



Chapter 7:

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Many people in this country save through good occupational or personal pension provision. We want personal accounts to complement this form of retirement saving, not replace it.

The exemption process for employer-sponsored schemes will help this. We also propose that transfers between personal accounts and other pension schemes are not allowed, but that this position is reviewed in 2020.

We welcome views on our proposed limit on annual contributions of at least £5,000.

We want to support saving between now and 2012, and we propose a contribution limit of £10,000 in the first year of personal accounts.

Stakeholder pensions will continue to be one of the options for pension saving but the designation requirement for employers will be removed on the introduction of personal accounts.

Addressing the problem of undersaving

“We already offer benefits which are at least as good as are being proposed. I guess the risk is that pension provision will be averaged down to the new level which would disadvantage people in better quality schemes but you do have to, as an employer, provide competitive packages which will attract the right sort of people.”

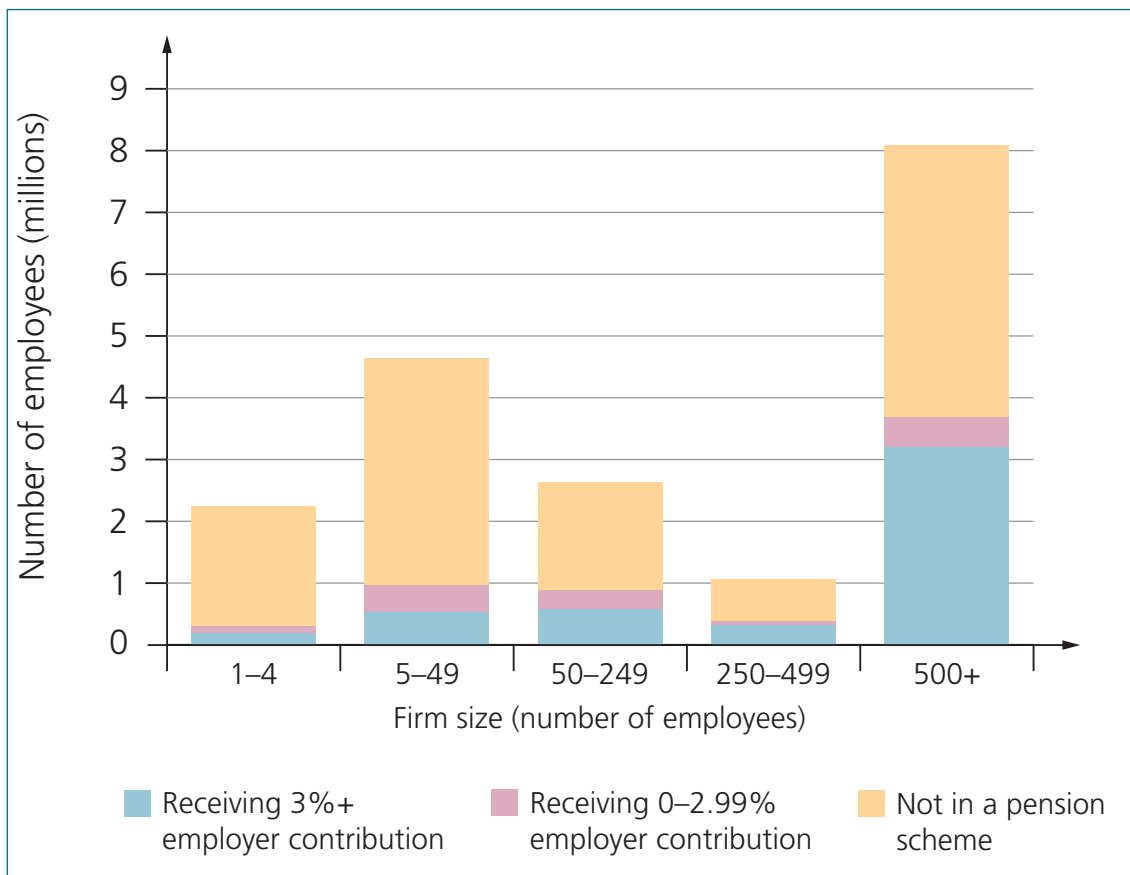
(1,000–4,999 employees, manufacturing, employer contribution)¹

- 7.1 The May 2006 White Paper was launched against the backdrop of a decline in private sector employer pension provision. This trend was clearly identified in 2004 by the Pensions Commission. Factors such as increases in life expectancy and the lower equity returns since 2000 have pushed the cost of pensions higher than had been anticipated. Some of these trends have accelerated in recent years, including the reduction in the number of employees in open private sector defined benefit schemes. As defined benefit schemes have been replaced with defined contribution schemes, average contribution levels from both employers and employees have fallen.

