



Personal accounts: a new way to save

Presented to Parliament by
the Secretary of State for Work and Pensions
by Command of Her Majesty
December 2006

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Prime Minister's Foreword



There has long been recognition of the need to overhaul our pension system for a society where we all live longer. But whilst significant reforms have been introduced since 1997, a lasting settlement needs to be built on the foundations of a strong national consensus.

This is why we set up the Pensions Commission to find how our society can provide an affordable and sustainable pensions system for future generations. Its report, published a year ago, proposed the biggest shake-up of both state and private pensions seen for half a century. It involved, as expected, difficult decisions for everyone – for Government,

business, the pensions industry and individuals. But the report also set out in stark terms the consequences of continuing to duck the challenge.

Over the last year, we have worked hard to forge a national consensus around these recommendations, culminating in the White Paper published in May. It set out proposals for a modernised state pension system to provide a solid foundation of support in retirement. Matched by a gradual increase in the State Pension age to reflect increasing life expectancy, it will provide more generous State Pensions and fairer treatment for women and carers. These measures are in the Pensions Bill currently going through Parliament.

Today we build on the Commission's proposals for reforms to promote private savings. A new system of personal accounts will extend the benefits of low-cost saving to those without access to a good occupational pension. For the first time there will be a matching compulsory employer contribution. We'll make sure individuals do not miss out by automatically enrolling them into the scheme.

These are radical reforms. But they are necessary to put in place a sustainable, affordable and trusted pensions system which will meet the needs of the country and future generations by helping security and dignity for all in retirement.

A handwritten signature of Tony Blair in black ink, with a horizontal line underneath the name.

The Rt Hon Tony Blair MP

December 2006

Foreword



Our White Paper, *Security in retirement: towards a new pensions system*, set out a new structure for the long-term future of pensions in the UK. A simpler and more generous State Pension paid for by a higher State Pension age that will ensure the system remains affordable and provide a solid foundation on which to save. More generous qualifying rules will, for the first time, properly recognise the social contributions people make – and in doing so deliver fairer outcomes, especially for women and carers. And, crucially, a new system of personal accounts that will give future savers an unprecedented opportunity to take personal

responsibility for building private savings.

We estimate that around 7 million people are not saving enough for their retirement. Many are from low-income households and have been poorly served by existing pension products. Inertia and short-termism – combined with the difficulty of making the right choice – stop people from making any choice at all, while pension providers find they cannot profitably supply what is needed.

The proposals in this White Paper seek to put this right. Combined with mandatory matching employer contributions, tax relief and automatic enrolment, the new personal accounts will radically improve access to affordable, low-cost pension saving for many on moderate to low incomes who do not currently save in a private pension.

Our goal is to give people a good expectation that if they contribute to the state system for most of their career, they will be better off for having saved. Between 6 and 10 million people could eventually save into personal accounts. By retirement their pension funds could be worth up to around 25 per cent more because of lower charges – and could generate an additional £4–5 billion of new saving, equivalent to around half a per cent of GDP.

I am grateful to everyone who has contributed to the consultation process over the period since May. The proposals in this White Paper are ambitious – rightly, because the challenges we face are pressing and substantial. But we believe that personal accounts can help us meet these challenges and in doing so, embed a new pensions savings culture at the heart of a sustainable, affordable and trusted pensions settlement.

A handwritten signature in black ink, appearing to read 'John Hutton'.

The Rt Hon John Hutton MP



Executive summary

Personal accounts: simplifying pensions, enabling choice

Our proposals

We estimate that around seven million people are currently undersaving for retirement. The Government is introducing radical reform to the private pensions system to help simplify pensions and overcome the obstacles to saving. Our main proposals are:

- all eligible employees will be automatically enrolled into either a personal account or an employer-sponsored scheme. Employees will contribute a minimum of 4 per cent, matched by a minimum 3 per cent employer contribution and around 1 per cent in the form of normal tax relief from the State. This will overcome the inertia and short-termism that characterise attitudes to saving;
- a new scheme of low cost personal accounts based on the approach outlined by the Pensions Commission. This approach will maximise coverage among our target group, minimising charges and delivery risk;
- a new national minimum employer contribution to improve incentives to save and increase pension participation;
- a simple choice for members, which we expect to include ethical and branded funds for those who want them, and a default fund for those who do not want to make a choice;
- an innovative approach to delivering the scheme using a delivery authority, staffed by individuals with expertise in business and financial services;
- a governance scheme with operational independence, whose duty to consult members and act in their interests will insulate it from external pressures; and
- a set of policies to ensure that personal accounts will complement, rather than compete with, existing high quality pension provision, including no transfers in and out of personal accounts and a maximum annual contribution of at least £5,000.

Section 1: The need for reform

1. Pensions are complicated, but the idea behind them is simple – save now to spend later. Yet too many people find it difficult to save what they need for retirement. Estimates suggest around 7 million people are not saving enough for retirement.¹ Only 40 per cent of those who have not yet retired are saving for their retirement at all – yet 80 per cent say that they will need more than a State Pension to live on.²
2. Although parts of the pensions market work very well, it is failing for people on average and low incomes who do not have access to a company scheme. It is difficult for customers in this group to find the right kind of pension product for their circumstances and pension providers cannot profitably supply what is needed.

Lack of demand

“I don’t really know what goes on in how to set up a pension or anything like that, but I know that you do it at the age of around 40/50. I’ve never actually thought about doing it, it’s not something I talk about with friends or anything.”

(Not saving, 18–21, £10–20k)³

“You think about it and think I’ll deal with it another time and then that other time don’t come.”

(Not saving, 31–65, under £25k)⁴

3. Consumer demand for pensions is lower than would be needed to fund the retirement people expect. Behavioural economics suggests that there are two main reasons for this:⁵
 - **choice paralysis** – people know that choosing a pension is an important decision, but the difficulty of making the **right** choice often stops people making **any** choice; and
 - **living for today** – it is easier to make decisions about today, than about what will happen in 40 years. Many do not want to think about getting older, let alone how to save sufficient money for their retirement.

¹ Estimates of the current level of undersaving for retirement are difficult to construct because they rely on different data sources, and there are measurement difficulties. The current DWP estimate is based on analysis by the Institute for Fiscal Studies (Banks J, Emmerson C, Oldfield Z and Tetlow G, 2005, *Prepared for Retirement? The Adequacy and Distribution of Retirement Resources in England*. Institute for Fiscal Studies).

² Atkinson A, McKay S, Kempson E and Collard S, 2006, *Levels of financial capability in the UK: Results of a baseline survey*, Financial Services Authority Consumer Research Report, 47.

³ Green E and White C, 2005, *Effective means of conveying messages about pensions and saving for retirement*, DWP Research Report No 239.

⁴ Green E and White C, 2005, *Effective means of conveying messages about pensions and saving for retirement*, DWP Research Report No 239.

⁵ Chapter 2 sets out further details about behavioural economics.

4. As well as being insufficient, the demand for pensions is often ineffective. Consumers on moderate incomes typically do not understand pension products well⁶, find it hard to make comparisons, and rarely switch providers.⁷ Research by Oxera for the Association of British Insurers (ABI) found that under 4 per cent of personal pension customers and just over 2 per cent of stakeholder pension customers switch; this is lower than the switching rate observed in sectors such as fixed and mobile telephones, mortgages, car insurance, gas or electricity, and only slightly higher than that observed in banking. The result is that customers do not impose effective pressure on providers to reduce cost or improve quality.
5. This is not true of the successful parts of the pension market. In occupational pension schemes, for example, trustees act as informed customers (supported by professional advice) and are able to exert more effective pressure on providers. And for the better off buying personal pensions (including stakeholder pensions), there is the independent financial advice network to help them.

Supply gap

6. The Pensions Commission's research suggests that it costs around £800 to sell a personal pension to someone working for a medium-sized employer.⁸ However, consumers often do not persist in making contributions. More than a third of all personal pension contracts lapse⁹ after four years and this percentage is increasing.¹⁰ Assuming present persistency rates continue then, of personal pensions started today, only 40 per cent will still be receiving contributions in ten years time.¹¹
7. The combination of high up-front costs and non-persistency means that providers have a relatively short period in which to recoup the large set-up costs. This has two implications:
 - firstly, it leads to **relatively high charges**. Few personal pensions (sold on an individual basis) have charges significantly below the stakeholder pension cap of 1.5 per cent of funds under management.¹² This compares to many occupational pensions which charge 0.3–0.5 per cent; and

⁶ Atkinson A, McKay S, Kempson E and Collard S, 2006, *Levels of financial capability in the UK: Results of a baseline survey*, FSA Consumer Research Report No 47.

⁷ Oxera, 2006, *How to evaluate alternative proposals for personal account pensions: An economic framework to compare the NPSS and Industry model*, commissioned by the ABI.

⁸ Pensions Commission, 2004, *A new pension settlement for the twenty-first century: The first report of the Pensions Commission*, TSO.

