



Chapter 6: Employers and private pension reform

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Employers are at the heart of the pension reform programme. Many employers already offer good pension provision for their employees. The Government aims to maintain this existing provision.

For those employers who are not already offering pension provision, the Government is keen to ensure that personal accounts present the minimum of additional burdens.

The Government is proposing simple exemptions from the requirements of personal accounts to help support existing provision. The tests will be based on tests already used for other purposes, and where possible will be self-certifying.

The Government is consulting on how it can phase in exemption to help employers manage costs and on whether more generous schemes should be able to operate a waiting period.

The compliance regime will be light-touch and designed to support employers in their new obligations. It will be based around a three-part strategy – education, enabling and enforcing.

- 6.1 The proposed reforms set out in the May 2006 White Paper to both the state and private pension systems were welcomed by employers' representatives as necessary measures to guard against future pensioner poverty and promote private saving. In particular, employers recognised the long-term economic benefits of addressing the issue now, rather than waiting until the problems became acute. They also recognised that increased private pension wealth will benefit the economy as a whole.
- 6.2 Public reactions to the proposals and research Government has done with employers demonstrate broad support for the Government's package of reforms:

"Members have welcomed the proposal to introduce a new system of low-cost personal accounts."
(Confederation of British Industry)

"EEF supports auto-enrolment into the new pensions savings scheme."
(Engineering Employers' Federation – The manufacturers' organisation)

- 6.3 Department for Work and Pensions (DWP) research shows that a majority of people¹, some 72 per cent, agreed with the proposals that employees should be automatically enrolled into personal accounts with the choice to opt out.² Further research with employers found 59 per cent of organisations with less than 50 employees thought that automatic enrolment was a good idea, rising to 81 per cent of employers with 250 or more employees.³
- 6.4 The Government's reform programme continues to place employers at the heart of pension provision, and can only be successful with the support and involvement of employers. Many employers in the UK are already making substantial contributions to pension schemes and are supporting their employees in saving for their retirement. The Government wants to continue to support employers who are already making these contributions. But to make the package of reforms successful the Government needs all employers to play their part.
- 6.5 Minimising the burdens on employers has been a guiding principle throughout the development of the reforms. This central objective has led us to a series of proposals:
- the level of the minimum employer contribution will be set in legislation to remove uncertainty as to future increases;
 - the minimum employer contribution will be phased in over three years;
 - one of the key criteria for deciding the delivery model was the impact of relative burdens imposed on employers;
 - the tests by which existing employer pension schemes will gain exemption from personal accounts will be as simple and straightforward as possible;
 - the personal accounts scheme will be designed to focus on the target market, and not to compete with existing employer schemes: the personal accounts board will have a specific duty covering this; and
 - the compliance regime will be light-touch but effective.

¹ Participants were recruited to reflect the United Kingdom population in relation to a series of key demographic and other variables.

² Opinion Leader Research, 2006, *National Pensions Debate Final Report*, research carried out for DWP.

³ Bolling K, Grant C, Fitzpatrick A and Sexton M, 2006, *Employer attitudes to personal accounts: Report of a quantitative survey*, DWP Research Report No 397.

- 6.6 Chapter 2 provides details of the model chosen to deliver personal accounts. Minimising the burden on employers was a key criterion. Analysis shows the National Pension Savings Scheme (NPSS) approach meets that test. In particular, government research and consultation with employers identified that those employers who do not currently offer work-based pension saving do not feel equipped to make decisions on their employees' behalf. In selecting the delivery model, the Government has ensured that these employers will not be exposed to this burden. Employers will have to decide whether to offer a personal account and/or their exempt scheme.

Over the summer of 2006, we conducted several in-depth consultation exercises with employers and their representative bodies, to help the Government analyse how the reforms could be designed to both promote existing workplace schemes and minimise any additional employer requirements. The Government is committed to minimising the burdens on employers and simplifying the process for them.

A key part of this consultation was a series of seminars held with employers and their representative bodies, including specific events on:

- the impact of personal accounts on all employers;
- employer scheme exemption from personal accounts; and
- the impact of personal accounts on small employers.

These events helped Government to understand the concerns of employers, and the contributions made at those seminars – and in the many other informal meetings – have been invaluable in developing our proposals for reform.