¹ Marshall H and Thomas A, 2006, *Employer attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 371.

7.2 Employees working in large firms are much more likely to be in a pension scheme and to be receiving relatively generous employer contributions compared to employees working in small and medium-sized firms. There are currently around 9.5 million individuals in the UK who work for an employer who does not make a pension contribution of at least 3 per cent of the employees' salary. Of these, about 8.8 million work for an employer who offers no contributions at all.² Figure 7.1 shows the proportion of employees receiving different levels of employer contributions by firm size.

Figure 7.1: Existing pension provision – scheme membership by firm size



Source: DWP analysis based on *Employers' Pension Provision Survey 2005*, *Small and Medium-sized Enterprise (SME) Statistics 2005* and *Annual Survey of Hours and Earnings 2005*

² Analysis based on *Employers' Pension Provision Survey 2005*, *Small and Medium-sized Enterprise (SME) Statistics 2005* and *Annual Survey of Hours and Earnings 2005*.

Opportunities for the financial services industry

- 7.3 The Government's proposals for automatic enrolment, minimum employer contributions and personal accounts have been designed to address these declining trends and large areas of under-provision. The combination of automatic enrolment and personal accounts will extend the private pension market to cover those individuals hitherto excluded. From 2012, between 6 and 11 million³ employees will become members of either the personal accounts scheme⁴ or an alternative employer-sponsored scheme.
- 7.4 Pension reform presents a significant new opportunity for the financial services industry. Pension schemes and providers in the existing employer-sponsored market will see a rise in membership and contributions. The personal accounts scheme will create competition for new contracts for administration and fund management services. It is estimated that the reforms will result in an annual increase in household savings of £4–5 billion a year, and in the long term the personal accounts scheme will have between £100–200 billion in funds under management.⁵

Supporting existing employer-sponsored provision

- 7.5 The personal accounts scheme is designed to be an addition to the already diverse market for pension products and not to replace existing employer-sponsored provision. Employers will be free to choose which type of scheme, or schemes, will be best suited to their business and employees' needs.
- 7.6 The principle of personal accounts as a complement to the existing market was overwhelmingly supported by a range of external partners in the consultation exercise conducted after the publication of the May 2006 White Paper. Employers and pension providers expressed a strong desire to maintain current good-quality pension schemes. We fully support this sentiment.

³ of which we estimate that between 6 to 10 million will participate in personal accounts.

⁴ Analysis based on *Employers' Pension Provision Survey 2005, Small and Medium-sized Enterprise (SME) Statistics 2005* and *Annual Survey of Hours and Earnings 2005*.

⁵ These are DWP estimates but our findings are supported by research carried out by PricewaterhouseCoopers for the DWP – Hawksworth J, 2006, *Review of research relevant to assessing the impact of the proposed National Pension Savings Scheme on household savings*, DWP Research Report No 373.

- 7.7 Many commentators have stressed the importance of ensuring that our proposed reforms result in additional saving rather than the levelling down of existing provision. It is argued that with the introduction of a minimum employer contribution of 3 per cent and mandatory automatic enrolment, employers currently offering a pension scheme may reduce access to their scheme, reduce contribution levels, or some combination of both.
- 7.8 The Department for Work and Pensions (DWP) undertook extensive research during 2006 to gain a better understanding of the impact of the Government's reform proposals on current employer-sponsored schemes. This included a nationally representative survey of over 2,500 private sector employers⁶, across a range of size bands, and in-depth research with 75 employers. The results showed that if employers experience additional costs as a result of pension reform, they will have several ways of managing them including increasing prices, offering lower wage increases or absorbing the increase through existing overheads. The option of reducing contributions into their pension scheme or levelling down did not emerge as a favoured approach. Of those employers who currently offered access to a pension scheme, only 1 per cent reported they were likely to reduce the level of contributions to their existing scheme, and only 2 per cent suggested they might close down or introduce eligibility restrictions for their existing scheme.⁷ Employers with relatively generous levels of contributions said they viewed their pension scheme as an important recruitment and retention tool that they wanted to keep.⁸

⁶ Interviews for this survey were carried out with the person responsible for making decisions about pension arrangements. About two-thirds (65 per cent) of those interviewed were the Managing Director or Chief Executive, owner or partner of the business, at director level, the Finance director or occupied senior positions in the Finance Department. Only 10 per cent of those interviewed occupied positions in the HR department.

