UK Pensions Reform 2004

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DWP Department for Work and Pensions

Contents

- The current UK pension system
- Why Reform?
- Reform timeline to date
- Auto-enrolment and Personal Accounts
- Reform Timetable – the future
- Deregulation

Pensions in the UK

State Pensions

- Basic State Pension
  - Flat rate
  - Based on National Insurance contributions
- State Second Pension
  - Contributory
  - Can opt-out if one has private pension
- Pension Credit
  - Means tested benefit
- Winter fuel payment
  - Lump sum payment – not related to a pensioner's fuel costs

Private Pensions

- Occupational Pensions (trust based/ statutory schemes through employer)
  - Defined Benefit
  - Defined Contribution
- Workplace Personal Pensions (contract trust based with insurance company and arranged through employer)
  - 'Stakeholder' pensions
  - Other WPPs
- Personal Pensions (to which employers may make contributions)

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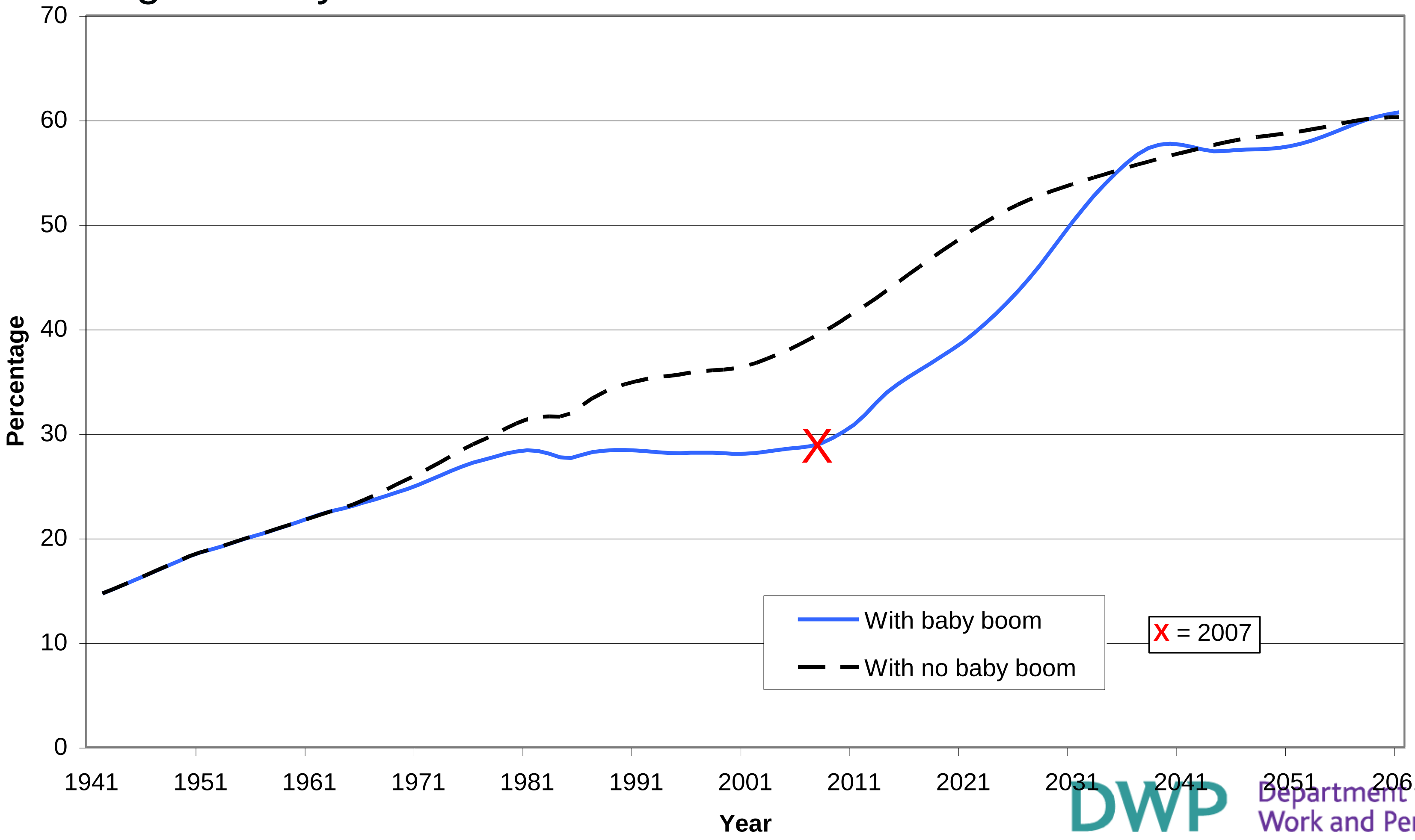
Why Reform?

