

# Annex 1: Response to the House of Commons Work and Pensions Select Committee Report: recommendations and conclusions

The House of Commons Work and Pensions Select Committee published their Fourth Report, session 2005/06, on pension reform. This report included a number of recommendations and conclusions about the design and operation of personal accounts. The Government responded to these recommendations and conclusions on 30 October 2006 but the recommendations on personal accounts were not addressed in detail, as work on this White Paper continued. This annex includes more detailed responses to those conclusions and recommendations that specifically referred to personal accounts.

## Personal accounts – participation in the scheme

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**The success of the new system of personal accounts will be critical to encouraging saving and delivering ‘adequate’ retirement incomes in the future for those on median earnings. This will need careful monitoring. (Paragraph 53)**

The Government has proposed a minimum contribution level of 8 per cent, in line with the recommendations of the Pensions Commission. This contribution level would achieve a replacement rate of pre-retirement income for a median earner, with a reasonably full working life, of about 45 per cent. This replacement rate combines income from personal accounts with the more generous State Pension provision brought about by re-establishing the link with earnings. Decisions about saving above this minimum level will be for individuals to make depending on their circumstances. This White Paper sets out how personal accounts will be delivered independently of government. The Government proposes that the remit for the personal accounts board will be to optimise contributions. As part of its governance structure, the board will submit annual reports to Parliament on its performance against its objectives.

## The decision to opt out

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The target group for the new system of personal accounts includes those on low to median incomes, many of whom do not currently have access to financial advice. For some people deciding to save for a pension will involve complex decisions regarding, for example, how to deal with existing financial commitments. Generic financial advice would assist people in doing this effectively. (Paragraph 64)

Providing good-quality information will be critical to the success of personal accounts.

A number of organisations are involved in communicating information about pensions including the Department for Work and Pensions (DWP), the Financial Services Authority (FSA), the Pensions Advisory Service and a number of organisations in the voluntary sector. The Government will be working with these groups to develop an evidence-based information strategy for communicating information about pensions and personal accounts over the next year. The Government will also be paving the way for the success of personal accounts by building awareness of pensions issues through its ongoing information programme.

This work will be developed in the context of the national strategy for financial capability led by the FSA and the Government's long-term strategy on financial capability, to be published shortly. The Government's strategy will also address the issue of widening access to generic financial advice in greater detail.

## Participation rates

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In response to this report, the Department should outline its strategy for maximising participation in the new system of personal accounts, explain what targets it intends to set for participation in personal accounts, identify a level of participation below which it will review the policy of auto-enrolment and consider whether people should be compelled to participate, and outline contingency plans for coping with the workload if participation is higher than expected. (Paragraph 72)

The Government will encourage participation in personal accounts through an evidence-based information strategy, highlighting, in particular, the value of the minimum employer contribution and the tax relief on contributions, and the importance of saving in a pension to ensure that individuals meet their expectations for income in retirement.

The Government will monitor and evaluate the success of automatic enrolment in meeting its overall aims and objectives. We have no plans at present to introduce compulsory membership of personal accounts, and our analysis suggests that we can build in sufficient capacity to deal with higher levels of participation, but this will be monitored throughout the implementation phases and once the system is up and running.

## Employees in small and micro businesses

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**Small employers are more likely than large ones to offer no pension provision and there is concern among this group at the prospect of being obliged to administer and contribute to employees' pensions. The Government should outline its strategy for maximising participation among employees in small businesses. (Paragraph 79)**

Over the summer of 2006, the Government conducted several in-depth consultation exercises with employers and their representative bodies, to analyse how the reforms could be designed to both promote existing workplace schemes and minimise any additional employer requirements. Part of this consultation included a seminar on the impact of personal accounts on small employers.

The proposals for personal accounts have been designed to minimise the burden on **all** employers:

- the level of the minimum employer contribution will be set in primary legislation;
- the minimum employer contribution will be phased in over three years;
- one of the key criteria for deciding the delivery model was the relative burdens imposed on employers;
- the criteria by which existing employer pension schemes will gain exemption from personal accounts will be as simple and straightforward as possible; and
- the compliance regime will be light-touch but effective.