⁷ 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.

⁸ Marshall H and Thomas A, 2006, *Employer attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 371.

- 7.9 A variety of additional surveys and studies has been carried out in addition to the research co-ordinated by DWP. Research findings can vary according to a range of factors: how many people were surveyed, who was surveyed and what questions they were asked. The additional surveys have produced a range of estimates of the potential impact of the reforms on existing provision, some indicating that the extent of levelling down will be greater than indicated by the findings described above.⁹ We have examined these studies carefully and we will continue to work with external stakeholders to understand their findings in more detail.
- 7.10 Although the messages emerging from our own research with employers are encouraging, we recognise the degree of uncertainty surrounding all of these studies. Given this uncertainty, and the importance of promoting a vibrant market outside the personal accounts scheme, we held a series of consultation events during the summer of 2006. The purpose of these events was to stimulate debate and obtain the views of external stakeholders – including pension providers, fund managers, financial advisers, regulators, consumer groups, other government departments and academic experts – on various aspects relating to the design of the personal accounts scheme. One such proposal was the National Association of Pension Funds' idea of awarding a 'quality mark' accreditation to employer schemes with contributions higher than the default level in personal accounts (see Chapter 6). Government looks forward to further discussion of this and other proposals.
- 7.11 These events were extremely useful in informing our policy development. A clear consensus emerged around the need to focus the personal accounts scheme on the target market, rather than design a scheme to compete with the successful parts of the existing market. Our stakeholders proposed several different mechanisms to achieve this, which are analysed in the next section.

⁹ Examples of other research include:

- Chartered Institute of Personnel Development, February, 2006, *Labour Market Outlook*;
- a survey of NAPF Pension Fund Members, cited in *Quantity vs Quality? Auto-enrolment and levelling down: the evidence*, June, 2006, NAPF Research Report No 5;
- research carried out by Deloitte for AEGON, AXA, Scottish Widows and Standard Life, *Pensions Reform in the Workplace*, key findings cited in press release of 17 August 2006, *Government must act to stop reform eroding workplace pensions*; and
- Association of Consulting Actuaries, *Small Business Survey*, cited in Placard, Issue 23, April 2006.

Targeting the personal accounts scheme effectively

- 7.12 The Government agrees with the emerging consensus that targeting the personal accounts scheme effectively should help to ensure that personal accounts will be a valuable addition, rather than a competitor, to existing employer-sponsored provision. We hope that successful targeting will encourage employers with current schemes to continue to provide them. The Government shares the view of the Association of British Insurers, the **National Association of Pension Funds** and others that one of the main objectives of private pension reform should be to increase the level of saving as well as the number of savers.
- 7.13 The previous chapters describe a series of measures designed to minimise administrative burdens on employers and promote the continuation of existing schemes. These measures include the proposal to phase in the minimum employer contribution and a simple, straightforward approach to the exemption of employer schemes from personal accounts. In addition, the May 2006 White Paper announced proposals to abolish contracting out for defined contribution schemes and allow occupational pension schemes to convert Guaranteed Minimum Pension rights into scheme benefits. We are conducting a deregulatory review of private pensions, which aims to make the regulatory framework simpler and less burdensome. We have already set out measures which, over the next three or four years, aim to deliver year-on-year reductions in administrative burdens. And we will set targets for reducing the burdens arising from requirements for businesses to provide information. We are working with key stakeholders to identify measures that will lighten regulation in this area. These proposals were developed after detailed discussions with key stakeholders and representative bodies.
- 7.14 The specific personal accounts consultation exercise over the summer looked at two further proposals for focusing the reforms on the target market: the policy on transfers to and from personal accounts; and the Pensions Commission's proposal for an annual limit on contributions.

