Our ref: ICAEW Rep 76/10

Paul Johnson, David Yeandle OBE and Adrian Boulding
Independent Reviewers appointed by the
Department for Work and Pensions
Caxton House
Tothill Street
London
SW1H 9DA

By email:
Paul.johnson@frontier-economics.com
caxtonhouse.auto-enrolmentreview@dwp.gsi.gov.uk ,
DYeandle@eef.org.uk

Dear Paul, David and Adrian

WORKPLACE PENSION REFORM: AUTOMATIC ENROLMENT

ICAEW is pleased to contribute to the review on automatic enrolment.

In view of the short time that we have been given to respond over the summer holiday period, we should welcome a meeting.

Please contact me should you need any clarification or wish to discuss any of the points raised in the attached response, my number is 020 7311 5738. Alternatively, please call either Liz Cole on 020 7920 8746, or Peter Bickley on 020 7920 8430.

Yours sincerely

Teresa Sienkiewicz
Chairman, ICAEW Workplace Pension Reform Working Party
T: +44 (0)20 7311 5738
E teresa.sienkiewicz@kpmg.co.uk

ICAEW REP 76/10

ICAEW REPRESENTATION

WORKPLACE PENSION REFORMS: AUTOMATIC ENROLMENT

Memorandum of comment submitted in August 2010 by the Institute of Chartered Accountants in England and Wales in response to an invitation published on 6 July 2010 by the Department of Work and Pensions on behalf of its independent review team

Contents

WORKPLACE PENSION REFORMS: AUTOMATIC ENROLMENT

INTRODUCTION

1. ICAEW welcomes the opportunity to contribute to the review of workplace pensions automatic enrolment announced on 6 July 2010 by the DWP on behalf of its independent review team at www.dwp.gov.uk/policy/pensions-reform/workplace-pension-reforms/.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. We are delighted that the new government is stepping back before finalising the new workplace pensions automatic enrolment regime and has commissioned an independent review, albeit in a very short timescale over the summer holidays.

5. Automatic enrolment, or possibly full compulsion, although we acknowledge that that option is outwith the scope of this review and may require a change in EU law, is necessary to ensure that more people save for retirement. However, the date of auto-enrolment should be allowed to be a number of months after employment starts (preferably six but at least three), rather on commencement of employment, with employees being required to opt out during this ‘waiting period’, to avoid the need for employers to refund contributions collected during the opt-out period.

6. We believe that in their present form, the legislative requirements for calculating contributions for NEST (or other qualifying schemes which conform with Pensions Act 2008 requirements) will add a major burden to payroll administration, similar in size to each of income tax or national insurance contributions, and the associated cost. Therefore, we recommend that contributions to NEST or other qualifying schemes should be calculated on the same earnings and using the same thresholds as Class 1 NIC (we recommend the NIC Earnings Threshold (to be replaced by Primary and Secondary Thresholds from 6 April 2011) and Upper Earnings Limit) and for the same pay periods as Class 1 NIC, and the due dates by which employers must pay over contributions to be invested in jobholders’ pension accounts and the periods to which they relate should be the same as for PAYE/Class 1 NIC.

7. We believe that these two changes (waiting periods and aligning contributions with NIC) will dramatically reduce the administrative cost for employers, which perversely could otherwise have exceeded the cost of the contributions themselves.

COMMENTS

8. We have been liaising with DWP, PADA and the Pensions Regulator during the development of the workplace pension reform rules. We are delighted that the new government is undertaking an independent review into auto-enrolment and that the terms of reference appear to allow for a strategic review of NEST as a whole. Our members in practice probably have as clients most UK business employers and pension providers, whether providing advice or running their payrolls, and our members in business make up an even larger proportion of our 134,000 members. We think that with our members' expertise we can help you to achieve a long term, practical and cost-effective solution to the objective of getting people to save more for their retirement.

Automatic enrolment

9. We do believe that there is a need for some sort of incentive or even compulsion if more people are to be persuaded to save for their retirement.

10. The need to incentivise or compel is only partly for the four reasons cited in the DWP document *Automatic Savings Changing Workplace Pensions* published in November 2009 at www.dwp.gov.uk/docs/automatic-savings-changing-workplace-pensions-nov09.pdf, namely:

- '*many people do not have a good understanding of pensions'*;
- '*they do not get around to it*';
- '*provision of occupational pension schemes has declined*'; and
- '*lack of suitable pension products [making provision costly]'*.