⁹ Lapse – either no new contributions are made or the funds are transferred to another provider

¹⁰ Pensions Commission, 2004, *A new pension settlement for the twenty-first century: The first report of the Pensions Commission*, TSO.

¹¹ Pensions Commission, 2005, *A new pension settlement for the twenty-first century: The second report of the Pensions Commission*, TSO.

¹² Falling to 1 per cent after ten years.

- secondly, it means that it is **not economic for providers to sell individual personal pensions** to consumers on low and moderate incomes. The high costs of advice in relation to the low level of funds under management result in disproportionately high charges. High earners, who will have more funds in the scheme generating higher revenue, or those working for large employers – where economies of scale are easier to achieve – are more attractive.
8. In addition, there have been problems such as mis-selling and scheme failures in the supply of pensions which have dented trust in the market. In both cases, assistance was put in place to rebuild confidence. For the future, the Pension Protection Fund (PPF) has been introduced to act as a safety net for today's occupational pension schemes.

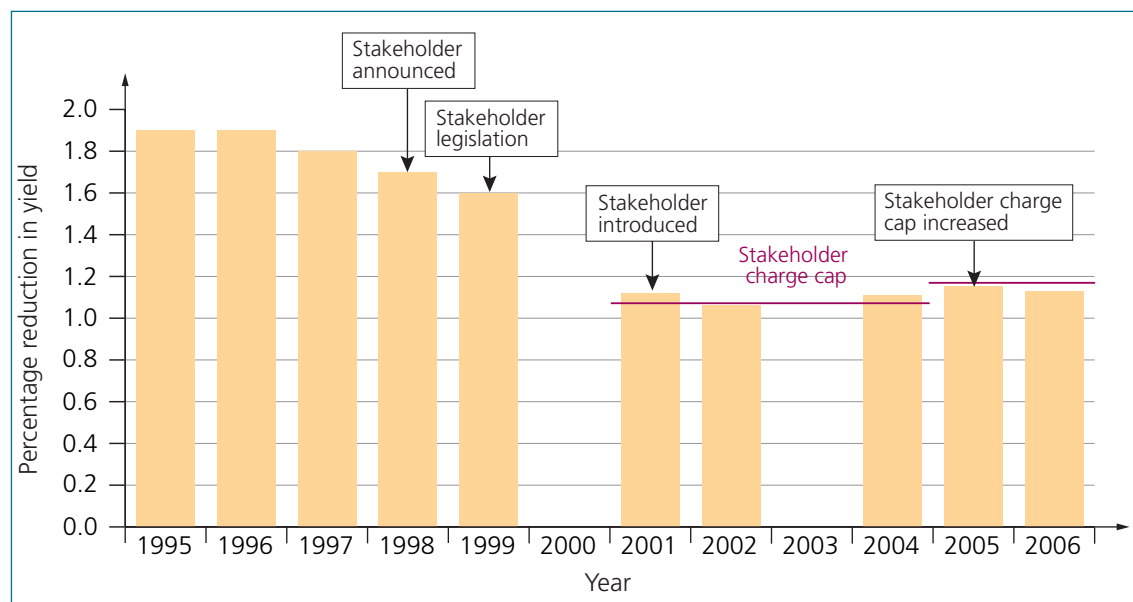
Ineffective competition

9. It is clear that competition alone is not sufficient to deliver simple, low cost, long-term savings products for those on average incomes without access to a good company pension. A well functioning market should produce improved outcomes for individuals, such as better service, reduced charges and innovative products. But the Sandler review¹³ found that this did not happen in the pension market, concluding that:
- "...competitive forces do not always work effectively to deliver value. Charges for near-identical products can differ widely."; and
 - "It is noteworthy that, in contrast to many other industries, the unit costs of the life industry have risen significantly in recent years."
10. The impact of fees and charges on the investment return in personal pensions has declined significantly since the mid-1990s, from around 1.9 per cent in 1995 to around 1.1 per cent in 2002 as shown in Figure 1. However, this may have been driven by regulation rather than competition. The Pensions Commission reported¹⁴ that the decline: "...to a significant extent reflects the introduction of the stakeholder pension charge cap, set at 1 per cent annual management charge (AMC)...in 2001, and regulatory guidance from the Financial Services Authority which has meant that financial advisers could not recommend products with charges significantly above this price cap."

¹³ *The Sandler Review of Medium and Long-term Retail Investment*, July 2002.

¹⁴ Pensions Commission, 2004, *Pensions: Challenges and Choices, The First Report of the Pensions Commission October 2004*, see Appendix C.

Figure 1: Impact of regulation on charges over time

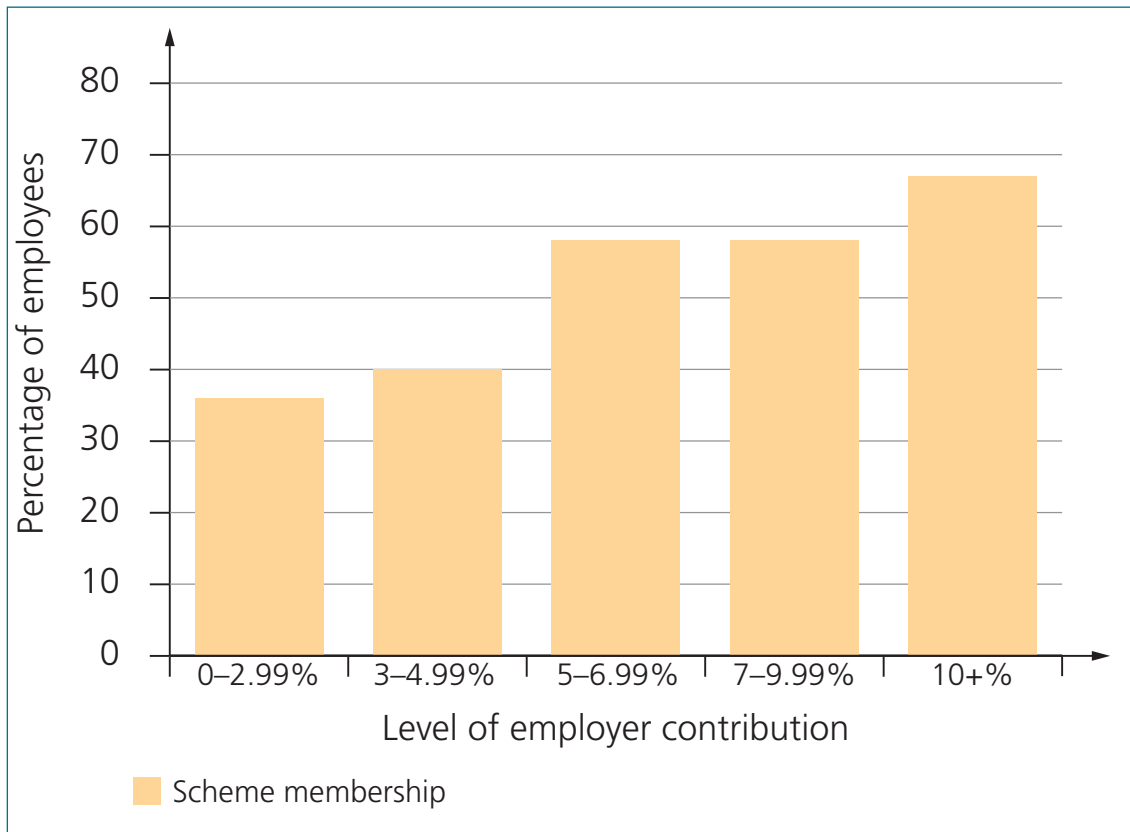


Source: FSA disclosure reports and comparative tables

Scale of the challenge

- Where the problems of low demand and supply do not apply, the pensions market works very well. Company pensions achieve much lower charges. People who work for a company with a good-quality pension scheme are more likely to be saving for a pension than those who are not in that position. As can be seen in Figure 2, the higher the level of employer contribution in employer-sponsored provision, the higher the participation rate.

