

Chartered Secretary
focus

*Issued as a supplement to the **ICSA** magazine*



The Pensions White Paper:

Are Government reforms heading in the right direction?

The Pensions White Paper

- ◆ A National Pensions Savings Scheme (also referred to as the 'personal accounts' scheme) will be introduced from 2012. Employees will be automatically enrolled into the scheme, but can choose to opt out. Contributions to the scheme will total eight per cent of all yearly earnings between £5,000 and £33,000, of which employees would pay 4 per cent, employers 3 per cent and the Government 1 per cent. Both employee and employer contributions would be phased in over three years.
- ◆ Non-employees (non-workers and self-employed) will be allowed to opt in to the scheme, while employers whose existing occupational schemes fulfil certain criteria will be allowed to opt out.
- ◆ The personal accounts will be administered by either a single organisation or a number of pension providers. There may also be extra financial assistance available to small businesses to help them cope with costs.
- ◆ The link between the state pension and earnings will be restored from 2012, and the amount of time needed to qualify for a full state pension reduced to 30 years.
- ◆ The retirement age will be increased in stages, increasing to 66 by 2026, to 67 by 2036 and finally rising to 68 by 2046.
- ◆ The initial contribution conditions for the basic state pension will be abolished, and entitlement to the basic and second state pensions simplified. The second state pension will be moved onto a flat rate basis from 2030.
- ◆ The contracting out of defined contribution schemes will be abolished, to reduce administrative complexity and remove confusion, and legislation brought forward to allow schemes to convert Guaranteed Minimum Pension rights into scheme benefits.
- ◆ Home Responsibilities Credit Protection will be replaced with a new 'carer's credit', and a new contributory credit will be introduced for those caring for the severely disabled.
- ◆ A rolling deregulatory review of pensions regulation will be introduced, and a Pensions Law Rewrite Project piloted.



William Booth is Editor of
Chartered Secretary

High stakes

The Pensions White Paper, unveiled in May, is a big gamble for a Government as deep in the political doldrums as the current administration.

It's still too early to tell whether it will turn out to be a success or not, but pensions have been something of a millstone around the Government's neck ever since Gordon Brown's removal of £5 billion in tax credits from pension funds sent shockwaves through employers.

One of the more telling signs of the shifting landscape on pensions is the way in which the White Paper brings together three different perspectives on the current crisis – that of the state, that of the employer, and that of the individual. It seems a very long time ago now that successive Governments were trying to convince us that the future for pensions lay with the employer and the individual, and not with the state at all.

Clearly, that's no longer the prevailing wisdom. As John Hutton writes in his foreword to the White Paper – and as the respondents to our special edition of the Big Question agree – the future depends upon striking a balance between state, employer and individual (and getting that balance right). That balance is even written into the heart of the White Paper's key proposal, the introduction of the new National Pensions Savings Scheme.

And even before the NPSS arrives – if, indeed, it does – there are, as our writers in this issue demonstrate, still some hard questions to be asked. Questions about the complexity of the new proposals, about employers having to chip into the new national scheme, and about the regulation of company pensions. Let debate commence.

Will Booth

EDITORIAL

Publisher: Clare Grist Taylor
020 7612 7043
cgt.icsapub@dial.pipex.com

Editor: William Booth
020 7612 7045
wbooth@icsa.co.uk

Assistant Editor: Kevin Eddy
020 7612 7094
keddy@icsa.co.uk

Designer/Production Co-ordinator:
Mareike Schulz
020 7612 7046
mschulz@icsa.co.uk

Marketing Manager: Kate Murphy
020 7612 7051
kmurphy@icsa.co.uk

E-mail for editorial enquiries only:

wbooth@icsa.co.uk
keddy@icsa.co.uk

E-mail for ICSA, student and general enquiries:

info@icsa.co.uk

ADVERTISING ENQUIRIES

Advertising Manager: Andy Mabbitt
McMillan Scott plc, 9 Savoy Street,
London WC2E 7HR
020 7878 2301
charteredsecretary@mcmslondon.co.uk

PUBLISHER'S NOTE

Chartered Secretary Focus is published by ICSA Publishing Ltd for ICSA International.

Opinions published herein are those of the authors and unless stated otherwise do not necessarily reflect ICSA policy.

ICSA and ICSA Publishing accept no responsibility for loss occasioned in any person acting or refraining from action as a result of any views expressed in these pages. All material published in *Chartered Secretary Focus* is copyright of the publishers and may not be reproduced without permission.