The exemption process for pension schemes

- 6.7 The Government wants to support existing provision. To achieve this the Government will allow those employers that offer pension schemes which are equivalent to, or provide more generous benefits than, personal accounts to automatically enrol their employees into those schemes rather than personal accounts. These types of scheme are offered by 15 per cent of employers and provide pensions for 23 per cent of all employees.⁴
- 6.8 The Government has used two key guiding principles in developing the exemption tests:
- **Simplicity** – any exemption test should be as straightforward as possible for employers, promoting understanding and avoiding unnecessary burdens.
 - **Participation** – we want to ensure that our proposals maximise the number of employees with good pension coverage.

Simple tests

- 6.9 The Government does not want to place unnecessary burdens on employers who already provide high-quality pension schemes for their employees. **Employers** should therefore be able to seek exemption through self-certification, based on a small number of clear criteria.
- 6.10 The diversity of employer provision reflects the choices that employers have made about how they want to support their employees' pension savings and reflects the needs of their businesses. **The Government has developed tests that reflect and support that diversity. We are proposing tests for occupational defined benefit and defined contribution schemes and consulting on how these tests can be adapted for employers who have chosen to provide hybrid schemes or personal pensions.**
- 6.11 The basic principle underlying the exemption proposals is that employer contributions and benefits for exempt schemes should be broadly equivalent to those for personal accounts. The earnings bands on which contributions are paid would also need to be the same to ensure parity for individuals.

⁴ Source: *DWP modelling of Employer Pension provision 2005 and Small and Medium-sized Enterprise (SME) Statistics 2005*. Proportion of employers that offer a pension contribution of 3 per cent to at least some of their employees. Number of employees in a pension scheme with a 3 per cent or more employer contribution as a proportion of total employees.

- 6.12 The Government also considered whether additional benefits associated with a pension scheme, such as death-in-service benefits, ought to be taken into account as part of the exemption test. This would involve additional complexity so it is not proposed to include them in the test.

Exemption for occupational defined benefit schemes

- 6.13 Defined benefit schemes based on final or average salary remain an important and significant part of employer provision.
- 6.14 The eventual level of benefits that savers receive through defined benefit schemes does not necessarily relate to the level of contributions from employers and employees. This means a simple comparison of contribution levels would not be a fair test of parity between a defined benefit scheme and personal accounts. **The Government has decided that the exemption test for a defined benefit scheme should be based on the rate of benefit accrual.** There are two types of defined benefit schemes – contracted-in and contracted-out. These need to be considered separately.

Contracted-out defined benefit schemes

- 6.15 Around 95 per cent of active members in defined benefit schemes⁵ are in a scheme that is contracted out of the State Second Pension. As a result their scheme has already been subject to a test – the Reference Scheme Test.⁶ There are about 6,000 private sector contracted-out defined benefit schemes with around 3 million scheme members.⁷

⁵ Government Actuary's Department, *Occupational Pensions Scheme Survey 2005*. Based on schemes with 12 or more members.

⁶ The Reference Scheme Test is a test of overall pension scheme quality currently used for defined benefit pension schemes that are contracted out of the State Second Pension. A scheme satisfies the test if the pensions provided to at least 90 per cent of the members are broadly equivalent to, or better than, the pension which would be provided under the Reference Scheme which: is payable from age 65; is paid for life; accrues for each year of pensionable service (maximum 40 years) at the rate of 1/80th of average qualifying earnings in the last three years of service; is based on qualifying earnings defined as 90 per cent of earnings between the Lower Earnings Limit and Upper Earnings Limit; and provides for a 50 per cent survivor benefit for a spouse or civil partner.

⁷ Source: Government Actuary's Department, *Occupational Pensions Scheme Survey 2005*. Based on schemes with 12 or more members.

- 6.16 Schemes that satisfy the Reference Scheme Test typically offer accruals at a rate of 1/80th of pensionable earnings each year and are recognised as high-quality schemes. The Government therefore sees no value in setting an additional test for these schemes and **we propose to use the Reference Scheme Test with automatic enrolment as the exemption test for contracted-out defined benefit schemes**. This should simplify processes for the people managing employer schemes.