Figure 2: Existing pension provision: scheme membership by contribution levels

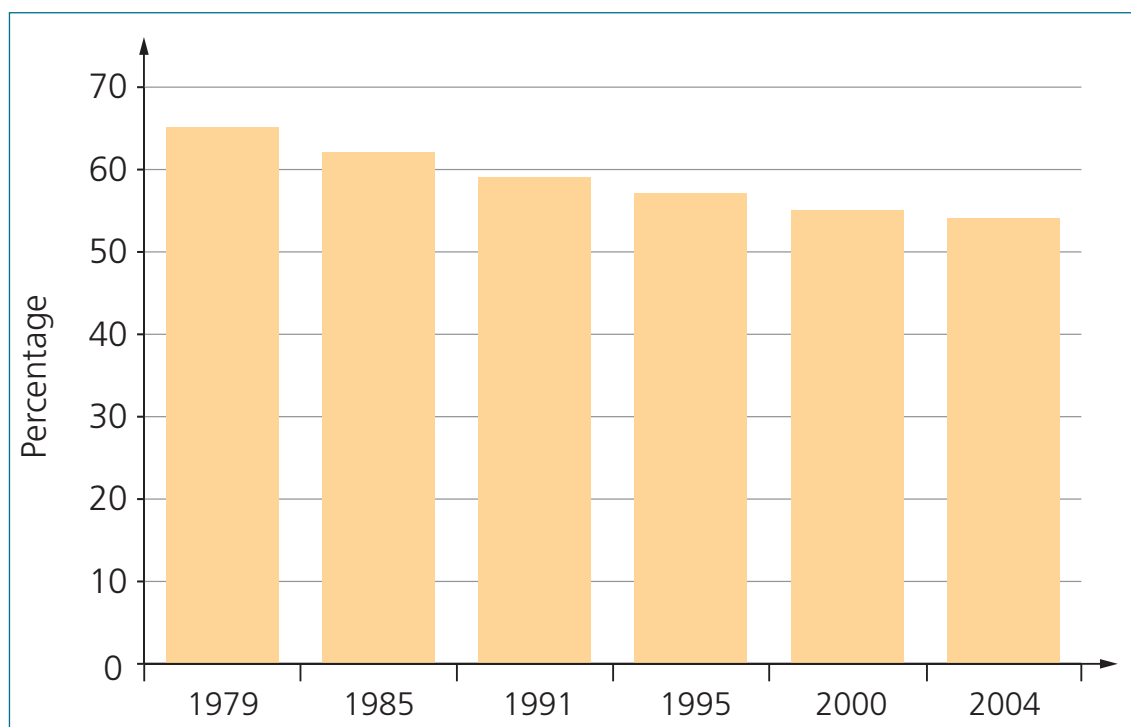


Source: DWP analysis based on Employers' Pension Provision Survey 2005, Small and Medium-sized Enterprise (SME) Statistics 2005 and Annual Survey of Hours and Earnings 2005

12. Where employers are engaged in pension provision, and employees are participating, employees are able to build up good pensions. However, as identified by the Employer Taskforce on Pensions¹⁵, there has been a retreat by employers from providing pensions and the Pensions Commission concluded that this trend was unlikely to be reversed.

¹⁵ ETF Report to the Secretary of State for Work and Pensions. Published December 2004 www.employertaskforce.org.uk

Figure 3: Membership of current employer's pension scheme for full-time employees 1979 to 2004



Source: General Household Survey, GB

Notes: Full-time employees aged 16 and over. Prior to 1985 full-time students are excluded. Later figures include full-time students who were working but exclude those on Government schemes. Figures include a few people who were not sure if they were in a pension scheme but thought it was possible. Data from 2000 onwards are weighted.

13. Overall participation in occupational schemes is falling as illustrated in Figure 3. In 1979, 65 per cent of employees were members of their current employer's pension scheme compared to 57 per cent in 1995, and around 54 per cent in 2004.¹⁶ The percentage of private sector employees participating in occupational pensions fell from around 40 per cent in 1991 to around 25 per cent in 2005.¹⁷

¹⁶ General Household Survey, GB.

¹⁷ Analysis based on the Government Actuary's Department's Occupational pension schemes survey and Office for National Statistics employment data.

14. The Government wants to support employers providing pension schemes. The combination of problems with both demand and supply, and a lack of effective competition within some sectors of the pensions market, mean that a voluntary approach to private saving is unlikely to be sufficient to tackle the current barriers that prevent people from saving optimally. This trend is particularly pronounced amongst young people, with fewer of those in their 20s and 30s saving than even five years ago.¹⁸
15. The Pensions Commission found that between 9.6 and 12 million people were undersaving based on the benchmarks they set out. Further analysis by the DWP has refined that estimate to around 7 million people.¹⁹
16. Without action, millions of today's workers could retire without having built up sufficient pension savings to fund the lifestyle they are expecting. The Commission concluded that a voluntary approach to private pension saving would not be enough to close that gap.
17. Automatic enrolment into existing stakeholder schemes would go some way to dealing with the lack of demand in the pensions market for our target group, by overcoming the inertia that leads many individuals not to make a decision to save. It would also increase the number of savers and the amount of savings in stakeholder schemes. However, automatic enrolment into stakeholder pensions would not help to increase the persistency of saving, because members would not automatically stay in the same pension when they moved jobs. This could also lead to increased burdens on employers. Our work, and that of the Pensions Commission, suggests that this would not lead to a significant reduction in charges for our target group and would therefore not represent good value.

¹⁸ *Family Resources Survey*.

¹⁹ Estimates of the current level of undersaving for retirement are difficult to construct due to: difficulties identifying appropriate saving targets; uncertainties about which kinds of wealth and asset to take into account; difficulties projecting individuals' future saving and working patterns, particularly around choice of retirement age; reliance on inadequate data; and reliance on a range of other uncertain assumptions, including the impact of future macro-economic developments. Consequently, such estimates should be treated cautiously. The current Department for Work and Pensions (DWP) estimate draws on analysis by the Institute for Fiscal Studies (Banks J, Emmerson C, Oldfield Z and Tetlow G, 2005, *Prepared for Retirement? The Adequacy and Distribution of Retirement Resources in England*, IFS). The May 2006 White Paper (*Security in retirement: towards a new pensions system*) sets out some of these issues in more detail.

18. None of these problems are new but they could have more serious consequences as people live longer and fewer children are born. Today there are almost four working age people for each pensioner.²⁰ By 2050, without action on the State Pension age, this would have fallen to two working age people for each pensioner.²¹
19. Without an increase in private saving, future generations could retire poorer than today's pensioners, and poorer than they expect to be. This could lead to pressure to increase State Pensions, but the demographic trends would make this hard to fund. If there were only two working age people for each pensioner, the cost of dealing with the consequences of a failure to save would be very high, and fall disproportionately on future generations.

Section 2: Our approach – fairness and empowerment

20. Since 1997, the Government's goal has been to provide security in retirement for all pensioners. On coming to office the priority was to tackle the legacy of pensioner poverty. Thirty per cent of pensioners were below the poverty line and those on means-tested benefits were expected to live on only £69 a week.
21. The Government introduced the Minimum Income Guarantee for pensioners, now part of Pension Credit. This has raised the minimum income that pensioners are expected to live on from £69 a week in 1997 to over £114 a week today. Pensioners have also benefited from the Winter Fuel Payments, basic State Pension rising 9 per cent faster than inflation, higher age-related tax allowances and free TV licences for the over 75s.
22. We now spend over £10 billion a year (nearly 1 per cent of national income) more on pensioners than we would have done if we had simply continued the policies inherited in 1997. The amount spent on pensioners has gone up faster than earnings. As a result, pensioners are, on average, £26 a week better off, with the figure for the poorest pensioners being £38 a week in real terms. More than 2 million pensioners have been lifted out of absolute poverty and 1 million out of relative poverty. A pensioner in Britain today is no more likely to be in poverty than anyone else.
23. In addition to tackling the immediate priority of pensioner poverty, the Government has started to reform the pensions system to meet the pressures of an ageing society.

²⁰ Working age is defined as those aged 20 to 64 for both men and women. Pensioners are defined as those aged 65 or over for both men and women.

²¹ Analysis based on the Government Actuary's Department's 2004 population projections. The proposed changes to State Pension age will increase this ratio from two to one, to three to one.

Helping more people to save

24. The State Second Pension was introduced in 2002, providing greater support for lower earners and some carers who did not qualify for its predecessor, the State Earnings Related Pension Scheme (SERPS). As a result, some 4 million people now have the chance to build up a decent second pension for the first time.
25. The Government introduced stakeholder pensions in April 2001 to provide access to good value and flexible personal pensions. Employers with five or more employees are required to provide access to a stakeholder pension scheme unless they already offer an occupational scheme to all staff, or make employer contributions of at least 3 per cent of basic earnings into personal pensions. The regulation of charges has led to a significant reduction in average charges, increasing the pension fund for an average earner by approximately 20 per cent.²² Stakeholder pensions were a first step to extending access to private pensions – but coverage is still not universal.
26. The Government has also acted to increase the security of private pension saving, in the light of failed company pension schemes. Whilst we cannot change the past, we can learn lessons for the future, and help those who are in greatest need. The Financial Assistance Scheme will provide over £2 billion in cash terms to help those up to 15 years from retirement who lost out before the Pensions Protection Fund (PPF) was established. For the future, the PPF creates a safety net for employees saving today in company pensions. Over 14 million²³ members of salary-related pension schemes now know that they will receive compensation if their employer becomes insolvent and the pension scheme is under-funded.
27. The new Pensions Regulator is also helping to protect members' benefits and promote good administration of work-based pension schemes. The Regulator has wide powers to investigate schemes and take action where necessary, and takes a proactive, risk-focused approach to regulation.
28. In April 2006, the many sets of rules governing the taxation of pensions were replaced by a single universal regime for tax-advantaged pension saving. There are now no limits on the amount of money people can save in a pension scheme, although there are some limits on the amount of tax relief. Savers have the opportunity to build up a tax-free pension fund of up to £1.5 million, rising to £1.8 million in 2010.

