



Workplace Pensions Review – Making auto-enrolment work

The TUC Submission

Executive Summary

1. The TUC supports the workplace pensions reform package under review. While the Turner Commission did not adopt all the policies urged on it by the TUC, we recognise that it produced a progressive, practical and skilfully constructed package that was able to win wide support, despite going against the then preferences of the previous government.
2. The details of the package were taken forward in a similar spirit, with real effort made to work by consensus and maintain wide support.
3. We therefore believe it would be a mistake to reopen the fundamental building blocks of the package as the consensus could easily collapse which could fundamentally threaten the reform package.
4. For example if it were decided not to take NEST forward, consumer groups would re-examine their support for the EU “letter of comfort” that allows GPPs to auto-enrol despite the potential difficulties with EU inertia-selling rules.
5. It needs to be recognised that there is no perfect pensions settlement. The test should not be “is this new settlement perfect?” but “does it make substantial progress towards providing decent pensions for all in retirement?” and “are there practical ways of making it better?”.
6. The Pensions Act 2008 requires there to be a wide review of its operation in 2017. That is the right time for a major independent assessment of the reforms, when there is some evidence base for how they are working. While the TUC has advocated a different approach on many of the issues under review, we will not therefore call for major changes in the current review. But where there have been changes in the external environment since the Pensions Commission did their work, we will advocate some relatively minor reforms.
7. The Turner Commission was established because of a growing realisation that the UK pensions system was no longer working properly. It had become increasingly complicated as a result of frequent intervention and change by successive governments, who also shared an objective to reduce expenditure on state pensions as a proportion of GDP. A sharp decline in employer support for pensions that began in the 1980s made the problem even more acute. The Turner Commission sought to establish a consensus across the political spectrum and the wider pensions community with a set of reforms whose structure would be sustainable over the very long term. While we accept that this new structure cannot be set in stone, we believe that it would be a big mistake for this review to begin a further process of intervention and change that both undermines the Turner consensus and starts to make the new system unnecessarily complicated.

Context

8. *The credit crunch* – We do not believe that the economic crisis makes a fundamental difference to the case for the reform package. While this has been an unexpectedly deep recession, the existence of an economic cycle does not come as a surprise. What the crisis does expose is the limited investment strategies of many pension products, making their risk profile unsuitable for the more risk-averse low to medium earners who will be better served by NEST. While the Treasury may be reluctant to fund extra tax relief for millions of new savers, the government will get a better return from lifting many of these savers above means-testing thresholds than they do from incentivising saving by those well clear of benefit levels.

9. *NEST costs and charges* – Although NEST's charges are somewhat higher than we would have liked, they are still extremely competitive. The self-employed and the staff of small businesses would only have access to much higher-charging stakeholders if NEST was not implemented.

10. *Phasing and staging employer duties and minimum contributions* – While the extended timetable is disappointing, it is probably no longer practical to speed it up given the anticipated implication for tax revenues over the short/medium term. This is not a fundamental reason to change the package.

11. *The review of state pension age* – A higher state pension age does not necessarily alter the age at which people retire. Some people stop work earlier – some through choice and some involuntarily. Others want to work beyond the state pension age. Raising the state pension age is a reduction in state pension provision and thus underlines the need for people to have access to other pension savings.

12. *Further increases in life expectancy* – This will lead to worse annuity rates and mean that people will need to save more to reach the target levels of income replacement suggested by the Pensions Commission. This points to a need to increase contributions. While this is more appropriate for the 2017 review, the review team should call for a higher annual contributions limit for NEST pensions of at least £5,000 – possibly linking it to the ISA limit.

13. *Further decline in private sector pensions coverage* – This underlines the need for auto-enrolment, contingent employer compulsion and NEST.