Personal accounts transfer policy

- 7.15 From 2012, between 6 and 10 million pension savers will join the personal accounts scheme¹⁰, which will be an addition to an already dynamic and diverse pensions market. Individuals will be able to continue to save in their personal accounts if they move between employers offering the scheme. However, the question of transfers between personal accounts and other schemes and products needs careful consideration. The ability of individuals to transfer pension funds to and from personal accounts could have an important influence on how the market responds to the introduction of automatic enrolment and personal accounts. **We think that there is a strong case for prohibiting transfers between personal accounts and other pension products and schemes.**
- 7.16 A prohibition on transfers between personal accounts and other schemes could help to minimise any market disturbance during the transitional period. It would remove the possibility of existing schemes moving funds into personal accounts. This measure would help to ensure that personal accounts remain focused on the target market of moderate to low earners who do not have access to good pension provision.
- 7.17 Prohibiting transfers would remove the need for employers and individuals to make complex and possibly costly decisions about pension transfers. Making a pension transfer can often involve more than just moving funds – many schemes offer a range of features that could not be easily translated into the simple, straightforward personal accounts scheme. In some cases, individuals may need to take regulated advice before making such a decision. Furthermore, if we were to allow transfers between the scheme and the rest of the market this would create additional administrative requirements.
- 7.18 The consultation exercise, conducted after the publication of the May 2006 White Paper, demonstrated support from a variety of organisations for an initial prohibition of transfers.
- 7.19 We recognise that this position should be kept under review as personal accounts evolve. **We propose that the personal accounts board should review these arrangements in 2020 to assess the market impact of the reforms and to see whether this prohibition remains appropriate.**

¹⁰ Analysis based on the *Employers' Pension Provision Survey 2005*, *Small and Medium-sized Enterprise (SME) Statistics 2005* and *Annual Survey of Hours and Earnings 2005*.

An annual limit on personal account contributions

- 7.20 In its second report, the Pensions Commission recommended that any new system of personal accounts should be designed as a targeted addition to the wider pensions market. To help achieve this, the Commission proposed an annual contribution limit of approximately £3,000 for a personal account. They believed that this would discourage higher-paid employees, the majority of whom already have access to pension saving, from leaving their current provision in favour of personal accounts. In our recent consultation exercises, a range of stakeholders agreed with the Commission’s proposal for a contribution limit.
- 7.21 The Government agrees that an annual limit on contributions to a personal account could be an effective way of targeting the scheme at moderate to low earners who do not have access to an alternative good scheme. However, as we want to encourage saving beyond the default contribution level, it is important that we do not overly restrict the potential for pension saving through personal accounts. In particular, we want to ensure that particular groups of individuals, such as the self-employed, and those returning from breaks from the labour market, are able to top up their accounts after any periods of non-saving.
- 7.22 We have calculated the effects of different annual contribution levels on individuals at different income levels. We have assumed that each individual is saving at the overall default rate of 8 per cent on a band of earnings between around £5,000 and £33,500 a year, and then calculated the potential for additional saving.

Table 7.1: Effects of different contribution levels upon individuals at different income levels

Income level	Default contribution rate (8%)	Potential additional saving given contribution limit of:		
		£3,000	£5,000	£8,000
£15,000	£800	£2,200	£4,200	£7,200
£23,000	£1,450	£1,550	£3,550	£6,550
£35,000	£2,300	£700	£2,700	£5,700

Table 7.1 illustrates that:

- for the lower earner on £15,000, reaching any of the illustrative contribution limits requires significant additional contributions;
- the median earner would be constrained by a limit of £3,000 if their total contribution is higher than the default rate of 8 per cent, for example if their employer contributes more than the minimum; and
- the higher earner would have very little opportunity to make additional contributions if a limit of £3,000 was imposed.

- 7.23 As well as suggesting a contribution limit, the Pensions Commission set benchmarks for replacement rates, with 45 per cent being the minimum and 67 per cent representing many people’s aspirations for retirement. In a defined contribution scheme, such as personal accounts, the replacement rate is dependent on investment performance. Our analysis indicates that a median earner would have to contribute up to £5,000 annually to be likely to achieve the aspirational replacement rate of 67 per cent. Chapter 5 of the Regulatory Impact Assessment provides more detail on this issue.
- 7.24 The analysis above suggests that a contribution limit of £3,000, as suggested by the Pensions Commission, would overly restrict the potential for voluntary saving. While we wish to maintain the focus of personal accounts on moderate to low earners, it is also important to allow sufficient flexibility for those individuals who wish to save more. **We therefore propose that personal accounts should have an annual contribution limit of at least £5,000 and would welcome views on whether this is the right level.**
- 7.25 We propose that the personal accounts board should be able to review the limit. In doing so, they will need to balance the two key objectives of focusing the scheme on the target market while retaining sufficient flexibility for individuals to save for their retirement.
- 7.26 We want to promote long-term saving in the period between now and the launch of personal accounts. To facilitate this, **we are proposing that in the first year of personal accounts the contribution limit is set at £10,000.** This approach will help any individual who may want to move their accumulated funds up to this limit from non-pensions savings products into personal accounts.