²² Average annual management charges have fallen following the introduction of stakeholder pensions, from approximately 1.9 per cent in 1995 to around 1.05 per cent in the long term. Estimate is based on a male aged 25 in 2012 who is a median earner (£23,000 a year in 2006/07) saving for 43 years.

²³ This figure is based on the numbers of active members, deferred members and pensioners in private sector defined benefit schemes from the Government Actuary's Department's survey *Occupational Pension schemes 2005*.

29. In the past the system assumed that everyone was the same and retired at either 60 or 65. But we know that people want the freedom to choose how and when to stop work. Rather than forcing everyone into the same mould, we recognise people's different aspirations and needs.
30. Now, those who choose to claim the basic State Pension at 70 will receive £130 a week basic State Pension – over 50 per cent more than the amount at 65. The Government has taken steps to outlaw age discrimination and promote older working. Already, 1 million people above the State Pension age are in work. The employment rate of those over 50 is closing the gap with those below 50.

Building a long-term consensus

31. Whilst these and other significant reforms to the pension system have been introduced since 1997, further reform is needed given the scale of change in society. This is why, in 2002, the Government established the independent Pensions Commission to review the regime for UK private pensions and long-term saving. It was asked to consider the longer-term pressures faced by the pension system and whether the existing voluntary pensions regime was an adequate response. The Commission concluded that there was no immediate crisis, but set out the longer-term challenge and the need for early reform.
32. If reform is to be successful it needs to be built on the foundations of a strong national consensus. That is why the National Pensions Debate was launched, culminating in a National Pensions Day involving over 1,000 people in March 2006. We invited a representative cross-section of the working age population to take part in simultaneous, interactive, discussion events in six different cities across the UK. After a day debating the issues, 88 per cent of participants agreed that people would have to save more for their retirement and almost three-quarters agreed that employees should be automatically enrolled into a personal account.²⁴
33. *Security in retirement: towards a new pensions system* set out the Government's response to the Pensions Commission's second report. The Government committed to:
 - improving the foundation for all in retirement whilst continuing to tackle pensioner poverty. Both the basic State Pension and the standard minimum guarantee element of the Pension Credit will be uprated in line with average earnings, rather than prices. The State Pension will be made fairer and more widely available and the State Pension age will be raised in line with increasing longevity; and

²⁴ Opinion Leader Research, 2006, *National Pensions Debate Final Report*, Research carried out for DWP.

- introducing low-cost personal accounts to give those without access to employer-sponsored pension schemes the opportunity to save. People will be automatically enrolled into either their employer's scheme or a personal account, with the freedom to opt out. Employers will make minimum matching contributions.
34. Since the publication of the May 2006 White Paper, the Government has consulted widely and worked with the main opposition parties, pension experts, lobby groups and the public. This consultation was summarised in the consultation response published last month.

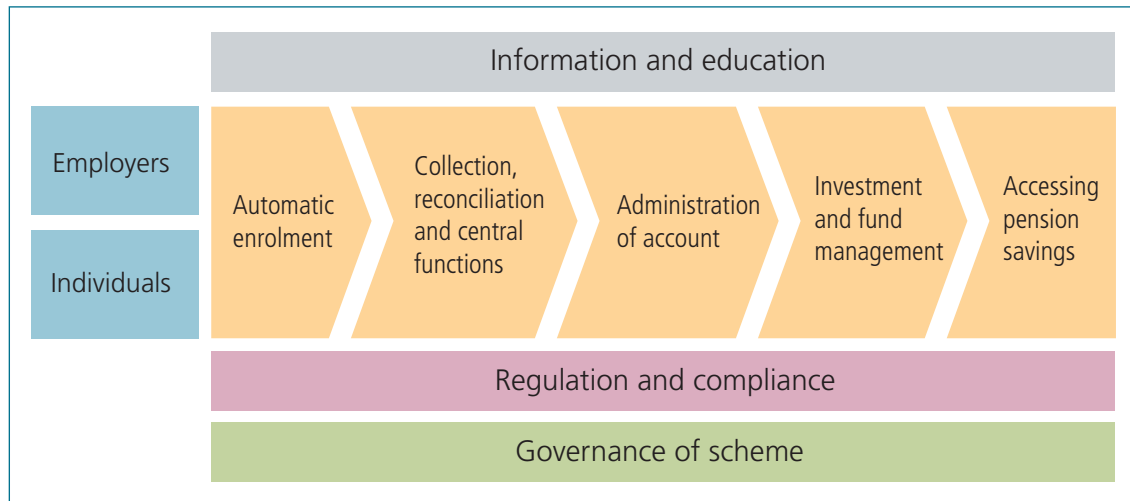
Conclusion: empowering savers, enabling markets, ensuring fairness

35. The Pensions Commission made clear, and the Government accepted, the need to act now. Without action, tomorrow's pensioners could end up poorer than they expect to be. Our approach will reform the system to:
- **empower savers:** it is difficult for those without access to good occupational pension schemes to provide for their own retirement. Personal accounts, together with reforms to State Pensions, will enable far more people to make clearer choices about how best to plan for their retirement;
 - **enable markets:** a combination of customer inertia and high costs means that the market has not delivered for those on low and moderate incomes. Automatic enrolment into personal accounts opens up a new market for the UK pensions industry; and
 - **ensure fairness:** women have traditionally done less well from the pensions system. Reforms to State Pensions will reflect the different ways in which people contribute to society and will ensure that carers are able to build up entitlement to the State Pension. And our analysis shows that 2 to 3 million women in employment could begin saving in a personal account, or into their employer's scheme, as a result of the private pension reforms.
36. This White Paper focuses on reforming private pensions by **empowering savers** and **enabling markets**. In this summary we show how we will tackle high costs and low portability through personal accounts (Section 3), inertia and short-termism through automatic enrolment (Section 4), and incentives to save through minimum contributions matched by compulsory employer contributions and tax relief (Section 5). Together, these reforms will give everyone the chance to build up a private pension through a simple, good value, new way of saving.

Section 3: What are personal accounts and how will they be delivered?

37. Personal accounts are intended to solve the problems of low portability and high charges. They will do this by operating as a large, multi-employer occupational pension scheme and extending the benefits of employer schemes to those currently without access to them.
38. The large scale of personal accounts means that the set-up costs can be spread over a longer period and recovered from higher funds under management, thus reducing the average charge. This large scale will allow personal accounts to achieve economies of scale similar to those of large occupational schemes. However, unlike many employer schemes, individuals will be able to keep their account as they change jobs and continue to make contributions.
39. The Government estimates that personal accounts could have between 6 and 10 million members with private pension saving of around £8 billion a year, of which approximately 60 per cent will be new saving.
40. Personal accounts are a major development in the UK pensions system and arriving at the right decision on how to deliver the scheme is vital. The May 2006 White Paper set out at a high-level those functions necessary for delivering any personal accounts system (illustrated in Figure 4):
 - **automatic enrolment:** individuals would automatically join the personal accounts scheme through their employer;
 - **collection, reconciliation and central functions:** a central clearing house would be responsible for collecting contributions through employers, handling employer queries, keeping records of contributions and ensuring that contributions are allocated to the right funds;
 - **administration of accounts:** the administrator would maintain the account for the individual, handle an individual's queries and be responsible for giving them information about their account;
 - **investment and fund management:** the fund manager would invest contributions on behalf of the saver; and
 - **accessing pensions savings:** when a saver retires they would annuitise their savings through the current annuity market, giving them a regular income throughout their retirement.

Figure 4: The structure of personal accounts



41. The May 2006 White Paper set out the broad consensus that this is the right overall structure for personal accounts. But it made clear that there were different views about how the model should be delivered. Two broad models, both based on primarily private sector delivery, had emerged:
- **the National Pension Savings Scheme (NPSS) model** – as proposed by the Pensions Commission, personal accounts would be run by a single organisation – the NPSS. Day-to-day management and operations would be outsourced to private-sector administrators. All customers would deal with the NPSS and would receive consistent service standards. Savers would be able to make decisions about whether to opt out of the scheme, whether to contribute above the minimum and their preferred approach to investment; and
 - **the provider model** – some argued that personal accounts should be delivered through existing pension providers. Rather than being governed by an arm’s length organisation, consumers would choose a pension provider. Those who did not choose would be assigned to a provider.

Evaluating the models

42. A number of variants of these two approaches have been proposed since the publication of the May 2006 White Paper. A thorough evaluation of the possible delivery models has been undertaken by government, working closely with industry, employers and their representatives, consumer groups and regulators. The detailed evaluation is set out in Chapter 2 and the accompanying Regulatory Impact Assessment.

43. As the full evaluation makes clear, all the operational models have advantages and disadvantages. At the heart of all the models is a choice of the appropriate form of competition: competition for the market or competition for the customer. With competition for the market, providers compete to win contracts for administration or fund investment. With competition for customers, branded providers compete to win more customers.
44. Our assessment is that competition for the market will be more effective in maximising coverage and delivering low charges for the target group. Our analysis has also shown the importance that people place on simplicity in pension design. This highlights the necessity of building a scheme that simplifies the decisions people need to take and focuses their decisions on the key area of investment. For the reasons explained in the following sections, we are proposing an NPSS approach for personal accounts but with a choice of funds for those who want it.