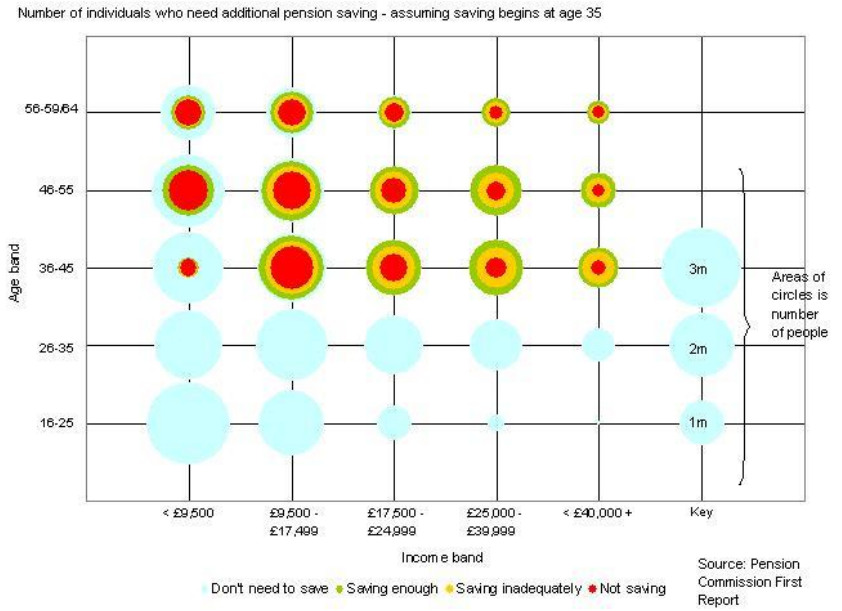
- Complexity
- Demography
- Under-saving
- Inequality

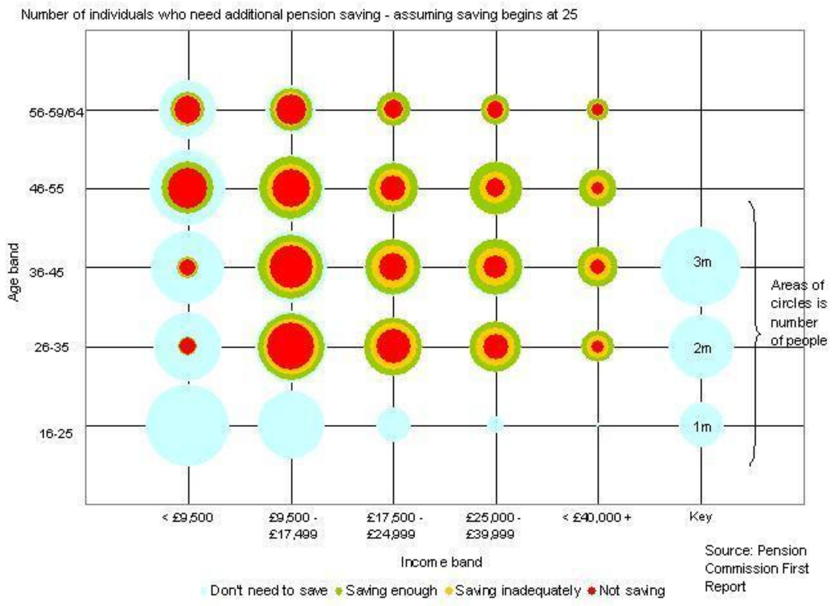
Reasons for Reform – Demography

Old Age dependency ratio (over 65s : 20-64 year olds) will rise significantly over next 4 decades