Contracted-in defined benefit schemes

- 6.17 For contracted-in defined benefit schemes – which are not subject to the Reference Scheme Test – the Government has focused instead on finding a level of accruals, supported by analysis from the Government Actuary's Department, that provides a comparison with what individuals could expect to achieve from personal accounts.
- 6.18 The Government concluded that contracted-in defined benefit schemes should provide automatic enrolment and accrual rates of at least 1/120th of pensionable earnings for each year of service to gain exemption from personal accounts. Analysis from the Government Actuary's Department suggests that a 1/120th accrual broadly equates to an 8 per cent contribution into a personal account throughout the working life of a median earner.

Exemption for occupational defined contribution schemes

- 6.19 Defined contribution occupational schemes are an increasingly important element of workplace pensions. As personal accounts will be an occupational defined contribution scheme it is easier to draw direct comparisons.
- 6.20 The test should be carried out at scheme level, ie the benefits applying to the scheme in general and be based on offering **automatic enrolment** and two other criteria:
- **Contributions paid into the scheme must be at least equal to the minimum being paid into personal accounts.** This means that schemes that offer a minimum default contribution for individual scheme members of 8 per cent with a minimum of 3 per cent from the employer, should be exempt.
 - **Schemes must offer a default investment option** but will be able to offer an additional choice of funds if they want to.

- 6.21 Evidence suggests that most occupational defined contribution schemes have charges equivalent to an annual management charge (AMC) of under 0.6 per cent.⁸ This level is broadly comparable with that anticipated for personal accounts so the Government has decided that charges should not form part of the exemption test. The Government proposes to take legislative powers to reconsider this question if charges in these schemes cease to be comparable with those offered by personal accounts.

'Non-occupational' workplace pension provision

- 6.22 Employer-sponsored personal pension provision, where an individual buys a contract-based personal pension and receives a contribution from their employer (including high-quality stakeholder pensions and 'Group Personal Pensions'), is a significant part of the existing market.
- 6.23 Under European law pure automatic enrolment⁹ cannot be used with these contract-based schemes since the employee's written consent to be enrolled is required. But the Government does not want this to be an obstacle to exemption. The guidance on automatic enrolment issued last year for workplace personal pensions outlines a modified type of automatic enrolment which could be used.
- 6.24 The Government would like to continue to support these arrangements without disadvantaging employees, and is interested in views on:
- How can the Government treat such 'non-occupational' workplace pension arrangements as 'schemes' for the purposes of exemption from personal accounts requirements?
 - How can the Government ensure that, in the absence of automatic enrolment, these vehicles can offer similar levels of coverage and saving to those estimated for automatic enrolment?

⁸ Government Actuary's Department, 1998, *Survey of expenses of occupational pension schemes*.

⁹ Where the written consent of the employee is not required for enrolment into the scheme.

Waiting periods

- 6.25 The May 2006 White Paper stated that the objective of introducing automatic enrolment and personal accounts was for all employees to have access to pension saving from the start of employment. A number of responses to the White Paper argued that there should be a waiting period of six months or even a year. However, waiting periods would disadvantage employees who change jobs often, or do seasonal work, as it could mean they lose the opportunity to save for significant periods.
- 6.26 The Government welcomes views on this point but there is strong evidence against requiring any waiting period:
- only a minority of workplace schemes, namely 16 per cent, currently operate a waiting period;¹⁰
 - of these workplace schemes, around 80 per cent have a waiting period of at least a year, representing around 320,000 members¹¹; and
 - the impact of a six-month waiting period on the final pension savings for a median earner (£23,000 a year) who saves for 43 years – assuming a 3 per cent employer contribution and an AMC of 0.5 per cent – would lead to their final pension savings being reduced by approximately 9 per cent if they had, on average, eight job moves over their lifetime.¹² Those who move more often would face even more of a reduction in their final pension savings if a waiting period were allowed.
- 6.27 **The Government is not proposing a formal waiting period in personal accounts**, although it recognises there will be a short period before the automatic enrolment process is completed. **This is an area on which the Government continues to welcome views.**

¹⁰ Source: supplementary analysis of data from the Government Actuary's Department's *Occupational Pension Schemes 2004* – 16 per cent of open schemes (weighted by active members) with more than 12 members that responded to the question stated that the scheme operated a waiting period.