Maximising coverage

45. Personal accounts are intended to serve a part of the market that has not previously had access to good-value pension savings. This is a diverse group of people – many of whom will value extra choice. However, there will also be many who feel uncomfortable when expected to make complicated, unstructured choices.
46. Evidence from DWP research suggests that savers, especially those earning less than £30,000 a year, prefer not making a choice of administrator, whether from a panel or the open market.²⁵ Less financially aware consumers expressed concerns about having to make a choice, which they considered daunting, and might put them off participating. The NPSS approach offers simplicity for these individuals (and employers) and as such, is likely to maximise participation levels.

Minimising charges

47. There is unlikely to be a significant difference in approaches to fund management between the models. Both models will use the best expertise in investment to manage individuals' funds. Low charges are critical to ensuring that people build up the maximum pension fund from their savings. A male median earner who started saving aged 25 in 2012 and saved for 43 years, could have around a 20 per cent smaller final pension fund if the level of charges was 1.5 per cent rather than 0.5 percent.²⁶

²⁵ Hall S, Pettigrew N and Harvey P, 2006, research by Ipsos MORI for DWP, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

²⁶ In this analysis we assume that there is no relationship between annual management charges and the returns achieved by managers for investors. 'Active' fund managers usually charge much higher fees compared with 'passive' fund managers, but evidence to date suggests that both types of fund managers achieve a similar rate of return. Research on this area is ongoing.

48. Higher levels of persistency are expected in the NPSS approach as it will not be based on firms competing to encourage people to switch. This, along with reduced marketing costs due to firms not competing for individual accounts, should drive down costs. As a result, the NPSS approach is expected to be 20 to 25 per cent cheaper than a system based on direct competition between firms for individuals. Like the Pensions Commission, we are confident that the scheme can achieve a radical reduction in pension charges even in the short term and we will give the personal accounts board a statutory duty to deliver low costs to its members. We estimate that the long-term costs for personal accounts will be in line with those set out by the Pensions Commission of around 0.3 per cent of funds under management or even lower.
49. Some of those proposing models with competition between branded providers have suggested that in the longer term these models would be cheaper as competition would drive down costs over time. There is little evidence that competition for customers will provide significant downwards pressure on charges. Recent falls in charges have been a result of regulation, not competition. Similarly, international evidence from other countries shows that the lowest-cost systems are those with a limited choice of provider and/or investments – for example the Thrift Savings Plan in the United States.

Minimising delivery risk

50. Simplicity is key to building a successful scheme. It is what individuals say they want and it will help to minimise delivery risks. The NPSS approach to personal accounts offers a clear line of accountability and responsibility for the overall project. It minimises the number of points of contact for employees and employers, and minimises the number of links between providers – where problems can typically occur. In contrast, the provider-led model would involve multiple contracting partners with no one body in overall control.
51. The simplicity of the scheme can affect the level of consumer protection. The Financial Services Authority has pointed out²⁷ that the risk of aggressive competitive practices, which could be detrimental to consumers, is removed in the NPSS approach. Confidence among individuals that any system of personal accounts is run in a fair and transparent manner is necessary to encourage people to remain opted in to the scheme. International experience, for example the Swedish PPM system, shows that pension schemes on this scale can be implemented successfully.

²⁷ *Security in retirement: towards a new pensions system*, The Government's White Paper on pension reform – Financial Services Authority response.

Investment choice in personal accounts

52. Evidence²⁸ reveals a widespread lack of confidence among UK consumers in their ability to make decisions about financial products. In our target market, this is aggravated by low levels of financial capability.²⁹
53. Personal accounts, therefore, must be designed so that they work for this part of our target group. We need to structure the choice so that as many as possible feel confident making the right decisions for themselves and those that do not feel able to take decisions are not disadvantaged.
54. Those who want a simple approach to saving will only have to decide whether to remain in the scheme and how much to contribute:
- There will be a default fund for this group.
 - It will be for the personal accounts delivery authority (see Section 7) to design an appropriate default fund that balances the need to maximise returns against the risk of individuals' funds falling in value.
 - We anticipate that the default fund will need to invest in a wide range of assets to reduce the risks associated with the performance of specific assets.
 - The default fund is also likely to incorporate a degree of lifestyling³⁰ to reduce the risks around the time of accessing savings.
55. Whilst the majority will be content with this level of choice, research shows that some members of our target group will want additional options.³¹ This could be a choice of administrator, fund or both. Whilst some on higher incomes said they would like a choice of administrator, the price of delivering choice for this small group would be higher charges for all customers. Given that high income customers are already well served by private pensions, choice of administrator is not a priority for personal accounts.

²⁸ Marketing Sciences (2006), *Retirement Planning Monitor*. Hall, Pettigrew and Harvey, 2006, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

²⁹ Atkinson A, McKay S, Kempson E and Collard S, 2006, *Levels of financial capability in the UK: Results of a baseline survey* Financial Services Authority Consumer Research Report, 47.

³⁰ where members' contributions are invested in riskier, higher return assets when they are young, and then in safer assets, such as gilts, as they get close to retirement.

³¹ Hall, Pettigrew and Harvey, 2006, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

56. Research suggests that there is a demand for additional fund choice.³² In particular, younger respondents say they want to have the choice to invest ethically³³ and it may also be the case that there will be demand for investment options that conform to religious beliefs.
57. We will, therefore, task the delivery authority and then the personal accounts board to design investment options that best meet the needs of members. This will include a default fund and we expect it to include other options such as social, environmental and ethical investments, and branded funds. The inclusion of extra fund choice for those that want it could provide competitive pressure on the main investment funds as well as promoting personal responsibility amongst this group by encouraging higher contributions. It will be important to structure the choice of investment so that it benefits those who want to make a choice, without making the scheme confusing, whilst ensuring that charges are fair between different groups of customers.
58. The delivery authority and the personal accounts board will design these options based on consultation with people in the target group. The role of the Government will be to set down the general objectives for personal accounts but not to be involved in specific investment decisions.
59. Clearly, the investment options will need to be able to evolve over time, and the personal accounts board will need to take account of the changing trends in financial markets to refine what is available and how choice is delivered.

Governance

60. Personal accounts will be a defined contribution, occupational scheme. The personal accounts board will be responsible for oversight and prudent management of the scheme as a whole. It will ensure that the scheme operates smoothly within the framework set out by legislation, and according to the principles of good governance and accounting. It will ensure that funds are invested prudently and in the best interests of members. In particular, it will be responsible for ensuring that contractors carry out their functions efficiently and in accordance with obligations set by the statutory framework.
61. It is the Government's expectation that the personal accounts regulatory regime will be based on the existing framework rather than adding to the regulatory landscape. Work to decide the allocation of regulatory roles will be taken forward alongside the deregulatory and institutional reviews, and in consultation with the appropriate bodies.

³² Malcolm K and Wilsdon T, 2006, *Branded choice in personal accounts*, CRA International.

³³ Hall, Pettigrew and Harvey, 2006, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

Section 4: What this will mean for individuals?

62. Personal accounts are designed for the approximately 10 million people who are currently not participating in a pension scheme offering at least a 3 per cent employer contribution, are aged between 22 and State Pension age and earning over £5,000. This is the target group for personal accounts. We know that employees who are not currently contributing to a private pension tend to be younger and on low to moderate incomes. They are also likely to be part-time workers and/or to work for small employers. A high proportion of women are lower earners and are less likely to be members of an employer pension. Personal accounts will help to address this.
63. We propose that:
- individuals will be automatically enrolled if they earn above £5,000;
 - employees will pay contributions of around 4 per cent on their earnings between approximately £5,000 and £33,500 a year³⁴;
 - the employee contribution will be matched by 3 per cent from the employer together with around 1 per cent in the form of normal tax relief from the State³⁵;
 - the band of earnings on which contributions will be paid will be uprated in line with earnings to ensure the scheme is sustainable;
 - employees aged over 22 and below State Pension age will be eligible for automatic enrolment; and
 - employees outside these age bands will be able to opt in to the scheme, with access to an employer contribution if they fall within the earnings bands.
64. The Pensions Commission argued that a voluntary approach would never be enough to change pension savings behaviour. They recommended that we create a new form of saving, where employees are automatically enrolled into a pension, and have to make an active decision not to save, to tackle the problems of the short-termism and inertia of savers.

³⁴ When launched, the limits for the personal accounts earning band will be aligned with the Primary Threshold and Upper Earnings Limit for National Insurance contributions (£5,035 and £33,540 a year respectively in 2006/07).

³⁵ 1 per cent represents basic rate tax relief on individuals' contributions – in addition, individuals may be entitled to higher-rate tax relief and neither employers nor employees pay tax or National Insurance contributions on employer contributions.