All advertisements appearing in these pages are as far as possible checked for accuracy, but persons accepting or offering to accept goods or services contained in any advertisements do so at their own risk.

**ICSA Publishing Ltd, 16 Park Crescent,
London, W1B 1AH**

Printed by: Headley Brothers Ltd
Queens Road, Ashford, Kent TN24 8HH

A little more complication?



Restoration:
the link with
earnings was
broken by the
Conservative
Government
in the 1980s

Several questions have been raised about the timing and complexity of the main proposals in the White Paper. Deborah Cooper examines the implications for employers and employees alike.

Auto-enrolment of employees into ‘personal accounts’ for retirement saving is the most significant of the proposals for future pension provision in the White Paper.

In general, personal accounts are likely to be beneficial for those in the Government’s target group – particularly those who currently have no access to any employer saving. It’s a pity, though, that the Government – and, before it, Lord Turner – has missed the opportunity offered by such comprehensive reform to establish a set of simple, straightforward solutions to the problem of future retirement provision. Instead, what we have are several proposals, the detail of which is still uncertain, and some of which will be complex to implement.

Employees on very low incomes can, for example, only expect to see a small increase in their retirement income. Most of their entitlement to Pension Credit will be replaced by a larger state pension and a small pension from their personal account, but because they are also likely to be eligible for other means-tested benefits it will still be difficult for them to know whether additional saving will be worthwhile.

Employees on middle and above-average incomes, meanwhile, can expect to be better off in retirement provided they save a sufficient amount in personal accounts, although they will have had to manage on less take-home pay to achieve this. Once the arrangement begins to mature, the personal accounts of people in this group are likely to lift them above eligibility for means-tested benefits, removing a major disincentive for them to save.

Still, the retirement income targeted for the middle income group is still only around 50 per cent of final salary, and even less for the higher paid. It is unlikely, therefore, to be enough to maintain their standard of living. The amount that can be saved via a personal account will be capped, so additional pension saving will still have to be made via personal or stakeholder pensions, or employer provision.

The White Paper proposes that contributions to the

personal accounts will be phased in over three years. At first glance, this appears to mean that the new regime will take longer to impact on people’s retirement incomes.

But a phased introduction, though, is that it’s likely to mean that fewer people will opt out of the new arrangement at its inception. And, once someone’s contributing, it’s less likely that they’ll opt out when contributions increase. This will be essential in helping personal accounts to succeed – especially since a high take-up is crucial for the arrangement to work. After all, the introduction of the scheme will mean a whole new administrative infrastructure, and subsequent costs for both the state and employers. These costs will be justified if the personal accounts prove to be a more efficient way of saving, running with very low charges due to economies of scale. If take-up is low and economies of scale do not emerge, a lot of effort will have been ploughed into a complex arrangement for very little gain.

The low cost of personal accounts also depends on a centrally mandated arrangement to avoid the need for providers to market themselves. The Government argues that this removes the need for regulated advice or disclosure, which impose significant financial burdens on existing schemes. Even so, many of the people at whom personal accounts are aimed will still need help to decide if they should remain in the scheme. Although the Government will provide some advice, it’s likely that it will fall to employers themselves to provide more detailed and better-targeted information.

Employers will also be allowed to use alternatives to personal accounts, provided they meet certain minimum contribution or target benefit levels and employees are automatically enrolled. By offering their own ‘branded’ provision, they will also be able to get best value from the contribution they will have to make on their employees’ behalf.

The other key proposal in the White Paper is the restoration of the link between the Basic State Pension (BSP) and earnings.

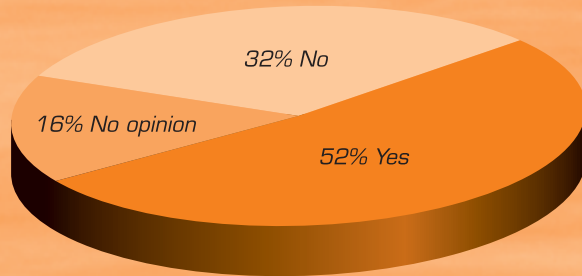
The Pensions Commission proposed that the earnings link be restored from 2010. Due to concerns about the cost of restoring the link, however, the Government has delayed its introduction to 2012 at the earliest. The longer the restoration of the earnings link is delayed, the lower the BSP’s value will fall compared to current earnings: it is currently only 17 per cent of average earnings, and looks set to fall to 15 per cent by 2012. Deferring will just make the existing arrangement fall further into disrepute, and it’ll take longer for the proposed reforms to have any effect on people’s retirement incomes.