¹¹ Source: supplementary analysis of data from the Government Actuary's Department's *Occupational Pension Schemes 2004* – 16 per cent of open schemes (weighted by active members) with more than 12 members that responded to the question stated that the scheme operated a waiting period.

¹² Over a 40–45 year working life, individuals, on average, change jobs around 7–8 times: *Labour Force Survey*, 2006 DWP analysis. Notes: Assuming a 3 per cent employer contribution. Job moves are spread evenly over the lifetime. These figures do not include contracted-out since in 2012 contracting out will not be possible. Monetary values are quoted in 2006/07 earning terms.

Waiting periods for exempt schemes

- 6.28 If employers operating their own schemes with a waiting period want to continue with these schemes rather than operate personal accounts, the initial assumption was that they would automatically enrol their staff into a personal account in the intervening period. During the course of consultation, some stakeholders argued that the Government should relax this requirement, particularly for employers who make contributions above the minimum for personal accounts.
- 6.29 The current estimate is that there are approximately 160,000 employers with 5.7 million members who offer an employer contribution of at least 6 per cent.¹³ The Government estimates that around 3.8 million individuals – aged between 22 and 64 – begin working for a new employer every year. Of these, some 1.2 million work for an employer offering a contribution of greater than 6 per cent.
- 6.30 Allowing a waiting period would mean that employers with high-quality exempt schemes would not have to automatically enrol employees immediately into personal accounts and would benefit in terms of reduced contribution and administration costs. However, this could affect individual outcomes as it excludes members of the Government's target group such as those with regular job changes, and casual and seasonal workers.
- 6.31 **The Government is interested in views on:**
- Whether employers with exempt schemes, and contributions above the personal accounts minimum, could operate a short waiting period, of perhaps three or six months, to encourage them to continue to offer high-quality schemes.
 - What should be the minimum level of contributions above which a waiting period is acceptable.

¹³ Number of individuals and contribution cost estimates based on DWP's analysis of *Employers' Pension Provision Survey 2005*, *Small and Medium-sized Enterprise (SME) Statistics 2005*, *Annual Survey of Hours and Earnings 2005* and *Labour Force Survey 2006*.

NAPF quality mark proposal

The National Association of Pension Funds (NAPF) has suggested that employers running high-quality schemes should be given greater flexibility than those employers who are contributing at, or just above, the minimum: they should be allowed to have a six-month waiting period before they are required to automatically enrol.

NAPF has proposed a 'Good Workplace Pension' quality mark which is designed to raise the profile of schemes and be something that employees can easily recognise as a scheme that offers high-quality pensions. They propose that accreditation should function in a simple light-touch way.

Under this proposal, the quality mark would be awarded to employers' schemes with total, and employer, contributions higher than personal accounts. All scheme members would be provided with information about the quality mark, thereby helping them better understand the value of the pension on offer.

The Government supports this proposal and is keen to see it happen, although it is the responsibility of the pensions industry to develop further details and ultimately establish a quality mark. However, the Government will consult on flexibility around waiting periods for high-quality exempt schemes.

Automatic re-enrolment for exempt schemes

- 6.32 Chapter 1 sets out the principle of re-enrolment. Within the personal accounts scheme the Government intends to re-enrol employees who have previously opted out every three years in recognition of the fact that people's circumstances change and they may now wish to save.
- 6.33 The Government has also considered re-enrolment into exempt schemes. We recognise that re-enrolment could incur significant costs, particularly for those employers offering defined benefit schemes. In defined benefit schemes the benefit a member receives is not linked to the contributions they have paid and so, could potentially be disproportionately costly for the employer. The Government therefore needs to consider re-enrolment requirements carefully to ensure they do not threaten the long-term stability of these schemes. Equally, the Government needs to ensure that individuals have access, on an ongoing basis, to pension saving through their workplace.