65. This does not mean employees will be compelled to save. The Commission rejected a compulsory approach to private saving because there will always be some groups who should not be saving towards a pension – for example those paying off high burdens of debt. But the Commission argued that automatic enrolment was necessary to help people make the right choice for their retirement and the Government agrees.
66. Evidence shows that automatic enrolment is one of the most effective ways of combating people's tendency not to act when faced with difficult financial decisions.³⁶ Automatic enrolment has the greatest impact among groups where participation rates are low. American research into 401(k) schemes showed that automatic enrolment had the largest effect among people with low incomes, minority ethnic groups and women.³⁷

Responses to automatic enrolment

"The CBI supports automatic opt-in policies and has consistently encouraged firms to consider introducing such a practice."
(Confederation of British Industry)

"We believe the 'soft compulsion' of auto-enrolment represents the right balance between encouraging and forcing saving."
(Age Concern)

How will automatic enrolment work in practice?

67. When an employee starts work, they will be automatically enrolled into a pension; either into a personal account or into their employer's pension scheme. We have decided that employees aged under 22 should not be automatically enrolled in this way, because the evidence suggests they are more likely to move jobs more frequently.³⁸ The administrative costs associated with frequent job changes in this age group might reduce the incentives for employers to hire younger workers. In addition, it is likely that younger workers' employment is more sensitive to non-wage costs, which is why the minimum wage has a lower rate below 22.

³⁶ *The Employers' Pension Provision Survey 2005* findings show a link between automatic enrolment and increased levels of pension scheme membership. Within private firms with 20 or more employees, the proportion of employees that were in a pension averaged 60 per cent (median 77 per cent) where the firm used automatic enrolment. This compared with 41 per cent for traditional opt-in.

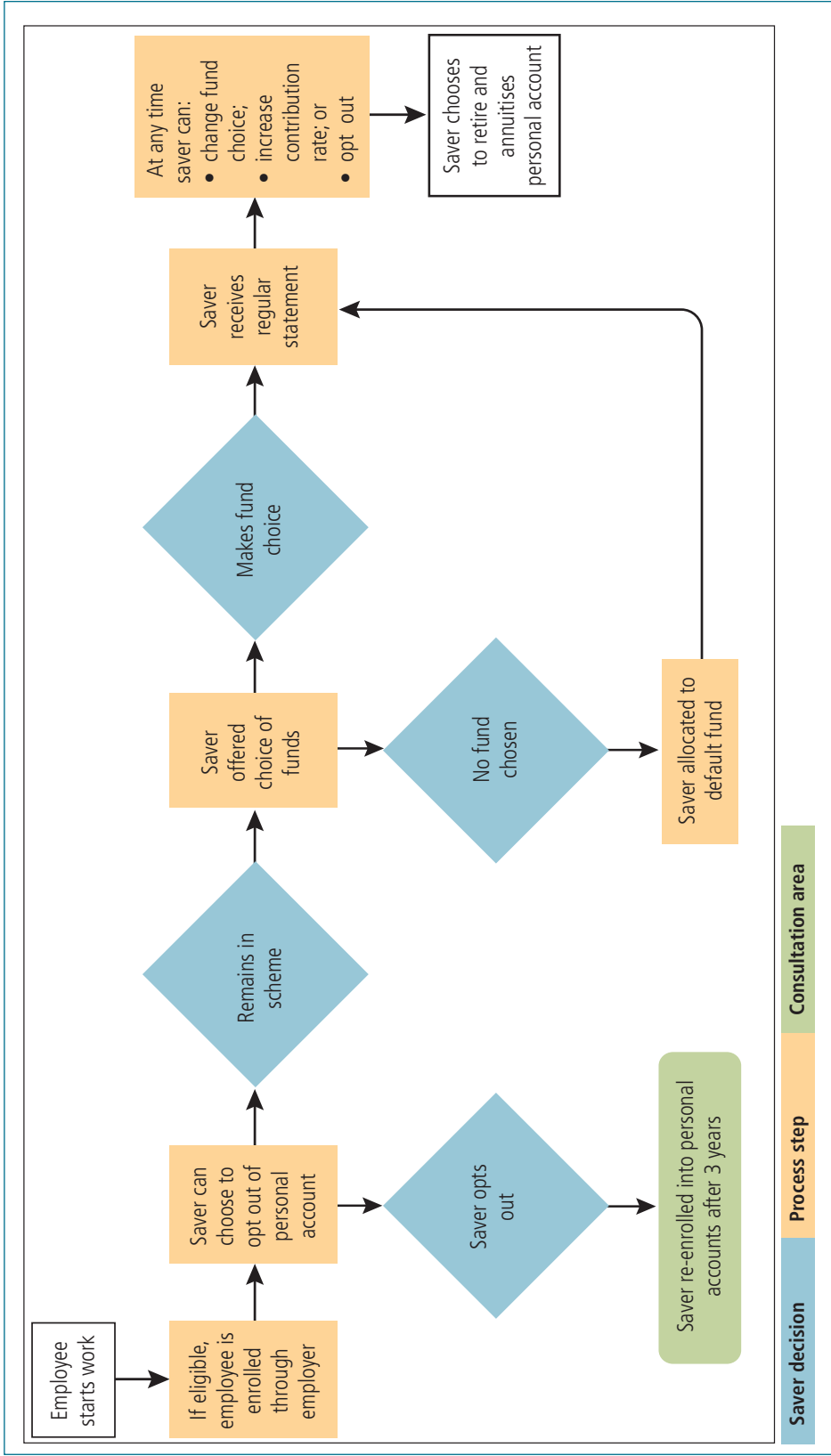
³⁷ Madrian and Shea, 2002, in Munnell and Sunden, 2004, *Coming up short: The challenge of 401(k) plans*, The Brookings Institute.

³⁸ Under 22-year-olds are more likely to move between various labour market states and change employment than people over 22. This is based on average annual flow data, Labour Force Survey, spring/summer 1997 to winter/spring 2004.

68. Employees will contribute around 4 per cent of their salary on their income between the earnings limits of around £5,000 and £33,500. This will be matched by a contribution of 3 per cent from their employer and around 1 per cent from the normal tax relief available on individual pension contributions.
69. The Pensions Commission recommended an 8 per cent combined contribution with the goal of providing a minimum level of pension for most people. Based on their research with individuals³⁹, they argued that the minimum the median earner wanted in retirement was 45 per cent of their working income. These contribution levels are intended to achieve that level, although actual outcomes will obviously depend on a number of factors, for example investment returns.
70. Many people will want more than this level of pension and should, therefore, benefit from additional contributions. These extra contributions would attract normal tax relief but not a matching employer contribution. The personal accounts board will be given a duty to encourage saving above the minimum level of contributions.
71. Once personal accounts are up and running and a new employee already has a personal account from a previous job, the employee could be 'fast-tracked' back into personal accounts. Figure 5 illustrates the individual experience of being automatically enrolled into a personal account.

³⁹ Pensions Commission, 2005, *A new pension settlement for the twenty-first century: The second report of the Pensions Commission*, TSO.

Figure 5: The individual's experience in personal accounts



72. Government provides generous tax relief to those who save in tax-advantaged pension schemes to encourage individuals to save for an income in retirement. Personal accounts will be a tax-registered pension scheme and so individual savers will have access to pensions tax relief on contributions. This means that for a basic rate taxpayer every £1 saved will be matched by 28p from the State.
73. Automatic enrolment will help people save for a pension. But it does not replace people's responsibility to ensure that their retirement income meets their expectations. The goal of our policy is to give people a reasonable expectation that if they save in a pension they will be better off for having done so. Whether to save or not must remain the individual's decision.

Impact of the state pension reforms

74. The state pension reforms currently before Parliament will provide a firm foundation on which people can build through their private saving to reach the standard of living they would like in retirement:
- **Increased coverage of State Pensions** – in the past, women and carers have not had the same access to State Pensions as men. After reform, around 75 per cent of women reaching State Pension age in 2010 will be entitled to a full basic State Pension and this will reach over 90 per cent of women (and men) by 2025.
 - **Reduced reliance on Pension Credit** – restoring the link between earnings and the basic element of the State Pension, and changes to how Savings Credit is calculated, will ensure that Pension Credit remains targeted at the groups who need it. We estimate that without change and assuming continued uprating policy, by 2050 around 80 per cent of pensioner households would have been entitled to Pension Credit. With the reform package, that will fall to around 30 per cent in 2050. This will mean that there will be greater benefits of saving for more people.
75. The state reforms will ensure that Pension Credit is targeted at those who need it – namely, groups who have not been able to contribute for enough years to build up rights to a sufficient State Pension.
76. As a result of the reforms, anyone who contributes for 24 years or more will be lifted above Guarantee Credit only. The Government will be able to give workers a reasonable expectation that if they work and/or care, and save, for most of their career they will not be on Pension Credit on retirement. Without reform, that would not have been possible.
77. Pension Credit will continue to be an important safety net for those who are not able to make such provision – but there will still be good incentives to save.