14. *Further changes in the pensions market* – We are alarmed at increasing indications that some contract based work place pension schemes set higher charges for deferred and non-contributing members. We are also very concerned about the situation whereby some employers require leavers to transfer out of the workplace defined contribution scheme. This is a worrying development in the pensions environment as it will result in lower pension saving outcomes for millions of people, particularly for those least able to

afford it. Some relief could be provided by lifting the ban on transfers of modest pension saving pots into NEST.

15. *The new trust based DC scheme loophole* – We are concerned that some employers with a high-churn workforce are planning to launch new trust based DC schemes to receive contributions from staff during the waiting period for their more generous scheme. Making this a trust based scheme allows the employer to refund both employee and employer contributions if a member of staff leaves during this time. We are concerned that employers will be able to use this in high-churn sectors to effectively not pay contributions for many of their staff. This loophole should be closed.

16. *Changes in the labour market* – The significant increase in the numbers of migrant workers from the rest of the EU aiming to live and work here in recent years is a strong argument for allowing at least some transfers out of the scheme, subject to their being moved to a suitable pensions vehicle.

17. *Changes in state support for pensioners* – The introduction of the triple lock on the state retirement pension and the linking of some means-tested benefits to CPI in future will help reduce the impact of means-testing on workplace pensions savings. While we were confident that the right balance had already been struck, this reduces the strength of arguments against auto-enrolment on 'pays-to-save' grounds. The benefit of the triple lock has been partially offset however, by the replacement of the RPI with the CPI for the indexation of the state second pension, S2P, post retirement. Much of the debate on the state pension focuses exclusively on BSP. The firm foundation of a more generous flat rate state pension, to support private pension saving, as recommended by the Turner Commission, is based on the accrual of both BSP and S2P

Scope

18. *Earnings threshold* – We are opposed to raising the earnings threshold:

- Using anyone's current earnings as a guide to their lifetime earnings is extremely risky, especially as people earning close to the threshold will be working part-time and can therefore easily increase their income by increasing their hours.
- Lifting the tax threshold by raising personal allowances will be welcomed by those who pay less tax, but there is no reason to link this to the lower earnings limit for pensions as it has no effect on their pension entitlements. Tax credit can still be given in the same way as it currently applies under the stakeholder regime. The Pensions Commission was right to link it to the lower earnings limit for NI as this is the gateway to building up entitlement to the basic state pension and S2P.
- A higher threshold would significantly reduce saving if contributions were only paid on earnings above the threshold. The income replacement

targets set by the Pensions Commission would therefore not be met. If the threshold for auto-enrolment was set significantly higher than the lower earnings limit for contributions, then the system would have an unworkable cliff-edge and present significant practical difficulties.

- Raising the threshold would disproportionately affect women. This is not only undesirable, but possibly has legal implications. It could potentially exclude millions of part time workers. There are 7.63m women in full time employment and 5.87m women in part time employment.
- Any change in the definition of pensionable pay would encourage some employers to abuse the change by redefining basic pay in future as bonuses or other non-pensionable elements.
- We would advocate a new opt-in arrangement that would allow workers who chose to make contributions from the first pound of pay to also receive employer contributions and tax relief on all their pay below the lower limit.

19. *A de minimis level* – While this causes fewer issues of principle than other proposed changes, we think this makes the system needlessly complicated without any great benefit to employers.

20. *Changing age-limits* – We are opposed to either a permanent upper age limit lower than the state pension age or a temporary lower limit that is then phased out. Older workers should either be able to add to their existing pension pots, or build up a useful lump sum that could be trivially commuted and which could help set them up for retirement, perhaps by paying off a mortgage or making repairs to their home. We do think the lower age limit should be reduced to 21 to bring it in line with the new lower age for qualification for the adult rate for the minimum wage. We would oppose the raising of the lower age limit. It would be potentially discriminatory and have a disproportionate impact on women. Part time working by women peaks in the 30s and 40s age groups when many have caring responsibilities. Increasing the years in their twenties when they are excluded from auto-enrolment would mean potentially many more women saving less in those early years when they are more likely to be working full time, earning more and when their savings would have a longer period to earn a real rate of return.