Helping employers adjust to the new arrangements

- 6.34 In the May 2006 White Paper the Government recognised that employers would need time to adjust to the proposed changes and would require certainty about the nature and costs of the reforms. Therefore, the Government proposed:
- setting in primary legislation the minimum level of the employer contribution; and
 - phasing in the minimum employer contribution for personal accounts over three years, starting with 1 per cent in the first year, rising to 2 per cent in the second and then to 3 per cent in the third year – with proportionate rates of employee contributions.
- 6.35 In research 63 per cent of employers said phasing in the minimum employer contribution over time would be helpful.¹⁴ **The Government thinks three years is a good compromise, as a longer phasing period would adversely affect the pension saving of individuals and increase the costs of running personal accounts.**
- 6.36 The Government's priority is to design the scheme and the transition phase so that the burdens on employers are minimised. **As part of this work, the Government is setting up a cross-government analytical group to look at the administrative impacts of the reforms. The Government will continue to work to understand this area and how it can minimise the impact and support employers as it implements this reform.**

Phasing-in requirements for exempt schemes and sponsoring employers

- 6.37 Where employers operate existing exempt schemes, automatic enrolment should produce higher participation rates and therefore, correspondingly higher costs for these employers. Many employers' occupational schemes are more generous than the minimum the Government is proposing for personal accounts, so these costs could be significant. **The Government proposes that these employers should have the same phasing-in period as those operating personal accounts.**
- 6.38 The Government does not believe it would be appropriate simply to set employers operating exempt schemes a deadline of 2015 to deliver this change. This could create inequalities compared with those employers operating personal accounts and their employees. The Government therefore believes that there should be a framework for the phasing although this need not be the same as the framework for personal accounts.

¹⁴ Bolling K, Grant C, Fitzpatrick A and Sexton M, 2006, *Employer attitudes to personal accounts: Report of a quantitative survey*, DWP Research Report No 397.

- 6.39 The Government thinks there are two ways to achieve this:
- by phasing in contributions in a similar way to personal accounts; or
 - by allowing employers to phase in membership for different employees in stages, for instance beginning with new starters.
- 6.40 The Government would welcome views on how to ensure that employers with exempt schemes have the flexibility to manage the implementation of the reforms in the same way as employers who will operate personal accounts, and in particular whether the approach should be by:
- phasing in the minimum employer contribution or levels of accrual for exempt schemes over three years or an appropriate period;
 - phasing in by groups of employees; or
 - some other approach.

A light-touch compliance regime

- 6.41 The May 2006 White Paper stated that the proposed new rights for an employee to be automatically enrolled into either a qualifying workplace scheme, or a personal account with access to an employer contribution, needed to be safeguarded by an effective compliance regime. At the same time the Government recognised that such a compliance regime needed to be light-touch, risk-based and proportionate, in line with best practice in regulation.
- 6.42 During the development of the proposals for personal accounts, further work has been done on how the compliance regime would work in practice.
- 6.43 Our proposals are based on the following assumptions:
- most employers will seek to comply;
 - the scheme processes will assist compliance;
 - effective support for employers will be available;
 - activity to enforce compliance should impose no, or minimal, additional burdens on those employers who are complying;

- consistent with the Macrory Review¹⁵ of penalties and, in order to create a level playing field, there will be proportionate penalties for those employers who do not comply;
 - employers who do not comply should not gain a financial advantage over those who do;
 - employees who choose to save in personal accounts should not suffer detrimental treatment by their employers compared with those who opt out; and
 - the compliance regime will have full regard for the principles of good regulation as set out in the Legislative and Regulatory Reform Act, 2006.
- 6.44 The introduction of personal accounts is a large-scale undertaking where the administrative economies of scale are based on maximising take-up and therefore compliance. The primary objective will be to achieve compliance from the greatest number of employers in the shortest time and at the least possible cost to employers, employees and the Government.
- 6.45 Compliance experience indicates that employers fail to comply for one of three main reasons:
- they are unaware of the requirement;
 - they are aware of the requirement but do not know what they have to do to comply; or
 - they are aware of the requirement and know what to do, but have chosen not to comply.
- 6.46 The Government, therefore, proposes to develop a three-stage compliance regime so that the numbers of employers in the first two categories are minimised, allowing compliance activity to focus on the third category of employers who are deliberately non-compliant:
- **Educating** – in the run up to the introduction of personal accounts there will be an emphasis on raising awareness among both employers and employees about the new rights and responsibilities.

¹⁵ Professor Richard B Macrory, November 2006, *Regulatory Justice: Making Sanctions Effective – Final Report*.