78. Lower charges and the presence of an employer contribution will directly enhance the value of pension funds. Payback will clearly depend on a range of factors such as investment performance⁴⁰. However, in the reformed system, in real terms, a median earner aged 25 in 2012 might expect payback of £2.55 for each £1 saved, compared with £1.13 for every £1 saved without reform, as illustrated in Figures 6a and 6b⁴¹. Someone receiving Savings Credit in 2050 could still get a return of £2 for every £1 saved.
79. The result of the reforms, bearing in mind the difficulty of all long-term predictions, is that there will only be a small group of people – less than 10 per cent of pensioner households in 2050 – who may not see any benefit from saving. To fall within this group, people would have to have a severely deficient state pension record and not have earned above £5,000 in many years of their working life. They are thus unlikely to have been automatically enrolled into a personal account or alternative pension scheme for long, and will have accumulated relatively small pension funds. Even this group may benefit as they will be able to take their pension as a lump sum if the total is less than the trivial commutation limit (£15,000 in 2005/06).
80. The reforms to State Pensions combined with the employer contributions mean that the incentives to save are better for all age groups compared to the system prior to reform. Very few people will see little or no benefit from saving. The majority will see significant returns.
81. Some people will rightly decide not to save for a pension. They could include those on persistent very low incomes or those struggling with high unsecured debt. But the large majority of people can expect to benefit from saving. Ultimately, it should be for the individual to decide whether and how much to save based on their particular circumstances.

⁴⁰ *Financial incentives to save for retirement*, November 2006, www.dwp.gov.uk/pensionsreform/pdfs/financialincentives.pdf

⁴¹ These savings are reinforced by Sefton J, van de Ven J and Weale M, December 2005, *The Effects of Means-Testing Pensions on Savings and Retirement*.

Figure 6a: Potential payback from £1 contribution for a male median earner aged 25 in 2012, without proposed reforms

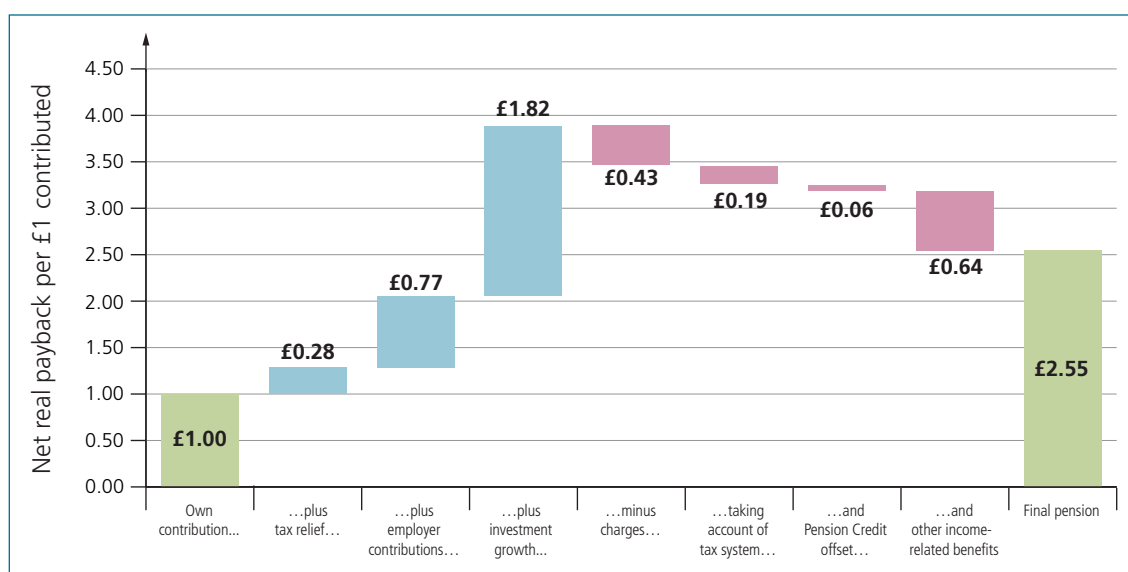


Source: DWP modelling

Notes: Median earnings in 2006/07 are £23,000.

This figure is for illustrative purposes only. It should not be used as the basis for individual decisions as specific circumstances or variation from the underlying assumptions will lead to different results.

Figure 6b: Potential payback from £1 contribution for a male median earner aged 25 in 2012, with proposed reforms



Source: DWP modelling

Notes: Median earnings in 2006/07 are £23,000.

This figure is for illustrative purposes only. It should not be used as the basis for individual decisions as specific circumstances or variation from the underlying assumptions will lead to different results.

Section 5: What this will mean for employers?

82. The Pensions Commission argued that all parts of society share the responsibility for tackling the problem of undersaving for retirement. Individuals would need to save more, the State would need to spend more – but employers would also have to increase their contributions.
83. Historically, employers have played a significant role in providing pensions. The existence of workplace pension schemes created a suitable product, and the efforts which employers (and trade unions) made to encourage people to join helped overcome inertia.
84. Many employers are committed to continuing to play that role, and the Government will continue to support them. However, the Pensions Commission made clear that pensions policy could not be based on the expectation that all employers would fulfil this role in the future.

The minimum employer contribution

85. In the May 2006 White Paper the Government announced the introduction of a minimum employer contribution of 3 per cent on a band of earnings. This contribution is the central pillar of this package of reforms. Without it, employees would not have a sufficient incentive to save. The contributions from the employer, together with tax relief, give workers a good expectation that saving will be worthwhile. Without this confidence, automatic enrolment on a large scale would not be possible. And without both these factors, we would not be able to increase participation in private pensions.
86. The role of employers is, therefore, crucial in making this policy work. However, the Government recognises that business will need time to adjust to this and employers will, therefore, be given enough time to adapt through the early provision of information about their new responsibilities and through the phased introduction of contributions. The employer contribution level will be set in primary legislation, to give employers clarity and certainty about the rate.
87. Our research shows that employers are supportive of the reform package and accept that they have a role to play. Around two-thirds of employers thought that a minimum employer contribution level of 3 per cent was either about right or not enough, and six in ten organisations with less than 50 employees thought automatic enrolment was a good idea, rising to eight in ten employers with 250 or more employees.⁴² Nonetheless, employers will face increases in costs: our research suggests that these will be around 0.7 per cent of labour costs on average.

⁴² 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.

88. The priority is to design the scheme and the transition phase so that burdens on employers are minimised. The Government is determined to ensure the system is operated in a way that imposes minimum administrative burdens on business.

How will the employer contribution work in practice?

89. These reforms must meet a basic test: they have to be simple to run for a small employer, such as the corner shop or plumber who will be covered by this scheme. The first decision for the employer will be whether they want to continue, or start, to provide a pension themselves. If they decide not to do that, they will be required to pass on 4 per cent from their employee's salary to the clearing house and match that with a 3 per cent employer contribution. The need to keep this a light-touch process is one of the two key reasons why a clearing house is necessary to implement personal accounts: as well as ensuring portability of pensions for employees, it will mean that employers need have only one point of contact for transferring these contributions.
90. We will task the delivery authority and then the personal accounts board with the objective of minimising the administrative burden on employers. This will be a key factor in the design of, and contracting for, the clearing house. The delivery authority will consult closely with employers on how to do this, including on whether the clearing house could build on existing collection mechanisms.
91. Some consultation responses, and some of the models which we considered, recommended that the employer should give advice to their employees about which provider to choose, or which funds to invest in. However, consultation with employers has clearly shown that a majority of employers do not wish to do this. Personal accounts will be designed so that employers are not required to give such advice.

Scheme exemption

92. The Government wants to support employers who choose to offer their own pension schemes. That is why we are proposing to exempt employers from the requirement to automatically enrol their employees into personal accounts if they operate a scheme of broadly equal, or better, value to personal accounts and automatically enrol employees into it.
93. We want to make the exemption process as light-touch as possible. Our consultation with employers over the summer identified ways of achieving this for occupational schemes. The test for most defined benefit schemes will be based on the existing scheme reference test, which employers already use to decide whether to contract out of the State Second Pension. The test for defined contribution schemes will be based on the employer providing contributions at the same level as personal accounts. In both cases employers will be able to check, in consultation with their scheme or provider, that the scheme qualifies for exemption and then certify that it is exempt.

94. Many consultation responses expressed concern that personal accounts would result in some employers already offering a scheme levelling down to the 3 per cent contribution level. The Government takes these concerns seriously and this White Paper suggests some ways to minimise the direct effect of personal accounts on existing provision. In particular, we are consulting on whether companies that offer higher-value schemes should be allowed to have a reasonable waiting period. This would allow them to continue to use their pension scheme as an incentive to employee loyalty, and could encourage employers to level up to that higher contribution level. The Government is also interested in working with the industry on the National Association of Pension Fund's (NAPF's) suggestion of a 'good' pension scheme kitemark to help employees identify companies that offer such pensions.