## The self-employed

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**The White Paper does not provide the self-employed either with access to the State Second Pension or with an automatic enrolment process to the personal accounts system. This will make a strategy to maximise participation in personal accounts by this group critical. (Paragraph 82)**

The Government will offer self-employed people membership of the personal accounts scheme on a voluntary opt-in basis. However, there will not be a minimum contribution level because, this is not practical given the changeable cash flow situation of the self-employed. Self-employed people will, therefore, be able to save in personal accounts at a level of their choosing, subject to the proposed cap on contributions which applies to all members.

Communications to support personal accounts will be designed with the needs of the self-employed in mind.

## Additional contributions

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**The Department should set targets for additional contributions above the minimum 8 per cent and publish a strategy to deliver, and closely monitor, progress. (Paragraph 86)**

The extent to which people save beyond the minimum contribution will depend on how much they can afford to save as well as on the replacement rate they wish to achieve in retirement. But this is only one factor that will be relevant. People will need to understand the benefits of saving more and the process of increasing contributions will need to be simple.

The personal accounts delivery authority and board will be tasked with encouraging people to increase their own contributions above the minimum 4 per cent. They will need to provide information to support people to make such decisions and ensure the processes remain as straightforward as possible.

## The implications for employers

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We agree that the Government will need to monitor closely the impact of the new personal accounts scheme on existing occupational provision and guard against levelling down. This will need to be a key aspect of consideration in the regular reviews of the system and the further independent study that we have recommended should be instigated before the end of the next Parliament. (Paragraph 100)

The aim of personal accounts and automatic enrolment is to increase saving for retirement. However, we will continue to support existing employer pension provision. To achieve this, the Government will allow those employers that offer pension schemes which are equivalent to, or provide more generous benefits than personal accounts to automatically enrol their employees into those schemes rather than personal accounts. We support the NAPF's proposal for a quality mark, and are keen to see it happen. In addition, the Government will consult on waiting periods for high-quality exempt schemes.

The Government has proposed that the personal accounts board should review the arrangements regarding transfers and contribution caps in 2020 to assess the market impact of the reforms and to see whether this proposed prohibition remains relevant.

## Monitoring and compliance

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The Committee welcomes the measures announced in the White Paper to support employers with the new requirements imposed on them by the personal accounts scheme. The Committee is concerned that employers should not encourage employees to opt out and recommends that the Government outline its proposed arrangements for monitoring and enforcing compliance with these requirements, the mechanisms for reporting breaches with compliance and the proposed penalty regime. (Paragraph 109)

The Government proposes to develop a three-stage compliance regime:

- **Educating** – in the run up to the introduction of personal accounts there will be an emphasis on raising awareness amongst both employers and employees about the new rights and responsibilities being created.
- **Enabling** – immediately prior to the introduction of personal accounts and in the early years after introduction, there will be an emphasis on supporting employers. The Government will produce clear employer packs to help them register for personal accounts and make their first payments. A comprehensive helpline service will be provided so employers have easy access to support.
- **Enforcing** – where, despite awareness raising and support, employers still fail to comply, the Government proposes a graduated approach with increasing penalties which uses remote data matching wherever possible. The Government also intends to provide a ‘whistle-blowing’ helpline for employees who are worried that their employers may be trying to deprive them of their new rights.

The Government will work with employers to ensure that the compliance regime is light-touch yet effective.

## How automatic enrolment will work

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**Participating in the new personal accounts scheme should be as simple as possible. We believe that employees should be opted-in within three months of beginning employment. Care will need to be taken to ensure that arrangements for auto-enrolment are workable for firms with employees on ‘non-standard’ work patterns, for example, temporary contracts or more than one job. (Paragraph 117)**

The Government intends that all eligible employees will be automatically enrolled into personal accounts or an exempt employer’s scheme. The Government will ensure that the automatic enrolment process is designed to be workable with firms and employees on ‘non-standard’ work patterns.

With regard to employees being opted in within three months of beginning employment, the Government does not recommend that there should be a waiting period for personal accounts, but views on this are welcomed.

## Charges

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The Committee agrees with the Pensions Commission that the focus should be on keeping Annual Management Charges as low as possible in order to increase retirement incomes. The Committee notes that if charges cannot be driven towards or below 0.3 per cent it would substantially erode the value of people's pensions. We believe that the option of fixed administrative fees should be considered but note that the impact of such a charging structure on those saving small amounts would have to be considered as part of that review. (Paragraph 122)

This White Paper explores different charging structures for personal accounts, and the Government will be seeking views on these structures. The remit of the personal accounts board will include achieving the lowest possible charges for members.

