a defined benefit scheme, there is a further concern. If younger, (usually) lower paid employees do not join the employer's defined benefit scheme as a result of being auto-enrolled in a personal account, the membership profile of the employer's scheme could change for the worse (the average age and salary of the membership is likely to rise) and the cost of providing benefits could increase. The viability of the defined benefit scheme could be threatened.

It would be disastrous if the introduction of personal accounts were to damage existing pension provision. Requiring auto-enrolment into existing schemes is not proposed, and would not be acceptable. Removing waiting periods from employers' schemes is not acceptable; neither, it would appear, is the obvious alternative of imposing a waiting period for personal accounts. **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 after a waiting period.**

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

1.3 Levelling down

- 1.3.1** In the face of competition from personal accounts, whether due to auto-enrolment or lower contribution rates, there is a real risk that final salary schemes still open to new members and/or future benefit accrual will close to new entrants, and levelling down will result. We believe most of our participating employers will consider offering personal accounts as a cheaper alternative to their current defined benefit arrangements to save on the increasing costs of voluntary occupational pension provision.
- 1.3.2** A great many of the participating employers in our Defined Contribution scheme pay a higher contribution on behalf of employees than will be required under the personal accounts scheme. There is a danger that they will level down their contributions for at least all new starters.
- 1.3.3** When Stakeholder pensions were introduced, six of our clients closed their good final salary schemes and offered a low contribution stakeholder instead. Take up has been very poor. **We urge Government to take lessons from the levelling down that took place following the introduction of Stakeholder pensions in October 2001.**
- 1.3.4** **We simply do not believe DWP research suggesting that only 1% of employers who face cash constraints with the introduction of the personal accounts scheme are likely to ‘level down’ (1.118)** The reality is that most employers have a limited budget for pension contributions. One would expect the impact to be most significant on those Defined Benefit (DB) schemes that are still open to new members, given the (in general) significantly higher employer contribution cost.

1.4 Replacement of means-tested benefits

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. **We urge Government to be open and honest about this and to provide clear information (per 1.136) to enable people to make appropriate choices.**

1.5 Charges

We remain unpersuaded that the product can be offered at 30 basis points (one fifth of the maximum initial charge for stakeholders) in anything but the very long run (1.182). 60 basis points seems more realistic in the short and medium term. We share the Pensions Policy Institute’s belief that the level of investment returns is likely to have a greater impact on final pension income than charges might.

Although we welcome the principle of more people saving for retirement, the proposals for personal accounts give us serious concern for the future of occupational pension provision, despite the White Paper saying “personal accounts are intended to complement, and not replace, existing pension provision from employers” (1.113) 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 lower earners may save while working to find they have replaced Pension Credit the state would otherwise have provided.

We cannot support personal accounts unless a means is found to protect existing workplace pension provision. We urge government to ensure that “complement, and not replace” is 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?

1.6 Supertrusts

- 1.6.1** Provided that a means can be found to protect existing workplace pension provision from the threats posed by auto-enrolment and proposed low contributions, we prefer the NAPF proposal for “Super Trusts” to the proposal for the personal accounts scheme. Whilst you have indicated that the Supertrust proposals do not completely meet your criteria, this is probably due to a lack of investment choice. If 80% + of the membership will end up in the default option, we have to question the importance of investment choice. If investment choice is required, it can be offered at additional cost. **We recommend that Government reconsider the Supertrust approach.**
- 1.6.2** The Pensions Trust would consider running a Supertrust for charities and not-for-profit organisations. The personal accounts scheme as presented in the White Paper is a ‘bare bones’ product. A Trust based DC arrangement offering a wide range of actively managed funds, including ‘guest fund managers’ and add ons such as life assurance would appear to be attractive compared to what might be on offer from the personal accounts scheme. However, it is unlikely we could deliver this for 0.3% in the short term. A figure of 0.6% reducing over a 10 year period is feasible.