Waiting periods

95. The May 2006 White Paper consulted on whether there should be a waiting period before automatic enrolment. A number of responses to the White Paper argued for a waiting period of six months or even a year. We will continue to consult on this issue, but there is strong evidence against having a waiting period:
- Employer groups were split on the issue of a waiting period, with a number arguing it would be a greater administrative burden for employers to have to remember to enrol employees at a later stage, rather than on joining.
 - Most existing occupational schemes do not have waiting periods, with only 16 per cent operating one.⁴³
 - A waiting period of six months could reduce pension funds by 10 per cent: a waiting period of a year by 20 per cent.
 - A waiting period would disproportionately affect temporary workers, and therefore undermine our goal of making pensions portable between jobs.
96. Given that it could undermine a key goal of our reforms, we are not proposing a formal waiting period in personal accounts.

⁴³ Source: Supplementary analysis of data from the Government Actuary's Department, *Occupational Pension Schemes 2005*.

Compliance

97. The new rights for employees to be automatically enrolled into either a personal account or into an exempt work-based pension arrangement, will be protected by a light-touch compliance regime based on:
- educating employees about the value of their new rights and employers about their new obligations;
 - enabling employers to comply through processes and helplines designed to support them; and
 - enforcing compliance by the minority of employers who deliberately fail to meet their legal obligations.
98. We will be consulting further on the detail of the compliance regime. We expect to build upon the model used for enforcing the National Minimum Wage, which combines the right of employees to take their case to an employment tribunal with whistle-blowing and risk-based investigation. To ensure minimal impact on the majority of employers who will do their best to comply with the new requirements, personal accounts will be designed to allow cases of possible non-compliance to be identified by remote data matching in the first instance.
99. Employers are keenly aware of the long-term challenges that are facing the pensions system. If no action were taken today, employers would risk facing increased taxation in the future to prevent coming generations of pensioners falling into poverty. Personal accounts are intended to prevent that problem. It is in the shared interest of employees and employers to act now. Moreover, the overall impact of our reforms is predicted to increase Gross Domestic Product (GDP), because of the increase in savings and the growth in employment from raising the State Pension age. We will continue to work closely with employer groups to ensure this new responsibility is implemented effectively and efficiently.

“The EEF welcomes the assistance that the Government states in the White Paper it will be providing for employers, particularly having the minimum employer contribution into the new pensions saving scheme set out in primary legislation and the phasing in of both employer and employee contributions over three years.”

(Engineering Employers’ Federation)

Section 6: What will this mean for the financial services industry?

100. Personal accounts should complement, rather than compete with, existing good-quality pension provision. There will be no public policy benefit if personal accounts result only in existing pension saving being moved from one savings vehicle to another.
101. Personal accounts are designed to serve up to 10 million people who do not have access to, or are not participating in, a pension scheme offering at least 3 per cent employer contributions. These reforms will effectively open up a new segment of the market to the financial services industry and will be a significant new business opportunity:
 - Firms with relevant administrative expertise will have the opportunity to manage the personal accounts scheme for potentially 6 to 10 million customers.
 - It is estimated that personal accounts will increase the level of private pension savings by an estimated £8 billion a year, of which approximately £4 to £5 billion will be new saving. Fund managers will compete to invest the £150 billion which is expected to accumulate in personal accounts in the long term.
102. In addition, we have taken steps to limit the impact on the successful parts of the market to ensure personal accounts complement, rather than replace, existing pension provision.

No transfers in or out of personal accounts

103. The Government proposes that there should be no transfers into or out of personal accounts from or to existing pension schemes. There are clear advantages in this approach:
 - Adverse impact on the existing market would be minimised. The start-up costs incurred when establishing pension products may not be recovered if funds are transferred into personal accounts.
 - Administrative cost and complexity associated with transfers, such as valuing pension rights, would be avoided.
 - There would be no need for advice from financial advisers to compare the relative advantages of the existing scheme and personal accounts, the cost of which individuals themselves would have to bear.
 - It would send an important psychological signal to employers and individuals that personal accounts are targeted at a specific market and this could be an important safeguard against the 'levelling down' of existing provision.

Annual limit on contributions

104. The Pensions Commission recommended that there should be an annual limit on the total value of contributions into a personal account. They suggested around £3,000 a year, which was twice the total minimum contribution for a median earner.
105. Further analysis indicates that the £3,000 contribution limit would be too restrictive to allow a range of individuals within the target group sufficient room to make additional contributions and reach higher replacement rates, which may reflect individual retirement aspirations. This analysis suggests that an appropriate limit, at least in the first years of personal accounts, would be £5,000. Chapter 7 provides more details of this analysis.
106. We propose to review both the limit and transfer policy in 2020, when the market impacts of the 2012 reforms are better understood, to ensure these policies are operating effectively.
107. The Government believes that there is a strong case for a higher contribution limit in the first year of personal accounts. A £10,000 limit in the first year of personal accounts would allow individuals to deposit accumulated non-pension savings in personal accounts. This additional allowance for the first year of personal accounts will allow individuals who currently do not have access to good-quality employer-sponsored pension provision to save in other products before 2012 and move them to personal accounts.

Section 7: A delivery authority to support reform

They would have to guarantee that even if Governments change, it will still be there and it won't be null and void after four years."
(35-49, £15-30k)⁴⁴

108. People need confidence that their money is being managed responsibly and that members' interests are at the heart of the organisation. Managing a major new occupational pension scheme is not a job for government. For this reason we have proposed setting up a delivery authority in the Pensions Bill currently before Parliament.
109. The wealth of expertise in business and financial services is in the private sector. Stakeholders across industry, employers and consumer representatives all agree that harnessing the skills of the private sector to deliver personal accounts within a framework set by government is the best way to build credibility and public confidence. We therefore propose to bring in leading experts from the private sector to help develop, deliver and manage the personal accounts scheme.

⁴⁴ Hall S, Pettigrew N and Harvey P, 2006, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

110. Initially, the delivery authority will act in an advisory capacity on the detailed design of personal accounts and on the commercial and procurement strategies.
111. We will build on this structure, expanding the remit of the delivery authority and providing it with the necessary independence and powers to establish personal accounts. In addition the delivery authority will need to look at both the charging structure and investment strategies that are to be put in place; neither are areas where government has expertise. It will be vital to ensure that investment strategies are independent from politicians and pressure groups and that they are developed with members' interests at their heart. The delivery authority will be replaced by the personal accounts board which will then be responsible for the live running of the scheme.
112. It will be the Government's role to lay down the remit for the delivery authority and personal accounts board to ensure that personal accounts can and do deliver the objectives of the reform. The remit is expected to include:
 - achieving optimal participation rates among the target group;
 - achieving low charges and costs;
 - encouraging additional contributions above the minimum 8 per cent level;
 - ensuring high levels of customer service;
 - a duty to act transparently and adopt a consultative culture;
 - setting an investment strategy in the best interest of members;
 - providing appropriate degrees of consumer protection; and
 - minimising impact on other good pension provision and employers more generally.
113. Members' needs must remain at the heart of personal accounts. As a minimum, the personal accounts board will be required to be open and consultative in its approach to making decisions. For example, we would expect the board to consult on its approach to ethical funds and to shape the funds that are available in accordance with members' wishes. Consultation could include the innovative deliberative polling approach which worked well in the National Pensions Debate. But the Government also wants to explore how members can influence the board's operations, as well as being consulted. Options on this could range from advisory bodies to representation on the board, and we would welcome views on the best approach to put members at the heart of personal accounts.

Conclusion: outcomes and next steps

114. Personal accounts are at the centre of our pension reform package. Combined with the proposed changes to the state pension system, we are in a position to make a lasting, sustainable set of reforms, supported by a strong evidence base and wide consensus across society.
115. Personal accounts will be delivered by a modern type of organisation: managed independently and for its members, though within a framework set by the Government; not delivered by the State, but by the private sector. Our goal is to set the framework for people to take responsibility for themselves: enabling millions of people to save for their retirement; making difficult choices easier and ensuring that there is a range of choice to suit everybody, whatever their level of income or financial understanding.
116. The reform package will lead to a significant shift in the pension savings culture in the UK. Our research indicates that we can expect:
 - potentially between 6 and 10 million members of personal accounts;
 - £8 billion a year in contributions, of which £4–£5 billion will be new saving;
 - a radical reduction in charges faced by pension savers leading to final pension funds that could be 25 per cent larger;
 - improved incentives to save; and
 - an invigorated and expanded pensions market.
117. The Pensions Commission warned that, without action, future generations of pensioners would be poorer than today's. We are taking that action now by introducing these reforms. Automatic enrolment will help overcome inertia and short-termism. Personal accounts will lower charges and improve portability. Together with the minimum employer contribution, they will transform incentives to save for ordinary working families.
118. The Government has now set out its plans for reform of both private and State Pensions. The State Pension will become fairer and more generous, providing a solid platform on which people can save. Personal accounts will extend the benefits of work-based saving to those who have not so far had that opportunity. Together, these reforms amount to one of the most significant reforms of the welfare state since Beveridge. They are based on the State as an enabler, giving people control over their lives. To work, these reforms need the commitment not just of the Government but of all parts of society. To last, they need to command a consensus both now and during implementation. We will continue to work to deepen that consensus with all those with a stake in a success of these reforms.