Finally, the design of the state second pension is also set to change: benefit accrual will become flat rate rather than earnings-linked from 2030. Retaining two flat rate pensions, with slightly different eligibility requirements, seems an unnecessary complication. And, given past experience, it is not just conspiracy theorists who might believe that this is only being done to enable future governments to tinker with state pension provision without anyone realising what’s going on.

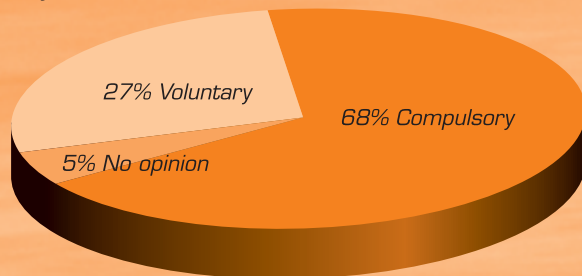
Dr Deborah Cooper is Principal at Mercer Human Resource Consulting. She can be contacted at deborah.r.cooper@mercer.com.

The future of pensions?

Q: Do the proposals in the White Paper offer a viable solution to the pensions crisis?



Q: Should employer contributions to the NPSS be compulsory or voluntary?



So, after years of speculation and conflicting arguments between any number of interested parties, the Pensions White Paper is finally here.

The Paper itself remains very close to the Final Report from the Pensions Commission, and accords with many of its key proposals – not least the re-establishment of the link between the state pension and earnings, the expectation that future generations will have to work longer to save for their retirement, and the plan to set up a national pensions savings scheme into which both employees and employers will have to pay. But just how effective are these plans really likely to be? We asked our panel of company secretaries what they thought.

Firstly, we wanted to ascertain whether our panellists believed the overall mix of proposals offered a viable solution to the UK pensions crisis. At the launch of the Commission's Final Report back in April, Lord Turner described the proposals as striking 'a reasonable balance between the need to prevent the future spread of means testing, the distributional impacts of more generous across the board pensions, and public expenditure constraints.'

There was something of a three-way split on this issue. More than half of the panel (52 per cent) agreed that yes, the proposals do offer a viable solution, with only 16 per cent feeling that, no, actually they don't. Worryingly, though, nearly a third of respondents said they didn't feel strongly either way, which is a significant number for such far-reaching proposals. Could it be our panellists' reservations reflect the more widespread apathy surrounding pension planning in the UK that the Paper is attempting to fix?

Moving on, one of the more controversial proposals in the Paper is the compulsory employer contribution to the 'personal accounts' saving scheme, especially given that the only 'opt out' for employers is in the event that they already provide a scheme of their own which is sufficiently

comparable to the proposed scheme. As departing CBI Director-General Sir Digby Jones commented when the White Paper first appeared: 'there will be anxiety amongst the business community that the Government is forging ahead with compulsory employer pension contributions despite the potential damage it could inflict on firms, particularly small ones.'

That anxiety may be felt in the small business community but not, it seems, amongst our panellists. Surprisingly, well over two-thirds of them (68 per cent) felt that yes, it is right that the employer's contribution should be compulsory, which suggests broad (if so far, largely silent) support for the plan. However, this is evidently still a divisive issue: only a tiny number – five per cent – didn't have an opinion either way, while the remaining quarter of respondents felt that the employer's contribution should only be voluntary, and that this part of the White Paper certainly wasn't right.

The proposal which received probably the most amount of coverage in the press, though, is the proposal that the employees of the future will be expected to continue working several years beyond the current age limit of 65. When we asked our panel for their views on the rise in the pension age from 65 to 68 over the next 40 years, they were evenly split. While just under half – 48 per cent – agreed that it was right that people should be expected to work longer before getting a state pension, almost exactly the same number of people felt it was wrong (47 per cent). The 'don't knows' accounted for a small but significant minority of six per cent.

We also asked for feelings on the restoration of the link between the state pension and earnings – a link which was originally broken by the Conservative Government in the 1980s. We wanted to know whether restoring the link would help to lift people out of pensions poverty. Well, a whopping 73 per cent of our panel reckon we'll have to wait it out to see what the effect is. As responses go, that's not wholly encouraging for the Government, but the small minorities that did feel strongly were evenly split – seven per cent thought the plan would work, while six per cent thought it would be a costly failure.

Even so, it does seem as though the balance of responsibilities for pensions provision in the UK is heading in the right direction. For our final question, we asked our panel whether they believed the primary responsibility for pensions provision should sit with the employer, with personal saving plans or with the State. The response was almost unanimous: 95 per cent answered that it should be a balance of all three. Interestingly, one in twenty felt that it should be the responsibility of the employer alone, and no-one at all thought it should be down solely to the State or personal savings plans to provide for old age.

