

What is in (and not in) the Pensions Bill?

1 February 2008

In this *In Focus* we briefly summarise the main components – and omissions - of the Pensions Bill that is currently before Parliament.

Eventually, the Bill will become the Pensions Act 2008, at which point we will analyse it in greater detail. In the meantime, it is subject to debate and changes are inevitable – and hoped for in the area of risk-sharing.

The bulk of the Bill is to do with the introduction of Personal Accounts, but it also touches on:

- simplification
- sharing Pension Protection Fund (PPF) compensation on divorce
- various miscellaneous matters.

Comments:

Deregulation

Perhaps most surprising (or disappointing for those employers still trying to provide high-quality schemes) is the omission of any reference to risk-sharing. It is hoped James Purnell, the new Secretary for State, with his previous role as Minister for Pension Reform and acknowledged good understanding of pension issues and problems, will address this area.

We believe freedom of choice is vital. In particular, those employers who are struggling to maintain defined-benefit (DB) schemes in their present form should have a viable alternative to offering the lottery of pure defined-contribution (DC) pensions to their employees. If not, worldwide competitive pressures are likely to force many more to abandon DB pension provision altogether and the introduction of Personal Accounts in 2012 may provide further impetus to this. Let us hope the new Secretary of State will understand the need for urgency and pave the way for the Pensions Bill to enable the creation of risk-sharing schemes.

It is a crying shame that the Association of Consulting Actuaries (ACA) has been a lone voice in the wilderness calling for employers to be given the opportunity to provide pension benefits on a risk-sharing basis without the fear of writing a blank cheque. We believe the ACA's proposals for risk sharing (termed "conditionally-indexed schemes"), with a degree of modification, could bridge the gap between DB and DC to the advantage of all. This includes the Government, as risk sharing would also reduce the risk of extremely low pensions emerging as a result of unfortunate timing and thus calls on means-tested benefits.

In outline, the way we see risk-sharing schemes working best is where:

- the employer's commitment is similar to that for a DC scheme, i.e. to a specified minimum level of contribution - if we accept this, the minimum level of contribution would define the employer's debt towards the scheme
- benefits are based on career-averaged earnings rather than final salary, as this reduces discrimination and cross-subsidies between leavers/stayers and low/high earners, respectively
- the employer is free to design the key principles underlying members' benefits (e.g. the normal pension age as well as whether there should be a link to earnings) so as to support its culture and employment policies

- the target rate at which pension is earned each year is set at a level well below that which can be supported by the employer's contribution commitment, providing scope for the provision of indexation and freedom for the fund to be invested in return-seeking assets
- indexation in deferment and in payment is the same (thus avoiding discrimination) and is set at a level that can be sustained over the long term
- just like the PPF, there is freedom to adjust benefits earned to date if needs be (e.g. to reduce/increase benefits if longevity increases/reduces)
- crucially, decisions regarding the target rate of accrual, indexation, adjusting benefits earned to date and investment strategy are divorced from the employer and taken by the trustees, whose sole interest is to look after members' interests.

This would enable the re-introduction of a form of scheme design that worked well in the 1970s and 1980s before legislation imposed additional benefits (and costs) on the arrangements provided voluntarily by good employers. Such schemes allowed employers to provide benefits at a known cost, avoided much of the unpredictability of the ups and downs of the investment and annuity markets from the perspective of members and benefited from economies of scale, many of which are lost with DC pension provision.

The perversity of where we are today is that the good employers who provided a DB pension (and their employees) have been punished whereas the employers who chose not to provide such pension benefits have thus far escaped scot-free. This suggests that successive governments have deeply misunderstood the original intention of good employers.

Personal Accounts

Under the Bill's provisions, where a person has more than one employment, each such employment is to be treated separately. This means the qualifying earnings threshold (just over £5,000 pa) is to apply to each employment separately and likewise the first £5,000 or so of earnings from each employment is to be disregarded for contribution purposes.

Someone with several low-paid and/or part-time jobs may end up not being auto-enrolled into the Personal Accounts system or, at best, will only qualify for minimal employer contributions. Such a person would be part of the group of people at which the Government is targeting Personal Accounts, but the system will have failed them.

Worse, there is a potential loophole for unscrupulous employers. They could create a series of different employments within a group of companies, with the pay from each employment being below the qualifying earnings threshold, so that they avoid paying contributions into Personal Accounts.

