ICAEW representation

ICAEW REP 52/06

PENSIONS WHITE PAPER

Memorandum of comment submitted in September 2006 to the Department for Work and Pensions in response to its White Paper 'Security in retirement: towards a new pensions system'

INTRODUCTION

1. The Institute of Chartered Accountants in England & Wales (ICAEW) welcomes the opportunity to comment on the White Paper issued by the Department for work and Pensions (DWP) entitled 'Security in retirement: towards a new pensions system, available at: http://www.dwp.gov.uk/pensionsreform/whitepaper.asp.

2. The ICAEW operates under a Royal Charter, working in the public interest. Accountants make up the largest professional group of FTSE 100 chief executives, with 24 of the UK's largest companies having an accountant as CEO, and over 60% of FTSE Finance Directors are members of the Institute. As the largest accountancy body in Europe, the ICAEW's 128,000 members run and advise businesses of all sizes across virtually every economic sector.

3. Members of the ICAEW play an important role in pensions. For example, many are trustees of pension funds, finance directors responsible for pension scheme strategy or otherwise involved in pensions policy or administration. To contribute to the national debate that followed the Pension Commission's second report, the ICAEW conducted a major piece of member research to road test Lord Turner's recommendations with finance professionals and UK businesses. We canvassed the views of nearly 1,000 of our members who had expressed interest in pensions issues, and the results of this research are reflected in the comments in this paper. A summary of the findings is available here: http://www.icaew.co.uk/index.cfm?route=129053.

4. We have also incorporated the views of the ICAEW Pensions Sub-Committee, and the comments of other ICAEW members, in particular those working in business, who have submitted their views on pensions reform to the ICAEW

5. We issued our 2006 pensions survey to 4,500 members after the White Paper was published (the ICAEW Pensions Policy Monitor 2006). We are analysing the results of this 2006 survey, which specifically asks our members who are employers, trustees, pension scheme members and advisers for their views on the White Paper proposals, in addition questions on changes to schemes, scheme funding, the PPF and trustee recruitment, retention and conflicts of interest. We will provide the DWP with a copy of the results as soon as these are available.

GENERAL COMMENTS

6. The ICAEW believes that the essential principles for rebuilding trust and confidence in the pensions system are simplicity, certainty and stability.

7. Over recent years, individuals have been subjected to a barrage of complicated and often conflicting information about the future of their pensions which has left them confused and uncertain about the state of their retirement provision or indeed what steps they should be taking. Individuals can only make informed choices about how they provide for their retirement if the pensions system introduced following the national debate is simple, certain and long term.

8. We note that in Paragraph 1.36, the White paper states that '*People are less likely to engage with long-term financial planning if the decisions they need to make and the system within which they make them are overly complex. The Pensions Commission concluded that the UK pension system is the most complex in the world. A recent survey found that two-thirds of people agreed – they find all pensions confusing. This complexity is likely to further affect undersaving for retiremen.*'. We agree that simplification of pensions-related legislation (especially regulations) is important and we make a number of suggestions of regulations that should be revisited (see paragraph 29 below). It is important to note that people running schemes need simplification, in addition to scheme members.

9. We also welcome the five tests for pensions reform set out in the set out in the White Paper, which are to:

   • <u>promote personal responsibility:</u> tackling the problem of undersaving for retirement;
   • <u>be fair:</u> protecting the poorest, and being fair to women and carers, to savers, and between generations;
   • <u>be simple:</u> clarifying the respective roles of the State, the employer and the individual;
   • <u>be affordable:</u> maintaining macroeconomic stability and striking the right balance for provision between the State, the employer and the individual; and
   • <u>be sustainable:</u> setting the basis of an enduring national consensus, while being flexible to future trends.

10. However, it is no use giving people responsibility and choice in such a complex area if they do not have the knowledge or ability to exercise it. We believe a key feature is not only availability of information, but also clarity of that information, and investment in financial education and greater financial literacy so that people understand the information provided to them. The ICAEW has linked up with the Personal Finance Education Group (pfeg), who have been tasked by the government with promoting financial education, and GE Money (a leading UK consumer finance provider) to help deliver financial literacy in schools. ICAEW members will be asked to go to schools and talk to teachers, giving them their expert advice which can be passed onto students. This project is currently being piloted, with a view to rolling it out across the country in 2007.

11. We also welcome the forecasts issued by the DWP aimed at helping individuals, particularly those with multiple pensions, to estimate their retirement income and any likely shortfall (see paragraph 1.21 of the White Paper).