The overall verdict from our panel? Well, it seems the White Paper is broadly welcomed as a step in the right direction, but clearly, reservations remain on some key aspects of the Government's proposals.

The Big Question is conducted in association with EJ Company Secretarial. Company secretaries of leading UK businesses wishing to take part in the survey should e-mail thebigquestion@ejgroup.co.uk.



The road ahead

*The pensions landscape in the United Kingdom has been shifting and changing for a few years now, and the latest development, the new White Paper, is only adding to the uncertainty. **Richard Evans** considers an industry in flux.*

Looking at the introduction to the new Pensions White Paper, one fact leaps out: UK pension provision is in decline. From a high of more than 12 million in 1967, the number of employees in occupational schemes had fallen by 2004 to fewer than 10 million. More striking is the drop in the number of employees in private sector defined benefit schemes: down from 5.2 million to 3.5 million between 1995 and 2004. While some of the original 5.2 million will now be in defined contribution schemes, many of those schemes will provide, even on the most optimistic assumptions, lower benefits than the defined benefit schemes that they have replaced.

The personal pensions market has fared little better. Take-up of stakeholder schemes – the low-cost arrangements introduced in October 2000 – has been low, notwithstanding the obligations imposed on employers to facilitate access.

A mass of recent legislation designed to simplify pension schemes and bolster security has, some say, served only to deter employers from making provision. Employers may now be forced to honour commitments as to past service, but many are seeking to reduce their exposure going forwards. All of which begs the question:

do the measures proposed in the White Paper constitute a new opportunity – or will they prove to be yet another burden?

To answer that question, we first need to look beyond the White Paper to other recent developments on the pensions front, and in particular to a key piece of legislation, the Pensions Act 2004.

The pensions landscape *Pension Protection Fund*

The Pensions Act 2004 has undoubtedly improved security for members of defined benefit schemes, most notably by the introduction of the Pension Protection Fund.

The PPF will underwrite members' benefits on insolvency of the employer – for most pensioners, 100 per cent of pensions, and, for other members, 90 per cent of pensions subject to a cap of £25,000. The PPF has helped to boost confidence among members, following some high-profile pension schemes insolvencies which left many members with little or nothing.

For employers, though, there is a two-fold sting in the tail. First, the PPF is funded by eligible schemes, and hence, indirectly, by employers. The PPF estimates that the total raised in 2006/7 will be £575 million; the



Many employers are seeking to reduce their pensions exposure going forwards.

hardest-hit (highest-risk) schemes may have to hand over, for the year's cover, a sum equal to 0.5 per cent of their liabilities. Second, in a bid to protect both members and the PPF itself, the 2004 Act and associated legislation effectively rewrote the terms of many pension schemes. An employer's obligations under a defined benefit scheme today may be radically different from those under the scheme when it was first set up.

The most dramatic change is to an employer's right to walk away from a scheme. A scheme's rules will normally say that an employer has the power to terminate the scheme or to withdraw while other employers continue to participate. But recently strengthened 'employer debt' legislation means that an employer who terminates or withdraws will now be liable, in most cases, to make good its share of any deficit in the scheme assessed on a buy-out basis (a basis that reflects the high cost of securing benefits by buying annuities).

The underlying policy here may be well-meaning, but the practical consequences can be peculiar or unfortunate. All sorts of events can, it seems, constitute an employer withdrawal for the purpose of the legislation, such that a debt – and, typically, a substantial one – is triggered. Examples include not only the sale of an employer

who participates in a group scheme, but also the last employee of a small employer leaving service, and even an intra-group restructuring under which employees are transferred from one employer to another. The Pensions Regulator does have power to reduce the immediate debt in such situations if arrangements can be made for the full debt to be guaranteed going forward, but a quirk in the regulations seems to mean that this is an option only where the withdrawing employer might otherwise be pushed into insolvency.

Employers seeking a way round the employer debt legislation risk falling foul of the 'moral hazard' provisions of the 2004 Act. These provisions allow the Regulator to impose liability upon employers and other associated parties (including directors), if they have been involved in an act designed to avoid or reduce an actual or prospective employer debt. Acts that may fall foul of the legislation here include special dividend payments, returns of capital and renegotiation of banking covenants – at least in cases where the position of a defined benefit scheme as 'creditor' is adversely affected.