21. *Exempting small firms* – We are strongly opposed to any exemption for small or micro-employers. This would do great damage to the idea that the Pension Commission's reforms added up to a new pensions system for everyone at work. There is no comparable exemption to other basic minimum rights at work such as the minimum wage, health and safety rights and paid holidays. It would introduce perverse incentives for small firms to stay small and not take on extra staff. It almost certainly has equality implications. It would also be unfair as workers in small firms would still have to work longer and experience a rising SPA but be denied access to the new employer duty.

The Turner settlement was intended to be a universal tripartite settlement between the Government, employers and the citizen.

22. *The introduction of a waiting period* – This would also do great damage to the idea that this is a new system for all workers, introduce incentives for employers to sack staff at the end of their waiting period, and is likely to have equality implications. A great strength of the Pensions Act 2008 is that it is comprehensive and includes all workers – a waiting period would undermine this and would be likely to exclude a majority of agency workers from building up a pension.

Effectiveness

23. *Tackling pensioner poverty as quickly as possible, including among women pensioners* – It will take some time before auto-enrolment has a big effect on pensioner poverty, despite the care taken to help women by the Commission. We would like to see higher contributions and quicker implementation.

24. *Maximising voluntary private savings and the speed by which this objective can be achieved* – We believe the new system will encourage extra saving. Individuals are much more likely to save more if they can already see their savings growing. Many employers will want to do better than the legal minimum, and may well want to incentivise extra saving by their staff.

25. *Minimising administrative burdens on employers and the impact on existing provision* – This will be best done by keeping the system as simple as it is at present. While employers may be lobbying for more exemptions, the experience of the minimum wage suggests that a straightforward system that is the same for all employers will most easily win acceptance in the medium term. We think the levelling down argument is something of a red-herring as employers can level down to zero at present.

26. *Achieving an effective balance between the achievement of policy objectives, pace of implementation, value for money and risk* – We think the Pensions Commission achieved an extremely skilful balance – and it would be unwise to make major changes.

27. *Maximising value for money for the Exchequer* – auto-enrolment will lift millions above means-testing thresholds. This is a much more valuable objective for the Treasury than incentivising higher-rate tax-payers to save more when they already have sufficient funds to ensure that they will be above the poverty line in retirement.

Section one

Introduction and background

The TUC speaks for Britain at work. With more than six million members in more than 50 affiliated unions, we are Britain's largest voluntary organisation.

We have long campaigned for decent incomes for all in retirement. This requires both a proper foundation provided by the state and pensions acquired through the workplace as a second tier. We have long been alarmed at the decline in employer support for occupational pensions and the failure of policies that encouraged individuals to make their own arrangements.

The TUC's campaigning was important in persuading the previous administration to establish the Pensions Commission under Adair (now Lord) Turner. While the Commission did not accept the TUC's full policy prescriptions, for example we favoured compulsion, we welcomed the Commission's report. Pensions policy, like other extremely long term areas of public policy, work best when done by consensus. Our view was that the Commission had produced a set of recommendations that were progressive, practical and capable of winning wide support across the various groups with an interest in pensions policy.

We would stress two points about the workplace pensions reform package. Firstly the Turner Commission recommended a policy direction rather different from that followed by the Labour government to that point. There had been no consideration of employer compulsion and resistance to re-linking the state pension to earnings. Instead the emphasis had been on making means-tested support more generous as it was felt that this was the best way to counter pensioner poverty. It would be wrong therefore to see the previous government as the “parents” of the reform package under review; its genesis was in genuinely independent policy work. Successive governments have planned on the assumption that private pension saving would rise to fill the real decline in spending on state pension.

Secondly the then government took forward the Commission's report through an active process of building consensus. This involved working with opposition political parties as well as the three broad interest groupings in the pensions world: the union/consumer groups, employers and the pensions industry.