Reasons for reform – Under saving





Reasons for reform – Under saving

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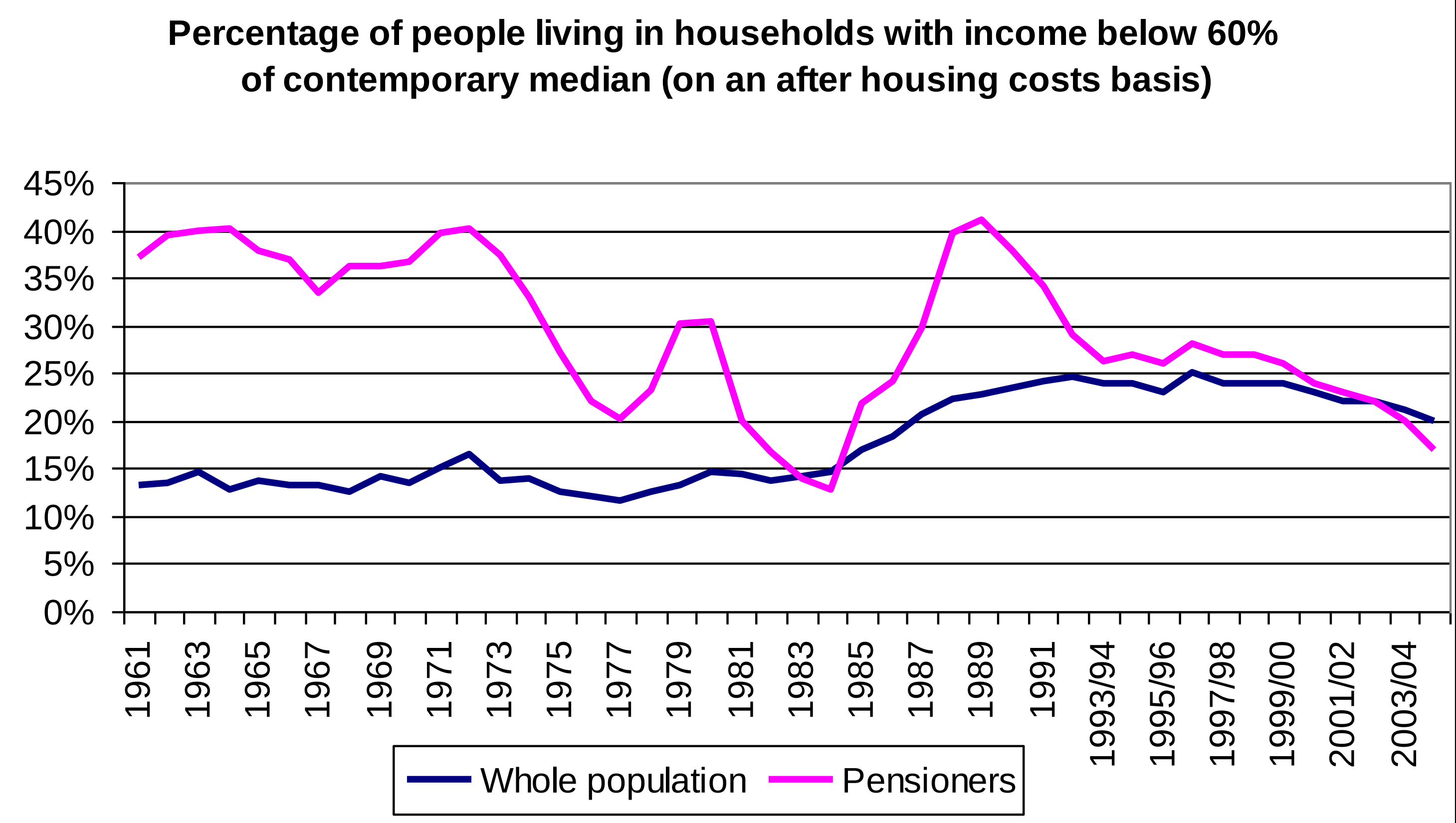
Reasons for Reform – Inequality