It is becoming common for nervous employers to seek formal clearance as to proposed transactions from the Pensions Regulator. In practice, the approval of scheme

trustees will normally be a prerequisite for clearance. Consequently, employers are finding themselves having to explain their business plans to trustees and to obtain trustee buy-in – with trustees sometimes demanding a one-off contribution or security over assets as a quid pro quo.

Balance of power

As regards ongoing funding, too, the 2004 Act has rewritten the balance of powers under many defined benefit schemes.

A new scheme-specific funding regime is being phased in from September 2005. Under the predecessor regime, if scheme rules so specified – and in many cases they did – the employer decided the contributions that it paid and the period over which any deficit was made good, provided that the (none too onerous) minimum funding requirement was met. This changes under the new regime: funding decisions will be made by trustees, subject to employer agreement. Even the provision as to employer agreement provides only limited comfort, because in the event of stalemate a decision can be made by the Regulator, who is likely to err on the side of caution.

All of this may well make for a subtle change in the relationship between employers and trustees. In the past, many trustees felt that their role was to work with the employer to deliver the promised benefits. Now, with new powers and with the Regulator looking over their shoulder, trustees will see themselves as fighting the members' corner – even to the point of scrutinising or challenging the employer's business dealings. The change in relationship raises questions about the position of individuals who have a foot in both camps – employer and trustee. Such individuals will need to watch out for conflicts of interest and consider the extent to which any conflicts can be managed. The Regulator takes a pragmatic attitude but has made the point that an individual cannot negotiate with himself. At least one clearance application has been rejected by the Regulator on the basis, in part, that the trustees had been subject to a conflict of interest when approving the employer's proposals.

Many employers, facing higher pension costs as a result of increased regulation, low investment yields and greater life expectancy, have responded by changing the basis on which benefits are provided for future service. In some cases, this has involved moving to less generous defined benefit provision or increasing employee contributions. In others, the move has been to defined contribution provision – normally the salary link is retained for accrued defined benefit entitlements.

An employer who wants to make changes to benefits without first obtaining employees' express consent needs to tread very carefully. Can the change be squared with employment contracts? Sometimes the contract wording will reserve a right for the employer to make changes using the scheme's amendment power. But, even where this is the case, the employer will still be subject to a duty of 'mutual trust and confidence'. The amendment power may, in any event, include restrictions as to the changes that can be made, and will almost invariably say that the trustees' consent must be obtained.

Persuading the trustees may be difficult, given the improved negotiating position that trustees enjoy under the 2004 Act. Under many schemes, for example, trustees will be conscious that termination is no longer a realistic option for the employer, given the substantial employer debt that would then arise. Comments made by the courts suggest that, when reaching their decision, trustees



can properly take account of the employer's legitimate aims and business needs. However, the law in this area is, surprisingly, untested and unclear.

Benefits

Employers struggling to meet pension costs might at least expect that legislation would not ratchet up the benefits that they have to provide.

The 2004 Act was a mixed bag in this respect, conferring new rights on some early leavers, but relaxing the statutory requirements as to pension increases for post-April 2005 service. More troubling, for some employers, will be the Employment Equality (Age) Regulations 2006. The Regulations will outlaw age discrimination in respect of service from 1 October 2006, save where discrimination can be objectively justified. Pension schemes could, of course, be said to discriminate on grounds of age by their very nature. Thankfully, the Regulations include a long list of exemptions, but they are not exhaustive, despite previous assurances from the Department of Trade and Industry that existing practices would be able to continue more or less unchanged.

It seems, for example, that schemes will no longer be able to specify (as many currently do) a cut-off whereby employees in service after normal retirement age cease to

Striking a balance: Work and Pensions Secretary John Hutton is keen that state, employers and individuals share responsibility for pensions

accrue benefits, unless the cut-off is capable of objective justification. Employers will want to carry out an age discrimination 'audit' in advance of 1 October. They can then consider whether any apparent discrimination can be either objectively justified or addressed by changes to scheme rules.

A white knight?

The 2004 Act dealt with those employers already providing pensions: the White Paper attempts to deal with the increasing number of employees who are entitled to nothing beyond the state scheme.

The Paper proposes two main changes: the introduction of a National Pension Savings Scheme (or NPSS, a UK-wide defined contribution scheme), to be launched in 2012; and an overhaul of state benefits stretching over the next two or three decades. It is proposed that, from 2012, employers should have to enrol all employees over the age of 22 automatically either into NPSS or – if employers so choose – into an occupational scheme of at least similar standard. The Government's hope is that automatic enrolment will overcome the 'inertia' factor and maximise take-up among employees. Employees will be able to opt out of NPSS if they wish to do so, although employers will have to re-enrol opters-out every three years.

