

A summer stocktake - part one

Pensions reform 8

June 2009

Introduction

The pensions reform agenda has continued developing apace during 2009. As we reach the halfway point for the year, and approach the parliamentary summer recess, it's worth taking a step back and reviewing the progress so far.

This factsheet gives a summary of the work done since the Pensions Act was passed at the end of 2008 to introduce the employer duties, including having to automatically enrol eligible members of their workforce. Factsheet 9 gives an overview of the development of the personal accounts scheme over recent months.


The main points

- The assumed working date for the launch of the new employer responsibilities is October 2012. We expect from this date these duties will be rolled out in stages across all employers.
- Employers will have to automatically enrol any eligible jobholders into a pension scheme that meets certain criteria, provided they're not already in a qualifying scheme. Jobholders can opt out if they want to. If they don't opt out, then a minimum contribution of 8% of a band of total earnings has to be paid, of which employers must pay at least 3%.
- The proposals for how employers can self-certify they've met the minimum contribution requirement will be set out in draft regulations, due out later in the year.
- The proposed process for employers to follow to automatically enrol eligible jobholders is complicated, with tight timescales for employers, jobholders, schemes and providers.
- Many commentators are still concerned the interaction of means-tested benefits with pension savings detracts from the message that it pays to save.

Pensions reform – a brief reminder

The Pensions Act 2008 sets out the new pension responsibilities for employers from 2012. In future, employers will have to automatically enrol all jobholders who are aged between 22 and state pension age into a pension scheme. Jobholders are workers who work in Great Britain and earn more than around £5,000 a year. The pension scheme could be a private pension scheme or the new personal accounts scheme. Employers don't have to automatically enrol jobholders who are already members of a qualifying scheme.

Jobholders can opt out of the pension scheme if they want to. If they do, neither they nor their employer has to pay any pension contributions. But if they remain a member, then minimum contributions of 8% of a band of total earnings has to be paid, of which their employer has to pay at least 3%. (Defined benefit schemes will have different requirements.)



Jobholders outside that age range can also choose to opt into a pension scheme. If they do, the same minimum pension contributions will apply.

The Pensions Act 2008 also laid down the foundations for creating the new personal accounts scheme. Factsheet 9 covers the development of the personal accounts scheme over recent months.

Launch date of the new employer responsibilities

The working assumption, by the Personal Accounts Delivery Authority (PADA) and others, is that the launch date of the new employer responsibilities will be in October 2012. Employers' pension responsibilities are expected to be rolled out in stages over an 18-month period, possibly starting with the largest employers first. The minimum contributions that have to be paid by both employers and jobholders will also be phased in over three periods, starting at 1% for each.

	Employer contribution	Jobholder contribution (including tax relief)
Period 1	1%	1%
Period 2	2%	3%
Period 3	3%	5%

We expect draft regulations due in the autumn to set out exactly how the staging of employer responsibilities and phasing-in of contributions will work.

Automatic enrolment schemes

The Pensions Act 2008 sets out that employers have to automatically enrol any eligible jobholders (see above) into an automatic enrolment scheme. An automatic enrolment scheme is a qualifying scheme (see below) that allows automatic enrolment into it.

A combination of European law and UK law doesn't currently allow automatic enrolment into group personal pensions (GPPs). However, the Department for Work and Pensions (DWP) through discussions with the European Commission, has ascertained that automatic enrolment after 2012, once the new employer responsibilities have been implemented, will be consistent with European law. Employers still cannot automatically enrol their workforce into GPPs before that date.

PADA intends to run a pilot programme, ahead of October 2012, with a small number of volunteer employers and employees. The aim is to 'test' operations, instead of going for a 'big bang' approach. It seems inappropriate that personal pension schemes – who expect as many new members as the personal accounts scheme when employer responsibilities are introduced – aren't also allowed to do this.

An automatic enrolment scheme cannot force the jobholder to make any decisions. So it must operate a default investment fund, in case the member doesn't make an active investment decision. Regulations due later in the year will set out the principles for default investment funds. These will probably include some form of lifestyle.



Qualifying schemes

Employers can use a qualifying scheme to discharge their new pension duties. A qualifying scheme can be either an occupational pension scheme or a personal pension scheme that's registered. Under a defined contribution qualifying scheme, there must be a minimum contribution of 8% of the band of total earnings (including bonus, commission, overtime and certain statutory payments) between £5,035 and £33,540. The employer has to contribute at least 3% of the band of earnings.

Currently, the DWP doesn't intend that charges should form part of the definition of a qualifying scheme. So private pension schemes won't have to have similar charges to the personal accounts scheme to be a qualifying scheme. However, the charging shape and level adopted by personal accounts scheme will influence the charges for private pension schemes.

Minimum contribution test

The Pensions Act sets out the minimum contribution to a qualifying scheme. However, currently, most contributions to defined contribution pension schemes are based on a percentage of pay (but probably not total pay, including items such as bonuses) with no lower band cut-off.

Employers will need to work with their advisers to assess if their current contributions meet the new minimum contribution test for each of their jobholders who are members of the pension scheme. If not, they'll have to make changes.

Employers could continue to pay contributions on their current basis and compare it against the legislative minimum contribution required, either at the time of payment (whether that is monthly, weekly or daily) or on a yearly accumulative basis. Employers would then have to make up any shortfall.