11. It is also necessary because of, first, the removal as part of the 1988 pensions reforms of the requirement for all employees to join their employer's superannuation schemes and, secondly, the decline over the last twenty years or so in confidence of ordinary people in the ability of pension investments to provide the quality of returns formerly associated with with-profits investment funds and guaranteed annuity rates. Accordingly, we do not find it surprising that the number of people saving for retirement by way of pension funds has dropped dramatically.

12. The current rules for auto-enrolment provide that eligible 'jobholders' shall be auto-enrolled immediately on commencement of their employment and that they can opt out within 42 days. Pending the employee deciding what to do, the employer has to deduct contributions via the payroll. As to accounting for contributions deducted in this interim period to the employer's default personal account administrator, to obviate the need for employers to reclaim contributions that have been paid over on behalf of employees who decide to opt out, which employers are likely to have to fund pending receipt of the refund from the scheme administrator, an easement has been agreed that allows employers to retain the contributions of new employees pending the passing of the decision deadline. The need for an easement in a regime that is effectively still in the design stage is a matter of concern and suggests a design failure.

13. We suggest that employees should be auto-enrolled not immediately on commencement of the employment but a number of months, at least three but preferably six, after the commencement of the employment with employees being required to opt out during this 'waiting period'. This would have a number of advantages, including:

- First, it will significantly reduce the administrative burden and therefore costs for employers, in particular, because it would obviate the need for employers to:

    - deduct and account for contributions until after the worker has decided not to opt out, which would avoid the need for employers to refund any such contributions collected during the opt-out period to workers who opt out. Additionally, this would obviate the need for the easement referred to above, (and will also save even more administration for those employers who for policy reasons would not have taken advantage of that easement, as they would be saved the task of recovering the monies from the default

pension fund personal account administrator and possibly in the meantime funding the repayment to the employee);
- enrol short term employees into the default auto-enrolment pension fund. We acknowledge that one of the policy objectives was to encourage eg transient/seasonal workers into saving for retirement. However, we believe the additional administrative costs caused by not allowing waiting periods outweigh the potential advantage of including these workers, especially as they are likely to have very small pots of savings which are unlikely to provide them with any meaningful income in retirement.

- Secondly, it will save costs for the auto-enrolment pension fund administrators who will not have to run so many personal accounts containing trivial amounts; and
- Thirdly, it would enable employees to take a considered view, including reviewing information provided by employers and where appropriate seeking independent advice as to the merits of joining their employer's auto-enrolment pension scheme – or maybe even a personal pension.

Calculating contributions

14. Bulk employer pension schemes need to be straightforward and inexpensive to administer, but in its present form NEST and other qualifying schemes will add a major burden to payroll administration, similar in size to each of income tax or national insurance contributions ('NIC'). This is because the contributions rules and the self-certification requirements for qualifying schemes that employers will have to follow do not tie in with anything that they are presently doing. Employers will have to assimilate a complex new raft of rules and put in place additional payroll procedures, for example, to ensure the correct contributions are paid to NEST or to check that the minimum has been paid to the employer's scheme to allow self certification. In particular, the definitions of earnings and bands of earnings on which contributions are to be calculated, the pay periods for which contributions are calculated and the due date for paying over contributions to the scheme administrator/trustee will all be different from what employers are used to. This will impose costs, especially for smaller employers who are less likely than larger employers to use computerised payrolls. We fear that this additional administrative burden may even affect the economic recovery.

15. We consider that the new workplace pensions regime should align with what employers are currently required to do. We have several recommendations, but our major ones are that contributions should be calculated on the same earnings and using the same thresholds as Class 1 NIC, as this regime would capture bonus payments and has already developed rules to cope with, for example, erratic pay patterns and with employees who have more than one job with the same or associated employers. We recommend that NEST contributions are based on the NIC Earnings Threshold (to be replaced by Primary and Secondary Thresholds from 6 April 2011) and Upper Earnings Limit) and the same pay periods as Class 1 NIC, and that the due dates by which employers must pay over contributions to be invested in jobholders' Pension Accounts and the periods to which they relate should be the same as for PAYE/Class 1 NIC.