Contributions to the NPSS would be based upon earnings between the primary threshold and upper earnings limit for National Insurance purposes – in other words, on current figures, earnings between about £5,000 and £33,000. Employers would contribute at 3 per cent and employees at 4 per cent, with the NPSS claiming back a further 1 per cent from HM Revenue by way of basic rate tax relief. The 4 per cent rate for employees is likely to be phased in gradually between 2012 and 2015, and the Government will consult about exemptions, transitional support and a longer phasing-in period for small businesses.

NPSS members would have various investment options, and benefits would be similar in form to the defined contribution norm – 25 per cent tax-free cash, with the remainder used to buy an annuity. The Government hopes that administration costs can be kept within 0.3 per cent per annum – significantly less than the cap for stakeholder schemes (now as high as 1.5 per cent in some cases), and comparable with large occupational schemes.

As regards state benefits, the Government has gone some way towards meeting demands for restoration of the link between the basic state pension and earnings inflation. The link is indeed to be restored – but not until some point between 2012 and 2015 (depending upon cost), and with no retrospective uprating. It will also become easier for people to earn a full basic state pension. The number of qualifying years needed will be cut to 30 from the current 44 (men) or 39 (women).

However, all of this comes at a cost. The state pension age will rise on a phased basis, to 66 by 2026 and to 68 by 2046. There will be changes to the state second pension, including a possible move to a flat rate over the period to 2030 (which might amount to a worsening for some). And, from 2008, there will be new rules for means-tested Pension Credit, so as to ensure that the benefit goes only to people with little or no savings.

The White Paper concludes with a nod towards simplification, in the form of a proposed deregulatory review and a 'Pensions Law Rewrite Project'. Provisions targeted for simplification include those as to pension increases, member-nominated trustees and the protection

of accrued rights. This may prompt a hollow laugh from employers struggling with the mass of recent legislation (some 80 sets of Regulations relevant to pensions were issued in the first five months of 2006). Many of the provisions targeted for simplification are, ironically, ones that have already been 'simplified' by the 2004 Act.

Some commentators have suggested that changes to the accrued rights legislation might allow schemes in severe difficulties to cut benefits for past service. It seems unlikely, however, that the Government will go this far, notwithstanding a comment from Secretary of State for Work and Pensions John Hutton that 'nothing is off the table'. Past service benefits have effectively been untouchable ever since the Pensions Act 1995. A change to that principle would seem to go beyond the mere 'drive to cut red tape' which Mr Hutton proposes.

Subject to this last point, for employers who already offer good quality pensions for all employees, the White Paper proposals may have little immediate impact – barring a possible increase in take-up resulting from automatic enrolment. Other employers will want to look carefully at the implications of admitting employees to the NPSS. The Government is quick to point out that employers' contributions, expressed as a percentage of total earnings, will never be higher than 2.5 per cent, and promises that the administrative burden placed on employers will be kept to a minimum.

The long-term ramifications of the White Paper proposals are hard to predict. There have been suggestions that employers may 'level down' occupational schemes to NPSS terms, so that a 3 per cent employer defined contribution becomes the norm. Perhaps, although it is notable that, while a great many employers have taken action to reduce pension costs in recent years, there has been little sign of a herd mentality: competing employers have in many cases settled on very different benefit structures for future service.

And what of the proposed increase in state pension age? The increase, particularly if coupled with 'levelling down' of occupation schemes, may result in an ageing workforce, with greater demand for phased retirement – but then, the first signs of this can be seen already.

* * *

The White Paper marks a radical departure from previous legislation, in that it targets the pensions 'have nots' rather than the 'haves'.

John Hutton says in his foreword that 'a new balance must be struck between state, employers and individuals to share the responsibility to save and provide for the future'. Whether that balance has been struck in the right place remains to be seen. However, the Government has at least recognised a crucial point: that the UK's pension problems cannot be solved by loading further obligations onto employers who already operate occupational schemes.

Further information

The White Paper, *Security in Retirement: Towards a New Pensions System* can be downloaded from the Department for Work and Pensions website at www.dwp.gov.uk/pensionsreform.

Richard Evans is a Partner with law firm Mayer, Brown, Rowe & Maw LLP. He can be contacted on 020 7782 8606 or by e-mail at revans@mayerbrownrowe.com.

Proposals to rewrite pensions law may prompt a hollow laugh from employers struggling with the mass of recent legislation.