The National Pension Savings Scheme (NPSS) approach to delivering personal accounts has been chosen as it is the lowest cost option, allowing people to keep more of their income in retirement.

The Government has set out a list of eleven criteria against which it intends to assess the two proposed alternative delivery models. We believe that two of these are particularly important: achieving a lower level of charges and simplicity for employers and individuals. For this reason, the Committee accepts the Government's initial view that this can be achieved through the delivery model proposed by the Pensions Commission. However, we await with interest the outcome of further work to establish whether similar objectives could be achieved through a limited multiprovider model. (Paragraph 127)

The evaluation of alternative models for personal accounts identifies advantages of both the NPSS and a branded provider approach. However, for the target group the Government believes that the NPSS approach would be the most effective delivery model. This is because the NPSS approach:

- is the simplest model for individuals, as they will be faced with a carefully structured range of choices that meets their needs;
- delivers low charges – because providers do not compete directly for individuals' accounts there is less marketing expenditure and switching of accounts. Low charges will ensure larger pensions for scheme members; and
- minimises delivery risk – it is not a Government model: instead, it utilises the skills, expertise and capacity of the private sector to develop, build and deliver personal accounts.

## Investment risk

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The Government has a responsibility for the running of the macro-economy and the regulatory framework for pensions. It does not have a responsibility for investment risk in the new system of personal accounts, but Government and regulators will have an obligation to communicate the risks and benefits clearly while still encouraging participation in the scheme. In response to this report, the Government should set out how it proposes to do this. We agree with the Pensions Commission that the default fund should be a 'lifestyle-smoothing' fund with a relatively high equity weight at early ages, and a gradual shift to bonds as people approach retirement. (Paragraph 134)

Good-quality information is critical to the success of personal accounts. The Government anticipates that DWP will continue to provide information about different types of pension saving and this will include personal accounts. The Government will be working with external stakeholders to develop an evidence-based information strategy for communicating information about pensions and personal accounts over the next year.

The delivery authority, and subsequently the personal accounts board, will make decisions regarding the investment strategy. However, with regard to the default fund, the Government anticipates it will have the following characteristics to ensure that individuals who do not make an active investment choice are defaulted into an appropriate investment:

- the default fund will be structured to deliver an appropriate trade-off between risk and return for the target group;
- the default fund will be diversified across many different asset classes to reduce specific investment risk; and
- the default fund will be life-styled, for example an individual's investments will be moved out of equities into bonds as they approach retirement, to ensure the timing risk related to accessing an annuity is reduced.

The response to the recommendation concerning governance arrangements refers to the issue of independence of investment strategy.

## Governance arrangements

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The Committee agrees with Which? and the IMA that governance arrangements – ensuring the scheme is overseen by trustees which are independent of government and have an overriding duty of care to protect the interests of savers – will be critical to the scheme’s success. Independence will also be vital to ensure that corporate governance standards are not compromised. Political interference in investment strategy and on how the voting rights of the personal accounts scheme investments are exercised would be unacceptable. (Paragraph 137)

The Government is committed to a personal accounts scheme that is independent from Government and is run in the best interests of scheme members. The task of establishing a financial scheme of this magnitude is not for government, and that is why the Government is looking to the expertise of the private financial sector to set up and eventually to run the scheme.

The Government envisages the scheme, when running, would be run by a board of governors, which would operate in accordance with statutory duties similar to those imposed upon pension trustees by trust law and specific pension-related statutory provisions. These would include setting the strategic direction of the scheme, overall management of the scheme and the investment strategy.

The governance structure will include an investment committee, serving the board of governors, with the expertise to develop an investment strategy appropriate to the best interests of scheme members within a framework prescribed by legislation.

## Setting up the new scheme

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The Government and Pensions Commission have rightly recognised that establishing the infrastructure for the new system of personal accounts will be a challenge. We strongly recommend that Government involvement in the development of any necessary IT system is based on a clear understanding of lessons learned from previous government IT systems failures. (Paragraph 143)

The Government agrees with the committee's recommendation that the development of any necessary IT system is based on a clear understanding of lessons learned from IT systems failures across government and the private sector. The Government recognises that it is essential to bring in appropriate private sector expertise with experience of the pensions and financial services industry at an early stage to ensure that the most effective systems to deliver personal accounts are built. The Government will ensure that best practice is applied from successful IT projects both within government and also the private sector.