12. We believe more focus should be placed on improving awareness of the requirements of running a defined contribution scheme, which require much more attention to detail in respect of the administration than defined benefit schemes (see paragraphs 15 to 17 below). We also think that means testing is a major disincentive to long term saving, and that it is important for the government to acknowledge that uncertainty in the annuity market is also a disincentive (see paragraph 18 below).

13. We think it is important for governments to stop treating pension funds as an opportunity for raising additional taxation revenue 'at no apparent cost' to the man

in the street. Years of taking a slice of pension funds' income, 'in the years of plenty', have rebounded in the lean years.

14. The priority for this government must be to make more workers save for their futures and those saving to save more. This government, far from encouraging savings, has and is doing the exact opposite. This is not a party political point, it is a simple fact that more must be provided for the future and this can only be encouraged by government changing the rules to make it a positively beneficial financial course of action. An example of the lack of incentive is the removal of tax relief on dividend income. We note the White Paper illustrates the large impact on member benefits for a relatively modest increase (1%) in fees (see paragraph 22 below). The removal of 22% tax relief on dividend income will clearly have a significant impact on schemes, and this will particularly impact on members of DC schemes as the employer doesn’t meet the shortfall and members themselves will suffer the reduction in available benefits.

ENCOURAGING AND ENABLING PRIVATE PENSION SAVING

Protection of member benefits

15. We note that as improvements in member protection, the White Paper mentions the establishment of the Pension Protection Fund and the new risk-focused Pensions Regulator (White Paper, paragraph 1.27). However, we also think that of fundamental importance to the security of member benefits in defined contribution (DC) schemes is improved awareness of, and adequate measures taken in respect of, the risks associated with poor internal controls.

16. We are increasingly concerned that the decision to move over to DC is made due to the desirability of fixed (rather than variable) costs, without considering the additional administration costs. Particularly in years to come, when these schemes are more mature with an increased number of pensions in payment, the administration surrounding the determination and settlement of member benefits will be a costly exercise. There is also the increased risk from serious under provision due to the risk and responsibility passing to the member. It is therefore disappointing to see that the impact of the level of regulation appears to have contributed to the move away from DB schemes.

17. Also, worryingly, as auditors our members often find that some DC schemes simply do not have adequate controls, for example, reconciliations are not carried out as often as necessary. This allows discrepancies to build up and makes the task of rectification of error difficult and expensive. We therefore welcome the imminent Code of Practice on internal controls, and urge the DWP to provide more information to employers about the considerations of switching to a DC scheme.

Incentives for saving

18. In our member survey, as would be expected, the most effective ways to encourage long-term saving were thought to be tax relief on pensions and tax

relief on savings. Interestingly, greater certainty on future value of annuities was thought to be the next most effective because of their vulnerability to fluctuating investment returns and the annuity market. The White Paper does not acknowledge this to be a current issue (see paragraph 1.77 *et seq*), whereas we believe it is. Means testing is seen as a major disincentive.

19. We note the White Paper mentions encouraging lower earners to save (paragraph 1.87) and we are concerned that means testing should be reduced to the absolute minimum to avoid the lowest earners saving but then effectively receiving no benefit, which can currently be the case.

Automatic enrolment with compulsory employer contributions

20. We are very supportive of this measure, which we agree will help prevent inertia from reducing the level of retirement provision in the UK, although we note that it needs to be implemented hand in hand with a better state pension and a reduction of means testing. We note that in a recent survey of our members, of the CFOs and Finance Directors we canvassed, 81% were in favour of auto enrolment with compulsory employer contributions. Notably, this was also true of those from smaller employers although, whilst our smaller members support compulsory employer contributions, we believe transitional relief for smaller employers will be vital and we therefore welcome the Government's intention to consult on such measures (White Paper, paragraph 1.130).

Risk of "levelling down"

21. The White Paper states at paragraph 1.118 that there will only be limited levelling down. Anecdotal evidence from our members in business appears to be divided, with some members saying they would not reduce employer contributions down to any national minimum level, but others saying they would level down. We also note the recent NAPF Research Report 'Quantity v Quality – auto-enrolment and levelling down: the evidence' which looks at the impact of auto-enrolment and how employers may respond to its introduction, which found a significant risk of levelling down. We are therefore concerned that more research should be carried out by the Government as to whether the introduction of a national minimum employer contribution will lead to more widespread levelling down, and what measures could be implemented to reduce the risk of levelling down.