Getting it right



Jane Dawson outlines the National Association of Pension Funds' response to some of the key issues in the White Paper.

The UK pension system is the most complex in the world, and needs simplifying to help change people's attitudes towards saving for retirement. The attitude of 'spend now, worry later' is seeing millions of people not saving enough to meet their expectations for income when they retire.

The Government has a unique opportunity now to make the UK's pensions system fit for the future, and the Pensions Reform White Paper should create the foundations for a positive savings culture in the UK. The Government has said that pensions reforms must be fair, simple, affordable and sustainable, and must fulfil the goal of promoting personal responsibility. The aim is to build a simpler, fairer pensions system, which will enable everyone to build a secure retirement income.

Provided we get the details right, then, the White Paper proposals should offer tomorrow's pensioners certainty and security, and should promote a step change in savings behaviour.

State pension reform

Two of the key proposals in the White Paper are the proposals to broaden the coverage of the basic state pension and to increase it in line with earnings, not prices.

NAPF fully supports both of these moves. The reformed state pension system needs to provide a firm foundation upon which people can build their own retirement savings, where 'it pays to save'. To do this, the state pension must be easy to understand and predictable – and it must genuinely reduce reliance on means-testing in future. The elimination of means testing over time will remove the disincentives to save for the less well off. Should the proposals fail to meet these tests, reform of private funded pensions savings could fail.

Meeting the cost of a higher state pension through a higher state pension age, adjusted in line with longevity, is clearly the way forward. The Government should also take the opportunity to extend this principle to the private sector to help ease the burden that improved longevity places on occupational pension schemes. NAPF supports the creation of a permanent Pensions Commission to

advise on future state pension age increases.

The proposals are an important step along the road towards building a simple, decent, state pension for all.

NPSS

The Government's purpose in its proposal for the National Pensions Scheme is to support and encourage saving, and this principle of extending pension coverage through auto-enrolment and employer contributions should provide the much-needed impetus many people need to become regular pensions savers.

Further thought and debate is needed, though, over the details of who should be auto-enrolled, the interface with existing schemes, and design of the new low-cost system. The Government is right to consult further on these issues and take the time needed to get it right. Attention must be given to the details of how the NPSS will work. While the NPSS will not be put into place until 2012, the main elements will need to be shaped over the coming months.

In the meantime, NAPF in February responded to the Government's challenge to devise a practical alternative to the Pensions Commission's model. Our proposal was for the establishment of Super Trusts – up to 20 collective, defined contribution schemes into which workers would be automatically enrolled. The schemes would be large enough to deliver economies of scale, driving down costs, and would be trust-based, thus ensuring the interests of consumers were put first. NAPF analysis indicates that management charges for such schemes could be kept around 40bps – significantly lower than envisaged under other proposals.

Encouragingly, in the White Paper, the Government recognised that Super Trusts could form part of the pensions landscape of the future. NAPF believes that Super Trusts have the potential to offer low-cost pensions to millions of working people and are more likely to be trusted than either the Government or the financial services industry. They should be given the opportunity to succeed.

But the pensions issue is not just about tomorrow's savers. It is also vital to consider the impact on those employers who already offer good quality pensions, and ensure that a significant levelling down of existing provision does not occur. This would be a highly undesirable consequence, and one that the Government should seek to avoid.

As we move towards a defined contribution world of pension saving, it is imperative that we embark on this course with our eyes open, and ensure that any new system is robust for the future. The impact upon current and future voluntary pension provision of setting up a new national savings scheme could be profound, with unintended consequences.

De-regulation

Finally, the White Paper also contains a commitment to look again at the burdensome regulatory regime for occupational pensions, and again that proposal is warmly welcomed.

A less prescriptive regime is needed if employers are to continue to provide pension schemes on a voluntary basis in future. The Government's commitment to revisit the regulatory regime for voluntary employer-sponsored pension schemes is key to this – but we need meaningful reform, and not more tinkering around the edges. Simply re-writing existing legislation in plain English is not the answer: real de-regulation is.

The cost of change



One of the most controversial elements of the personal accounts scheme is the requirement for a compulsory employer contribution. Morag Williams looks at what that could mean for businesses.

The proposals in the White Paper aim to increase personal saving for retirement by making it as simple as possible to save, particularly through the establishment of personal accounts. Compulsory employer contributions are absolutely core to making these accounts work.