2 Strengthening existing provision

2.1 Proposals to simplify defined benefit contracting-out

The White Paper proposes (2.31) that schemes may convert GMP into scheme benefits. 'Pre 1988 GMP' is fully indexed by the State, and 'post 1988 GMP' increases above 3% are met by the State. We need more information on how the proposals will work without detriment to schemes. **We would be opposed to any proposal that would pass the cost of post-retirement increases back to the scheme. This would increase scheme liabilities and deficits. The industry has already invested in administration systems to deal with GMPs so we question the cost savings quoted as an incentive to schemes to consider this change (2.32). In any case, cost savings would not compensate for the increased liabilities and deficits.**

2.2 We welcome any attempts to simplify pensions regulation (2.42/45). **We recommend that a start be made with areas that were not fully thought through to start with, such as debt on leaving a multi-employer scheme.**

3 Providing a foundation for private saving

3.1 Simplicity

Simplicity is one of the five key tests for reform (Exec Summary 51) but simplicity does not appear to be the end result of the White Paper proposals for State pensions.

For example, we note S2P will become flat rate from 2030 but it will increase in payment in line with prices (not earnings, like BSP and Guarantee Credit). The qualifying period for full benefit will be shorter, but the benefit will be paid at a later age. NICs will continue to be payable during employment until retirement, which might be 20 years after qualifying for the full state pension. Is this simplicity?

We recommend that Government should rigorously re-examine the proposals for state pensions as the 'simplicity test' is not being met and much more could be done to simplify state pensions.

3.2 Basic State Pension (BSP)

We welcome the measures being proposed to extend the coverage and value of Basic State Pension (reduction in qualifying years; carer credits; increasing BSP in payment in line with earnings) and the potential reduction in numbers reliant on means tested benefits (3.13; 3.16).

3.3 State Pension Age (SPA)

3.3.1 We accept as inevitable the increase in SPA (3.34) in line with the increase in longevity and rise in the dependency ratio; Government is correct to recognise the need to make pensions sustainable in terms of costs.

3.3.2 However, although people are generally living longer, it does not necessarily follow that they will still be in good health and able to continue to work past the age of 65. The greatest adverse effect will be on manual workers because of the nature of their work. We note there is now scope to delay drawing the State Pension in return for either a taxable lump sum or an increased pension at eventual retirement. **We recommend that the possibility of offering 'early retirement' from the State Pension, which would be payable at reduced rates, should be investigated.** This would alleviate the effects of future increases in SPA and would cater for those who want this flexibility.

3.4 Means testing

3.4.1 Whilst we welcome the measures proposed to reduce, over time, the numbers eligible for means tested benefits (3.65), nevertheless it appears that means testing will continue indefinitely. **Means testing acts as a disincentive to private saving and its retention is almost certain to undermine the success of personal accounts.**

3.4.2 We recognise that affordability is an issue, and to increase the current BSP to the subsistence level of the Guarantee Credit (£114.05pw) for all might be too expensive. However, subject to cost analysis, we believe that reliance on means testing could be greatly reduced if the following proposal were developed and implemented:

The current BSP could be split into two parts: (1) a basic state pension and (2) a supplementary state pension. Both elements would be payable to everyone who qualifies, on whatever basis. At current levels the basic state pension (single person) is £84.25 a week and the supplementary basic state pension (single person) would be £29.80 a week, making £114.05 in total - the level of the Guarantee Credit.

If the tax and benefits system were aligned, taxpayers would pay extra tax so that they did not receive the £29.80 p.w. at all i.e. 100% of the supplementary pension would be clawed back through taxation. In effect, non taxpayers would receive the full amount of £114.05 a week but taxpayers would not.

4 Extending working life in an ageing society

4.1 As SPA increases, people must work for longer and much of this chapter concentrates on measures to encourage and assist the individual to work for longer. This is one side of the equation; however, employers will need to be more flexible in their approach to employing older workers. **Employers are unlikely to take this forward on a voluntary basis so legislation will be required.**

Concluding comments

In closing, The Pensions Trust's key concerns are:

Auto-enrolment (1.85)

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 after a waiting period, or where the employer cannot afford to auto-enrol all employees into the existing scheme.

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

Levelling down (1.113)

We cannot support personal accounts unless a means is found to protect existing workplace pension provision. We urge government to take 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.

Supertrusts (Box 1d)

We recommend that Government reconsider the Supertrust approach as an alternative to personal accounts.

State pension simplification (Executive Summary 51)

We recommend that Government should rigorously re-examine the proposals for state pensions as the 'simplicity test' is not being met and much more could be done to simplify state pensions.

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 otherwise pensions will continue to be a political football, as they have been for many decades.