Can NPSS achieve a fee of 0.3 per cent.?

22. We are concerned that this fee level of 0.3% will not be achievable, and we note the significant impact that fees can have on levels of benefits; increasing fees by 1% of funds under management can lead to a 20% reduction in benefits (White Paper, paragraph 1.78). We note that the Government invites comments on whether this fee level is achievable, and we urge the DWP to conduct further research in addition to this consultation as to whether this fee level is achievable.

Balance of responsibilities

23. We agree with the suggestion by the Pensions Commission that resposibility for pensions provisions should be a balance between individuals, employers and the state (White Paper, paragraph 1.106). We note that the majority of chartered accountants who participated in our recent survey were clear that everybody concerned – employers, employees and the state – should contribute.

Opt out for 'suitable alternative schemes'

24. We fear that defining suitable alternative schemes may be difficult, particularly in relation to waiting periods (see White Paper, paragraph 1.113). For instance, many employer schemes will wish to retain a 12 month waiting period, to avoid the administrative burden and disproportionate expense of enrolling short term employees into their scheme. However, one of the intended benefits of establishing portable personal accounts would be that they would be available for workers who frequently change employers. A compromise may need to be reached, for instance, permitting employers that retain longer (eg twelve month) waiting periods to opt out of the national scheme in respect of employees who have exceeded the waiting period, with shorter term workers being auto-enrolled into the national scheme (in practice this may not be administratively burdensome because employers are already required to have payroll systems in place for deductions to be made in respect of such workers should they wish to join stakeholder schemes, and this could be in respect of several stakeholder schemes whereas there would only be one national scheme).

Financial literacy

25. We agree that more should be done to improve financial literacy (White Paper, paragraph 1.134), and we note our partnership with the Personal Finance Education Group (pfeg) and GE Money (a leading UK consumer finance provider) to help deliver financial literacy in schools (see paragraph 10 above).

Independent pensions commission

26. The majority of the members we surveyed supported the creation of an independent pensions commission as a way of restoring confidence in the pensions system.

STRENGTHENING EXISTING PROVISION

Abolition of contracting out

27. We support this proposed simplification. Further, we also call for earlier simplification of the contracting our regime (see paragraph 29(iii) below).

Request for suggestions of De-regulatory measures

28. We welcome the proposed Pensions Law Rewrite project (White Paper, paragraph 2.46), and we make some specific suggestions of regulations relating to pension schemes that could be improved below. However, as a general point, we are very concerned about the lack of accounting and audit expertise available to the DWP. This consistently gives rise to regulations being drafted that prove to be unworkable in practice for our members. If it is not possible for the DWP to take on staff with this expertise, time needs to be built into the timetable for issuing regulations to enable proper consultation with the accountancy profession to ensure that regulations are workable.

29. We also suggest the following measures where we think it is important for the legislation to be changed and simplified, about which we would be happy to meet with the DWP to discuss in more detail:

    (i) revising the pension scheme disclosure regulations;

    (ii) re-writing the rules for pension schemes in relation to audited accounts in a simple and understandable format; these are currently inconsistent and spread across numerous sets of regulations, many of which have been the subject of amending regulations, making them even more difficult to follow (eg the pensions scheme audited accounts and administration regulations);

    (iii) accelerating the abolition of contracted out rebates for earnings in the nil rate band of National Insurance Contributions, which would remove a layer of complexity and save administration costs for employers and the indirect costs of explaining the current system to employees;

    (iv) removing from the funding regulations the requirement for multi-employer schemes to produce accounts for every section of the scheme;

    (v) removing the requirement for a payment schedule once a scheme has commenced wind-up; and

    (vi) removing the requirement for an auditor’s statement on contributions.

PROVIDING A FOUNDATION FOR PRIVATE SAVING

Linking state benefits with earnings

30. We support the proposal of linking the basic state pensions to earnings instead of Retail Price Index (White Paper, pagaraph 3.19).

Reducing means testing

31. We agree that means testing should be minimised as it is a major disincentive. In our survey, 81% of our members agreed that means testing was a disincentive to long term savings.

Residency vs. contributory basis

32. We support the proposal to retain a contributory basis, as opposed to moving over to a residency basis (White Paper, paragraph 3.75). We note that in our survey, over two thirds of our members preferred NIC-based pensions rather than a "citizen's pension" based on residency.

LC, 11.9.06