The White Paper follows a number of previous attempts to encourage this. Employees were provided with access to a simple, low cost product in April 2001 in the form of stakeholder pensions, but the take-up and the level of contributions failed to meet expectations. Subsequently, the Informed Choice programme – including the development of various types of forecasts of state pensions – has tried to raise the awareness and understanding of individual responsibility for retirement planning. It could even be said that the need for individual pension accounts demonstrates the failure of previous policies.

Two particular elements in the proposed scheme have already been shown to increase saving. First, automatic enrolment has a significant effect on increasing participation levels: occupational schemes using this method show higher levels of participation, particularly among the lower paid. Second, in cases where the employer is contributing to an occupational arrangement, research has shown that participation is generally higher than if the employer pays no contributions.

Under the proposal, employers will contribute the equivalent of 3 per cent of an employee's earnings for those who choose to stay in the scheme. All employees aged 22 or over will also pay 4 per cent of their earnings into the savings scheme, and the Government will make up a further 1 per cent as normal tax relief. Contributions will be payable by employers as a percentage of earnings between about £5,000 and £33,000, and will be exempt from tax and National Insurance. The contribution level will be set by primary legislation, so once established any change would take some time to come into effect. The White Paper proposes that the first contributions will be not be made into the accounts until 2012, and employers will be able to phase in their contributions over a three-year period at a rate of 1 per cent a year.

Employers can, however, opt out of the requirement to enrol employees into personal accounts, but only if their

existing occupational scheme meets certain requirements. First, they must offer an occupational arrangement with automatic enrolment. That arrangement must also provide equivalent-level benefits either through a money purchase arrangement with contribution levels at the proposed personal account level, or a defined benefit arrangement that is deemed to accrue total benefits equivalent to those that would be earned through the personal accounts.

In practice, however, most current occupational schemes allow employees to choose to join rather than having auto-enrolment with an opt-out. The reason may be a practical one – reducing the burden of administration, especially when it comes to dealing with opting out – but, in many cases, it is because the employer is happy with the level of take-up from employees that comes from providing an opt-in scheme. One employer – with a take-up level on its money purchase scheme of 17 per cent – told me that the provision of a pension scheme meets the needs of the employer in attracting and retaining those staff who consider pension provision important, but a low level of take-up keeps the cost at a level with which the finance director feels comfortable.

So, not only will the changes increase costs for employers with no existing occupational arrangements, they will also have a significant upward effect on costs for employers with good occupational schemes as more employees join. There is no assessment within the White Paper of this element of the cost impact on employers.

Employers with less than 50 employees are also likely to be substantially affected by the reforms, since this is the group that may also be most exposed to direct pressure on costs and market forces. The background research in the White Paper indicates that employers will not be against paying the 3 per cent contribution as 'they felt that they had a share of the responsibility for the issue and that they wanted to help their employees'. The Confederation of British Industry in particular is lobbying the Government for extra financial support to help small businesses meet the contribution. Without this, the most likely way to recoup the cost of the employer contribution will be through lower wage increases.

The average total contribution to occupational defined contributions schemes is currently around 9 per cent, so it will be interesting to see the effect of the proposed 8 per cent contribution level. The success of the 'Save More Tomorrow' approach in the US is encouraging in increasing member contribution rates, and the UK Government is working with pension providers over here on an initiative called the 'Pension Increase Pledge'. The approach in both cases is for members to agree at the time that they join the scheme that they will increase the percentage that they pay in future. Against this backdrop, it will be very interesting to see if employers will indeed reduce their contributions to 3 per cent.

Either way, we are still at an early stage in the reform process. My personal appeal is for as many people as possible to respond to this consultative paper. After all, we cannot blame others for new law unless we get actively involved in shaping that law ourselves.

Morag Williams can be contacted by e-mail at morag.williams@dunnettschaw.co.uk.



In the pensions business, **investment** is about spotting the best opportunities and committing funds to them with a view to benefiting your investors in the long-term.

At EJ Company Secretarial we take exactly the same view: if you want someone who will really repay your long-term investment, we're the people to consult. We've pruned all the dead heads and offer only the freshest, most appealing candidates.

EJ: Recruiting the best

EJ • COMPANY SECRETARIAL

Please contact **Jon Moores** 020 7400 2042 jonm@ejgroup.co.uk or **David Press** 020 7400 2048 davidp@ejgroup.co.uk, **Suzanne Strickland** 020 7400 2023 suzannes@ejgroup.co.uk
t 020 7400 2000 303-306 High Holborn London WC1V 7JZ www.ejgroup.co.uk

EJ • LEGAL EJ • HUMAN RESOURCES EJ • MERGERS EJ • TAXATION