Stakeholder pensions

- 7.27 The combination of a prohibition on transfers to and from personal accounts, and the annual limit on contributions, will help keep the scheme focused on the target market of non-savers among moderate to low earners. We also need to consider the market impact of automatic enrolment and personal accounts on the existing low-cost pension savings product – stakeholder pensions.
- 7.28 In the May 2006 White Paper, we advised that the future of stakeholder pensions would be considered carefully in the light of the introduction of personal accounts, including the current requirement placed on most employers to designate a stakeholder pension scheme for their employees.
- 7.29 We continue to see a role for stakeholder pensions in the future pensions market. Since their introduction in April 2001, stakeholder pensions have become an established pension product, with over 3 million sold at the end of June 2006. In the 2005/06 tax year, around £2.7 billion was invested in stakeholder pensions. Stakeholder pensions are a flexible and portable product, with a limit on charges and no transfer penalties, and they allow individuals to contribute intermittently, thereby enabling people with irregular income patterns to build up a pension fund.
- 7.30 We see no case for withdrawing stakeholder pensions and restricting the choice available in the pensions market. We envisage that stakeholder pensions will continue to provide a suitable option for people who may wish to supplement their other pension arrangements.
- 7.31 Looking at the stakeholder pension regulations, it is clear that, with the introduction of automatic enrolment and personal accounts imposing new obligations on employers, it would not be appropriate to retain the current stakeholder employer-designation requirements. These provisions require most employers with five or more employees to select a stakeholder pension scheme, consult their workforce about the choice, and formally designate a scheme as the one to which the company will give its workers access.
- 7.32 **We therefore plan to remove these requirements when personal accounts are introduced.** This is in line with our objective of introducing personal accounts in a way that minimises the burdens on business.

Encouraging savings in the run-up to implementation from 2012

- 7.33 Setting up a new pension scheme will necessarily take time and the problem of undersaving identified by the Pensions Commission is likely to continue between now and 2012. The Government, the Financial Services Authority and the financial services industry are already leading initiatives designed to promote public awareness and understanding of personal finance. For example:
- simplifying the tax rules has made it easier for individuals to make lump sum contributions to pensions;
 - the Financial Services Authority has moved into the delivery stage of its financial capability strategy and is providing seminars on 'managing your money' in workplaces across the country; and
 - the ABI has recently announced its 'Save More Now' campaign.
- 7.34 The decision to allow contributions of up to £10,000 in the first year of personal accounts will give people the opportunity to roll-over any savings they make between now and then.
- 7.35 We plan to work with others across government, the Financial Services Authority, industry and consumer representatives to ensure that we give the public greater clarity about saving between now and 2012. This will allow us to share expertise and market knowledge, and consider how existing savings products might be used more effectively.
- 7.36 Employers – particularly those who offer occupational pensions, make contributions and use automatic enrolment – **have a central role to play in encouraging individuals to save in pensions. We want to build on the relationships individuals have with their employer by encouraging employers to commence automatic enrolment into their existing schemes in the run-up to 2012. We will continue to provide the right environment for retirement saving, and will explore, with the industry and employers, ways to facilitate saving for retirement, in the run-up to the introduction of personal accounts from 2012.**

Conclusion

- 7.37 In this chapter, the Government put forward its proposals on transfers, contributions limits and stakeholder pensions, and described measures to facilitate retirement saving before the introduction of personal accounts from 2012. These measures will promote the continued existence of existing pension provision.
- 7.38 Our package of reforms will result in the expansion of private pension saving in the UK, to the benefit of the financial services industry. We will continue to monitor the impact of our reforms on existing pension saving, and continue to work with our stakeholders to achieve our common aim of promoting a diverse market for private pensions.

Question for consultation

Given the twin aims of focusing the scheme on the target market and allowing sufficient flexibility for individuals within the scheme:

- Should the annual contribution limit be set higher than £5,000? If so, at what level?