Of course during that process it was not possible for every group to get their own way on every issue under discussion. But each got enough to maintain their broad commitment to the policy. Compromises were needed on all sides, but this active process of building consensus meant that this was not a matter of simply splitting the difference on each issue as it came along. Instead all

sides tried genuinely to understand the concerns of others and DWP officials acted as honest brokers to find solutions that would be widely acceptable in a spirit of give and take.

We make these introductory points not to complain that these issues have been re-opened. A new government has every right to do this, and of course there is a case for a 'stock-check' to see if changed conditions or new knowledge suggest refinements.

But we do want to stress two important points.

i) The fragility of consensus

As we have said, the workplace pensions reform package is a result of a consensus building exercise and is considerably stronger because of that. If fundamental planks of that consensus are removed then the whole structure could collapse. Consequently, reforms introduced would be unlikely to hold over the long-term.

Let us give one example. EU law rightly protects consumers against inertia selling. Auto-enrolment into a contract-based pensions policy sold by a pensions company for profit and chosen by someone's employer looks very much like inertia selling.

Yet the growth of GPPs at the expense of trust-based DC provision means that they already constitute an important element in existing employer pension provision. While unions have always favoured trust-based provision, we recognise that much contract-based provision is of reasonable quality with contributions in excess of those prescribed by the Pensions Act 2008.

Auto-enrolment will inevitably lead to a growth in GPPs. Many more people will join existing schemes. This will include many lower paid workers who may not have been encouraged to join a scheme designed to suit the needs of the employer to recruit and retain more senior staff.

In addition, some employers who have not previously provided pensions will establish GPPs in order to have a single scheme that can suit all staff, given the contribution limits to NEST pensions that limit their suitability for well-paid staff.

EU law at one stage looked as if it could be a major obstacle to auto-enrolment to such non-trust based schemes. Because union and consumer groups saw auto-enrolment as a prize worth having we were prepared to join with government and representatives of all the interested parties in the pensions world to ask the European Commission to provide a 'letter of comfort' that would allow auto-enrolment into GPPs as part of a comprehensive pensions settlement, despite our strong preference for trust-based schemes. The Commission agreed to this joint request (which we include as an annex to this submission).

However, as the letter to the European Commission made clear, our support for relaxing this consumer protection was based both on its being part of a comprehensive new system of pensions savings and on there being quality conditions for qualifying GPPs.

For the TUC, a central recommendation of the Pensions Commission was the creation of a new low cost pension scheme particularly aimed at low to moderate earners.

The comprehensive market failure of the pensions industry is obvious to any objective observer as we can see from the low take-up of stakeholders and other efforts to spread saving. We do not need to agree on why this has happened to accept that it has. Various explanations have been advanced. Market incentives are not great for pension companies to provide small, high-churn products; mis-selling means that pensions have a poor image and, in recent years, the study of behavioural economics suggests that there are fundamental obstacles in persuading people – particularly those with modest incomes – to make proper provision for their future.

This means that we need both auto-enrolment to overcome the behavioural issues **and** NEST to provide low-cost pensions designed for low to moderate earners.

What is now called NEST also serves another function within this new system. As both the largest trust-based scheme in the UK and the only one with a mission to serve low to moderate earners it will set a benchmark for other auto-enrolment pensions, setting de-facto standards on issues such as charging and default fund quality. Its existence as a default choice for employers will be welcome to those with no expertise or appetite for choosing a pension suitable for their staff, and this will help prevent mis-selling to employers with no inclination to get involved in judging the suitability of the pension that they need to provide for auto-enrolment.

Already we have been disappointed that the regulations for establishing qualifying GPPs contain very little in the way of quality standards. But if the Government were to announce that NEST is not to go ahead, we – and we suspect other consumer groups – would have to think hard about whether we could still support the approach to the EU as this allows the inertia selling of products outside the kind of quality assurance system that we said was a necessary condition in our letter to the EU.