- **Enabling** – immediately prior to the introduction of personal accounts and in the early years following introduction, there will be an emphasis on supporting employers. There will be clear information packs to help employers register for personal accounts and to make their first payments. There will also be a comprehensive helpline service so employers have easy access to support.
- **Enforcing** – if, after awareness raising and support, employers still fail to comply, there will be a graduated approach to enforcement with escalating penalties and an appeals process.

6.47 Responses to the May 2006 White Paper suggested that enforcement should be similar to that for the National Minimum Wage. The compliance regime for the National Minimum Wage includes:

- a helpline for employee or third-party whistle-blowing;
- penalties for non-compliance;
- claims to an employment tribunal on behalf of an employee if arrears are not repaid; and
- a limited amount of risk-based investigation.

6.48 The Government agrees that this is a good model on which to build, but considers that by itself it may not deliver the degree of compliance needed to protect the new employment rights which will have a long-term effect on people's ability to build up pension rights. The Government is, therefore, considering how to maximise protection for individuals without imposing additional burdens on the majority of employers who will comply with the new requirements. This might be through the use of remote data matching¹⁶ to identify possible non-compliance followed by enquiries and escalating penalties where employers remain non-compliant without appropriate explanation. Such an approach would be in line with the current thinking on better regulation and should have minimal impact on compliant employers.

6.49 The precise nature of the compliance regime, particularly the allocation of responsibilities, will depend on the final shape of the personal accounts scheme. The Government is looking at ways to incorporate compliance that enable enforcement activity to be automated, thereby reducing costs and burdens on employers.

¹⁶ Remote data matching is a way of identifying possible non-compliance by comparing different sets of information held for personal accounts without the need to contact employers and to ask for further information.

- 6.50 The Government will continue to discuss with stakeholders how this outline approach might work in practice. Views on the approach to compliance would be welcome, in particular:
- How can employees, who choose to save in personal accounts, best be protected from suffering detrimental treatment by their employers compared with those that opt out?
 - What type of information and support would encourage compliance?
 - How can processes be designed to encourage compliance?
 - How could the proposed penalty regime be structured?
 - How valuable would a whistle-blowing helpline for employees be?

Conclusion

- 6.51 Employers play an important role in pension provision and are central to the Government's pension reforms. The Government continues to recognise the valuable contribution they make to the pension savings of their employees. In introducing reforms, the Government wants to provide an environment where employers continue to do this either through their own provision, or through personal accounts.
- 6.52 The Government wants to help employers to adjust to the proposals. This is why the Government proposes a range of measures both to support employers' existing provision and to help them deliver personal accounts. These include:
- the minimum employer contribution for personal accounts will be phased in over three years;
 - requirements for employers' exempt schemes will be phased over three years and the Government will consult on how best to achieve this;
 - the personal accounts scheme will be designed to focus on the target market, and not to compete with existing employer schemes; and
 - the compliance regime will be light-touch, but effective.

Questions for consultation

For employers offering 'non-occupational' workplace pension arrangements, the Government is seeking views on:

- How can the Government treat such arrangements as 'schemes' for the purposes of exemption from personal accounts requirements?
- How can the Government ensure that, in the absence of automatic enrolment, these can offer similar levels of coverage and saving to those estimated for automatic enrolment?

For waiting periods in personal accounts:

- The Government is not proposing a formal waiting period in personal accounts, although it recognises there will be a short period before the automatic enrolment process is completed. This is an area in which the Government continues to welcome views.

In relation to waiting periods and scheme exemption, the Government is interested in views on:

- Whether employers with exempt schemes, with contributions or benefits that are higher than the minimum level, could operate a short waiting period, of perhaps three or six months, to encourage them to continue to offer high-quality schemes.
- What the minimum level of scheme contributions above which a waiting period is acceptable.

The Government welcomes views on how to ensure that employers with exempt schemes have the flexibility to manage the implementation of these reforms in the same way as employers who will operate personal accounts, for example by:

- phasing in the minimum employer contribution or levels of accrual for exempt schemes over three years or an appropriate period;
- phasing in by groups of employees; or
- some other approach.

With regard to the approach to compliance, the Government is interested in views on:

- How can employees who choose to save in personal accounts best be protected from suffering detrimental treatment by their employers compared with those that opt out?
- What type of information and support would encourage compliance?
- How can processes be designed to encourage compliance?
- How could the proposed penalty regime be structured?
- How valuable would a whistle-blowing helpline for employees be?