16. We are also concerned that many of the difficulties and burdens with calculating NEST contributions referred to in our previous submissions to DWP during the course of consultations/discussions still have not been resolved. See for example ICAEW REP 145/08 and the general comments in ICAEW REPs 28/09, 67/09, 77/09, 83/09 and 115/09. The web addresses for these documents are in Appendix 1.

Staging dates

17. We note that employers are to be arbitrarily 'staged' into the regime each month based on number of employees due to the inability of NEST and tPR to cope with many employers being staged in eg in April of each year. However, this results in additional burdens on some employers, eg some employers with heavy pre-Christmas sales are to be staged in in November. If this is to be the case, we believe that, at least going forward, once within the regime, employers should be able to change their own anniversary or 'staging date' for re-auto-enrolment, employer re-registration, etc, so that, in the long term, NEST procedures can be fitted in with their commercial business needs or the payroll/tax year or accounts year or occupational pension scheme fund year, as the employer chooses.

Other comments

18. We also recommend that consideration be given to the following:

- in order to encourage long term saving amongst those whose private pensions income in retirement might turn out to be very small but will have a disproportionate impact on means-tested benefits, we suggest that a de minimis amount of personal/ occupational/ NEST/ employer-selected substitute for NEST pension scheme pension should be disregarded when assessing means-tested benefits post retirement; and
- to help protect unsophisticated investors (who are likely to comprise the majority of NEST contributors) from adverse market fluctuations, we recommend that the NEST default investment fund be a deferred index-linked annuity.

19. In addition to the above, the terms of reference refer specifically to two other specific issues:

- the age group to which automatic enrolment should apply; and
- the size of firm to which automatic enrolment should apply.

20. Imposing an arbitrary upper age limit will increase the administration burden for employers, and therefore we suggest that the upper limit for auto-enrolment is aligned with that under the NIC regime, namely , state retirement age. We also believe there should be no lower age limit, with contributions becoming payable on earnings in the same way that NICs become payable. This will reduce the administrative burden for employers and will also achieve the objective of encouraging younger people to save. If an arbitrary lower age limit is to be used, it should be 21 (not 22), to align with the lower age threshold for national minimum wage, again to avoid unnecessary additional administration burdens for employers.

21. Regarding the second, ie the size of firm, we do not see why those employed by small employers should not have an equal right to those working for large employers to be in NEST or an employer-selected substitute for NEST if they wish. We therefore feel that there should be no de minimis size of employer so that the default option is that even a single employee is auto-enrolled unless (s)he elects to opt out.

22. As this is a new regime, the final rules and guidance need to be in place as soon as possible so that software can be capacity tested at least a year before the tax year in which the first employers have to use it (similar to Recommendation 23 in Lord Carter of Coles' report of 22 March 2006 on HMRC Online Services) and to provide sufficient time for employers with existing occupational pension schemes to make any necessary changes to ensure that they will be 'qualifying schemes'. Given the regime is still under review, implementation may need to be postponed in order to give employers and schemes sufficient preparation time.

23. In the early years we trust that penalties will be administered with a light touch and we should welcome a ministerial announcement to this effect.

24. Raising awareness amongst employers will be key to the success of these reforms, and we look forward to continuing to work with DWP, NEST and tPR, including the pensions roadshow that we are running with NEST and tPR in the autumn.

25. We should be very happy to discuss any of the foregoing with you, and if you would like to meet, then do please contact us.

E peter.bickley@icaew.com; liz cole@icaew.com
13.8.10

icaew.com

APPENDIX 1

SOME PUBLISHED SUBMISSIONS BY ICAEW TO DWP ON NEST AND WORKPLACE PENSION REFORM

ICAEW REP 145/08 Employer obligations
www.icaew.com/index.cfm?route=162535

ICAEW REP 28/09 Securing a retirement income
www.icaew.com/index.cfm?route=164244

ICAEW REP 67/09 Automatic enrolment, and delegation of powers of the Pensions Regulator
www.icaew.com/index.cfm?route=166085

ICAEW REP 77/09 Scheme order and rules
www.icaew.com/index.cfm?route=166797

ICAEW REP 83/09 Designing an investment approach
www.icaew.com/index.cfm?route=167093

ICAEW REP 115/09 Draft regulations
www.icaew.com/index.cfm?route=169164.