At the very least we would need to see an extremely tough and detailed regulatory regime for GPPs including charge capping and the regulated investment practices for their default funds to ensure that they will meet the approach set by PADA in its recommendations to the NEST Trustee Corporation for how NEST pensions will work.

ii) The impossibility of perfection

On paper it is no doubt possible to construct a perfect pensions policy from scratch. In the real world we start with an imperfect system and aim to make it better within the constraints of practicality and affordability.

This inevitably leads to compromises and trade-offs, and a less than perfect system. This makes it easy for critics to pick away at aspects of the policy, in the hope of discrediting the whole architecture.

This however is not responsible politics. The test should not be “is this new settlement perfect?” but “does it make substantial progress towards providing decent pensions for all in retirement?” and “are there practical ways of making it better?”.

One example of this has been the attempt by some to use the interaction of means-testing and auto-enrolment as a wedge to try to prise the consensus apart.

We do not deny that this is a real and difficult issue (and we return to this in further detail later in this submission). We have always been interested in ways of reducing the risk of creating a means-test trap – whether macro-changes such as higher state pensions or increased minimum contribution levels; or micro-changes such as increased trivial commutation limits and disregards in means-testing.

If groups can be identified with a substantial risk of losing out then it would be right to think hard about whether they should be auto-enrolled. It would be unrealistic to expect, as some critics apparently do, that auto-enrolled NEST pensions should be free of risk and that no-one should ever lose out.

This is of course unrealistic. No-other pension product has to meet this test, and indeed many critics seem curiously uninterested in whether people lose out from saving in GPPs or other employer organised pensions, as undoubtedly some people already do. Nor do the critics usually have a serious and funded alternative to the reform package.

This is not the time for major changes

The Turner Commission was established because of a growing realisation that the UK pensions system was no longer working properly. It had become increasingly complicated as a result of frequent intervention and change by successive governments, who also shared an objective to reduce expenditure on state pensions as a proportion of GDP. A sharp decline in employer support for pensions that began in the 1980s made the problem even more acute. The Turner Commission sought to establish a consensus across the political spectrum and the wider pensions community with a set of reforms whose

structure would be sustainable over the very long term. While we accept that this new structure cannot be set in stone, we believe that it would be a big mistake for this review to begin a further process of intervention and change that both undermined the Turner consensus and made the new system unnecessarily complicated.

Two years after Royal Assent for the 2008 Act is not the right time for major changes. The act requires a substantial review of the reform plans in 2017, and we believe that this is the right time and place to look at the fundamentals of the Turner Commission settlement. This will give the new system some time to get established and thus provide some evidence of how well it is working.

As we have already argued that there are strong dangers in reopening the building blocks of the consensus, we will resist the temptation to remake the case for fundamental changes that we have unsuccessfully pressed for at various times in the evolution of the reform package.

That does not mean that all changes should be ruled out, particularly if based on developments that have occurred in the wider environment since Lord Turner and his colleagues considered their report. We therefore do make some relatively minor evolutionary suggestions that do not challenge the fundamentals of the consensus.

Other groups may not take this self-denying ordinance, but we have confidence that the review team will judge submissions on their arguments and examine the evidence, rather than split the difference between the different viewpoints expressed.

Section two

The context

The terms of reference for the review start by asking us to consider changes in the wider context since the Turner Commission completed its work. We consider each point suggested and add some of our own.

1. The credit crunch in financial markets, the economic downturn and the fiscal deficit

Pensions have to be seen as a long term issue. While the timing and severity of the global recession may have taken people by surprise, the fact that the global economy has an economic cycle is not news. What it does do is highlight the failure of the pensions industry to provide products that appeal to the risk-averse nature and modest pension contributions of low to moderate earners. PADA's research and consultative process has made a real contribution to our understanding of this, and their proposals for the default investment strategies for NEST have been widely seen as innovative. This is further evidence that the pensions industry is characterised by market failure, and that NEST is a necessary and vital element in the new pensions architecture.

While the credit crunch does not reduce the need for pensions reform, the resulting fiscal deficit has made the Treasury reluctant to fund the tax relief element of contributions. This lay behind the unfortunate decision by the previous government to extend the timetable for phasing and staging – a move opposed by both coalition parties at the time.