Source: Institute for Fiscal Studies caclulations based on Family Expenditure Survey (1961 to 1993/94). HBAI figures based on Family Resources Survey (1994/95 to 2004/5).

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Reform Timeline

October 2004	Turner Commission's 1st report – Evidence
November 2005	Turner Commission's 2nd report - Proposals
April 2006	Turner Commission's final report
May 2006	White Paper 'Security in retirement: towards a new pensions system'
November 2006	1st Pensions Bill introduced (State Pensions)
December 2006	White Paper 'Personal Accounts: a new way to save'
July 2007	1st Pensions Bill enacted as Pensions Act 2007
2008	2nd Pensions Bill (Private Pensions)

Turner Commission

There were essentially four possibilities

- Poorer pensioners;
- Higher % of taxes to older people;
- Save more;
- Work longer.

Proposals

Turner Commission, November 2005

- State Pension Reform
  - More generous, earnings-linked basic state pension
  - Flat-rate state second pension
  - Improved coverage for women and carers
  - Raise State pension age 1 year every 10 to 68 by 2046
- National Pension Savings Scheme (NPSS)
  - "auto-enrol" employees with opt out
  - 3% employer contribution

White Paper, May 2006

- State Pension Reform
  - Restore earnings link for state pensions
  - Move to flat-rate (contributory) state second pension [check this]
  - Improved coverage for women and carers
  - Pension Simplification
- Enabling retirement savings
  - "auto-enrolment" into 'good quality' employer based pension schemes
  - Creation of "personal accounts" to address potential non-existence problem
- Extended Working Life policy
- Reset State Pension Age by 1 year per decade
- Pension Credit uprating

First Pension Bill - now Pensions Act 2007

- **State Pension Age**

- **State Pensions Reforms – Enacted July 2007**
  - women/carers package - e.g. cut qualifying years to 30
  - Basic State Pension earnings uprating from 2012 subject to affordability or within lifetime of next Government
  - Second State Pension to become flat weekly top-up

- **Personal Accounts Delivery Authority (PADA)**
  - advisory powers on development of Personal Accounts scheme

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Second Pension Bill: Auto-enrolment

- All workers must be automatically enrolled into a scheme which meets a qualifying test:
  - Minimum contribution 8%
  - Minimum 3% employer contribution
    - of annual earnings £5000-33000
  - there must be a default mechanism for those individuals who do not make an investment choice in a DC Scheme
  - Government will monitor charge levels to identify if high charge levels are preventing individuals from accruing meaningful savings
- Individuals can opt-out of scheme at any time once enrolled
  - Opted out members are re-enrolled (and can opt-out again) every three years.

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Second Pensions Bill: Contract based schemes

•2012 Pension Reforms will complement existing good quality workplace pension arrangements.

•We plan to legislate to enable automatic enrolment into Workplace Personal Pension schemes from 2012, after discussions with European Commission..

- The aim is automatic enrolment across all employers and workers.
- WPPs are the second largest form of private sector pension membership.
- It provides the insurance industry with more opportunity to increase participation in WPPs

Second Pension Bill: Personal Accounts

- A new scheme to ensure all employers can access a scheme that meets these requirements

Key Features of Personal Accounts

- Universal Service Obligation
- Portable pension
- Classified as an occupational Defined Contribution pension
- Collective scheme run by the Personal Accounts Delivery Authority (PADA) with trust type governance
- All significant operational functions outsourced
- Low charges
- Per member contribution capped at £3,600 pa.