The Government should consider the position of people with multiple employments and ensure it prevents abuse of the Personal Accounts contribution structure where employments are related. Perhaps this is a good example of where it would be better to have principle-based legislation rather than swathes of regulations that attempt - but often fail - to cover all the angles.

Overall

The Government appears to be relying on imposing a low limit (originally thought to be £3,600, but still the subject of some discussion) on the amount that can be paid into a Personal Account in any one year together with a prohibition on transfers into Personal Accounts from occupational schemes to prevent a wide-scale levelling-down of pension provision. These are negative measures.

Crucially there is nothing to promote or resurrect good-quality pension provision. This is why we consider further deregulation and, in particular, the ability to create risk-sharing schemes to be so important. Without such measures the future of retirement provision in the UK will look very bleak.

The detail:

Personal Accounts

A key chapter of the Bill deals with employers' duties in terms of:

- which employees should be automatically enrolled (or re-enrolled) – basically those aged 22 or over who have “qualifying earnings” in excess of the threshold (£5,035 pa in 2006/7 terms) – and when.
- the right of employees to opt in or out
- the elements of pay that count as qualifying earnings – most elements of pay between £5,035 pa and £33,540 pa (in 2006/7 terms)
- the minimum contribution requirements – at least 8% of qualifying earnings in aggregate, with at least 3% coming from the employer and the balance from the employee (less tax relief) – with there being provision for the employer's obligations to be phased in over a period of time
- the information to be given to employees and the Pensions Regulator
- the quality requirements to be met for exemption in respect of existing schemes – based on an accrual rate of 1/120ths of qualifying earnings averaged over 3 years for a contracted-in DB scheme (a higher accrual rate of no more than 1/80ths may apply for contracted-out DB schemes) and the same minimum contribution rates as above for DC schemes (whether occupational or group personal pension plans). (*Note: Contracting-out for DC schemes is meant to be abolished by the time Personal Accounts arrive on the scene.*)

It also enables:

- the trustees of an occupational pension scheme, with the employer's consent, to modify their scheme by resolution to permit the automatic enrolment of members into the scheme
- the employer to deduct contributions from any employee who has been automatically enrolled.

Other chapters deal with:

- compliance, including:
 - the Pensions Regulator's powers to apply penalties on employers who breach their duty either to enrol eligible employees automatically or to pay contributions where required
 - a requirement for records to be kept
- protection of employment rights, protecting employees from detriment or dismissal as a result of their right to be enrolled into a Personal Account and to receive the benefit of employer contributions
- the Secretary of State's power to establish a pension scheme (the so-called “National Pensions Savings Scheme”), including:
 - the power to determine how the scheme is to be administered and managed
 - the requirement to impose an upper limit on contributions in any tax year
 - the establishment, operation and functions of a trustee corporation
- the functions of the Personal Accounts Delivery Authority (PADA)
- amendments to the requirements for employers to provide access to a stakeholder pension scheme.

Simplification

The Bill includes two deregulatory measures for occupational pension schemes:

- The abolition of “safeguarded rights”, which is what contracted-out rights become when converted into a pension credit under a pension-sharing order.
- A reduction in the maximum rate of statutory revaluation for early leavers from 5% p.a. to 2.5% p.a. over the period of deferment. However, this will only apply to members who leave after a future date (yet to be determined) and then only in respect of pension earned in respect of pensionable service after that date, so it will not have retrospective effect.

There are also measures to simplify certain elements of the state pension.

Sharing PPF compensation on divorce

To date, it has not been possible for compensation paid by the PPF to be split on divorce under a pension-sharing order.

The Bill provides for the creation of pension compensation debits and credits.

Miscellaneous provisions

The Bill ends with a number of miscellaneous provisions. These include:

- The creation of the power for the Secretary of State (or the Pensions Regulator on his behalf) to charge interest at a prescribed rate on levies if and when they are paid late. This covers the general levy and the pension protection levy amongst others.
- An addition to the circumstances in which the Pensions Regulator can use its powers of intervention in the funding of a defined-benefit pension scheme. This is where it appears to the Regulator that the scheme’s trustees have not complied with the statutory requirements relating to the determination of the method and assumptions used in the calculation of the scheme’s technical provisions (e.g. where the assumptions have not been chosen prudently).