Alternatively, the Pensions Act included the ability for employers to self-certify in advance that their contributions will meet the test for each of their jobholders.

Draft regulations due in the autumn will set out the proposed self-certification basis. It's expected that employers will be given some leeway, so if contributions only fall short by a small margin then they won't be forced to make up the difference.

Automatic enrolment

The DWP has issued draft regulations setting out the process employers must follow to automatically enrol any eligible jobholders into a pension scheme. The consultation closed on 3 June 2009, and the final regulations should be published later this year.

Broadly, the key points of the proposed process are as follows:

- Employers have to 'create active membership' for jobholders within 14 days of them starting work or becoming eligible (their automatic enrolment date).
- For personal pensions, employers have seven days to give jobholders information about why they've been enrolled, contributions that will be made, and their right to opt out. Employers also have to make sure jobholders will receive key features information about the scheme within those seven days. Jobholders then have a fixed seven days after receiving this information to consider it. They then have 30 days to opt out.



- For occupational pension schemes, employers must give jobholders the enrolment information within 14 days of them starting work or becoming eligible (their automatic enrolment date). Once they have this, the 30-day opt-out period can begin.
- If jobholders want to opt out, they have to complete and return to the employer an opt-out form, which DWP proposes they get from the scheme or the provider, but not the employer.
- Pension contributions have to be deducted from the jobholder from their first paypacket. If the jobholder opts out, the employer must return these contributions to them within a set time.
- Employers are able to postpone the automatic enrolment date for up to 90 days after the jobholder started work (or became eligible). If so, the contribution to the pension scheme must be at least 11% of the band of total earnings, with the employer contributing at least 6%.

The proposed automatic enrolment process is complicated, with tight timescales for employers, trustees and providers to comply with. Automatic enrolment with the right to opt out is, in principle, the correct way forward. But, instead of the proposed rules, we need a sensible, pragmatic and, especially, flexible approach - one that fits all sizes and all types of employers with different capabilities and resource. We can review the details and make changes once weve had real-life experience of the system.

Means-tested benefits

The interaction of pension benefits with means-tested benefits remains an area of great interest.

At the beginning of February, the DWP published analysis showing that, even taking inflation into account, 95% of people will benefit from auto-enrolment. They would receive back an amount that was more than their original contributions, with over 75% expected to receive more than twice what they'd put in. Some, however, would lose out: those with 'extremely limited' entitlement to the state pension, and people renting in retirement, who have potential housing benefit.

However, many commentators are still questioning whether, given the interaction between means-tested benefits and private pension income, people should be automatically enrolled into a pension scheme.

We believe it's in the best interests of most people to save for their retirement. The DWP report should be useful to help the government, industry and media to get behind the savings message. However, there's more the government could do to simplify the benefit system to make it easier to understand and, if possible, reduce the number who lose out.


The government also needs to make sure people have help, information, guidance and advice at the point they make the important decision whether to opt out of their employer's scheme.

The political context

The last possible date for the next general election is June 2010.

If the general election results in a change in government, then this will have implications for the pensions reform agenda and proposals. However, the key issue remains that not enough people in the UK are saving enough money for their retirement.

It's not impossible that the Pensions Act 2008 legislation can be 'rejected' and new proposals, devised from scratch, put in place. However, the details of the structure and planned operation of the new regime are advanced, making this difficult.



We don't believe a Conservative government would consider moving away from automatic enrolment and/or mandatory employer contributions. However, recent public comments show the Conservatives have concerns over the interaction of means-testing with pensions savings, and that it may not be worthwhile for some people to save. Should the Conservatives take power, they may decide to address this.

Generally, Conservative shadow ministers are aware of the need to create a culture of savings, which may mean a wholesale review of the tax rules for pensions and other savings vehicles.

Timetable

The table below gives a guide to the **possible** development of the pensions reform agenda, including the building of the personal accounts scheme.

Date	Development
20 July 2009	DWP and PADA's joint consultation on the personal accounts scheme rules closes.
7 August 2009	PADA's consultation on 'designing an investment approach' for the personal accounts scheme closes.
Autumn 2009	DWP publishes its second batch of draft regulations including staging of employer duties, phasing-in of contributions, the requirements for a quality scheme, and automatic re-enrolment.
Late 2009	DWP publishes the final automatic enrolment regulations.
Late 2009 / early 2010	The DWP announces the charging shape and level for personal accounts scheme.
Late 2009 / early 2010	PADA announces the new name for personal accounts.
2010	The personal accounts' trustee corporation is formed.
2010	DWP publishes the final regulations on staging, phasing, the qualifying scheme, and automatic re-enrolment.
June 2010	The last date for a general election
2011	PADA launches its pilot programme for personal accounts, to test implementation ahead of the official launch date.
October 2012	The employer duties are expected to start.

What does this mean for you?

There are still some unanswered questions on pensions reform, but DWP, PADA, and the Pensions Regulator (who will be overseeing employer compliance with their new duties) are advancing the agenda. By the end of 2009, we'll have a much clearer picture of the final details.



In these tough economic times, it may be difficult for employers to consider taking action on pension arrangements. However, advisers have a role in keeping up to date with the debate, understanding how the legislation is developing, and making sure their corporate and their individual clients understand the long-term implications.

All types of employers will need help assessing in advance what action should be taken, and how they can best absorb the pension contribution and additional administration costs pensions reform will create.

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