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Second Pension Bill - PADA

Why a Delivery Authority?

- **Needs to be, and be seen to be, independent from Government**
- **Civil servants do not have the required expertise**

What is it?

- Stage 1 (from 1st Bill) to advise on detailed policy design and develop a commercial and procurement strategy;
- Stage 2 (from 2nd Bill) to implement this strategy, oversee suppliers' design, build and test of systems and secure people/premises
- Stage 3 (from start of auto-enrolment period) hands over to the Personal Accounts scheme (also an NDPB) for live running.

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State Pension Consolidation

A Simpler Future:

- By 2012 second state pensions will:
  - Accrue pension at a fixed rate of £1.50 a week for each qualifying year.
  - Have a residual earnings related element that will be withdrawn gradually by 2030.
  - Only be contracted out to DB schemes

Consolidating the Past (2nd Pensions Bill):

- GRAD, SERPS and old S2P all very complex and will permeate system for the rest of the century.
- Propose calculating all accruals to 5 April 2012 using the existing rules of the schemes and placing a single weekly cash valuation on contributors accounts.
- The valuation will be re-valued by earnings to SPA.

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Going forwards

2008	* Pension Credit - ongoing uprating in line with earnings - Savings Credit threshold earnings uprating
2010-20	* Equalisation of women’s State Pension Age begins
2010	* Implementation of State Pensions Coverage Package
2012	* Basic State Pension earnings uprating, subject to affordability * Abolition of Defined Contribution “contracting out” * Auto-enrolment obligation to start * Personal Accounts to start
2024-6	* Rise in State Pension Age to 66
c. 2030	* State Second Pension (S2P) accrual becomes flat rate
2034-6	* Rise in State Pension Age to 67
2044-6	* Rise in State Pension Age to 68

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Deregulatory Review

Government response to Deregulatory Review December 2007

Pensions Bill

- Reduce mandatory revaluation of deferred pensions
- Pension-sharing on divorce

Secondary legislation or guidance

- Trustee knowledge

Further "rolling review" work

- Disclosure
- Surplus
- Employer debt
- Risk-sharing

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Thank You!

Deregulatory review recommendations

•Accrued rights - No changes which will adversely affect the position of pensioners or deferred pensioners at the present time or the past-service rights at the present time of active staff.

•Contingent benefits - the present formulation of section 67 should give sponsors and trustees sufficient scope to affect change.

•Normal pension age – Schemes should be able to adjust normal pension age for pensionable service from now on and we believe that current regulations do not inhibit this.

•Revaluation - We recommend no change in the statutory revaluation cap of 5% per annum compound for early leavers from most DB schemes.

•Risk-sharing in DC schemes – permitting employers to prefund (with tax relief) any top-up payments they wish to make in order to supplement the funds available at retirement to DC scheme members

Deregulatory review recommendations (cont 1)

•Trivial Commutation - The current regulatory difficulties regarding trivial commutation should be resolved by HM Revenue and Customs (HMRC) as quickly as possible.

•Employer debt

- one year grace period for employers with no employees.
- debt should not be triggered, where the original covenant was strong and if the remaining employers' covenant remains as strong

•Compensation and risk based levy - We recommend that the DWP examine and further calibrate the basis for compensation to ensure a better match between PPF protection and the structure of risk based DB schemes.

•Disclosure and Rolling Programme - A framework of outcome-related principles accompanied by guidance, should take the place of the existing disclosure regulations.

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Deregulatory review recommendations (cont 2)

•Surplus - The current provisions in section 37 of the Pensions Act 1995 should be amended to allow return of surplus to employers once the scheme has reached the scheme specific funding target and the trustees agree at that time that such a payment should be made.

•Trustees – Trustee boards (not individual trustees) should have sufficient knowledge and understanding between them to carry out their duties properly.

•Pensions sharing on divorce – Review policy and legislation.

•Principles based legislation - Renewed emphasis should be placed on a principles based approach to regulation of pensions.

•Statutory override – to implement regulatory changes in schemes