However, this delay was short-sighted. The sharp and rapid decline in employer support for workplace pensions means that the tax-payer will have to fund a big growth in means-tested benefits when those in work today with little or no pensions saving retire.

While it may be outside the scope of the review, we would suggest that a restructuring of tax relief away from higher-rate tax payers towards new savers would be a sensible way to absorb the cost of providing tax-relief on the extra savings that will be made by low to modest earners.

2. A greater understanding of likely costs and the proposed charging structure for NEST

The Pensions Commission always stressed that what they called personal accounts should be low cost. The effects of costs has been emphasised by recent work by the Tomorrow's Investor team led by David Pitt-Watson at the Royal Society of Arts. The initial cost of NEST pensions does not fully meet

the hope that charges could be 0.3 per cent. This is mainly because the previous government made the decision that the additional costs of meeting the public service obligations put on NEST should be met by scheme members rather than the tax-payer, other than some minor assistance through the provision of loans at less than market rates (which has been approved by the European Commission).

However, NEST's charges are still low, particularly from the perspective of the self-employed with low to moderate incomes, those who work for SMEs and others who will not be able to save in pensions with comparably low charges to those planned by NEST.

We see no prospect of the pensions industry making similar low-cost pensions available at charges significantly below stakeholder pensions, particularly since the industry has lobbied for *higher* charges within stakeholder pensions.

3. The proposed approach and profile for introducing the new employer duties and phasing in of minimum levels of mandatory contributions

The TUC has always accepted that any system involving employer compulsion would need to be phased in so that costs could be more easily absorbed by employers. Phasing in contributions from employees may also help to deter them from opting-out after they have been auto-enrolled.

We have also accepted the arguments for staging implementation of employer duties. Auto-enrolment will bring millions of people into pension saving, many of them within NEST, and it always makes good sense to avoid a big-bang introduction of such major administrative challenges.

However, we thought it was possible to combine phasing and staging in a somewhat more ambitious timetable than was originally proposed. And we joined with the then opposition parties in expressing our disappointment at the extra year's delay to the final year of phasing announced by the previous Chancellor of the Exchequer.

However, we now accept that it would not be practical – or politically realistic – to speed up this timetable. While this extended timetable does postpone the date on which the new system is fully operational to 2017, it does at least give employers more time to absorb the extra costs. While consumers see this delay as a significant departure from the original plans to introduce auto-enrolment, many employers will no doubt welcome the delay

It is important to be clear about the extent of the burden on employers. Understandably people often talk about the new system in shorthand and talk of eight per cent contributions. It is worth stressing that this overestimates both the extra cost to employers and the size of the pension pot that savers will build up. The employer contribution will be three per cent not on the whole of employee earnings, but on a band.

While the band figures that will be used in 2012 are not yet known, in order to illustrate the point let us simplify and say that they will be £5,000 and £35,000 (in practice they will be somewhat higher).

The employer contribution for a staff member earning £6,000 will therefore be 3% of £1,000 or £30. This is just 0.5% of their pay.

The most an employer will have to pay is capped at contributions for a staff member who earns the upper limit. This cap is 3% of the £30,000 gap between the bottom and top band in our simplified model.

This is £900 or 2.6% of earnings for someone earning exactly the upper boundary earnings of £35,000. While this maximum £900 minimum is fixed, this becomes a declining percentage of pay for those earning less.

So the most an employer has to find is an extra 2.6% of someone's pay phased and staged over four years. For the vast majority of staff the percentage contribution will be smaller - and in many cases significantly so.

This is not to deny that this is a genuine new cost for employers, but, given the phasing-in period, our worry is not that this will be a burden on business but that it will be taken from employees in reduced wage packets, particularly in non-unionised workplaces.

4. The proposed review of state pension age

We do not believe that this is a reason for any changes to the workplace pensions reform package.

People often confuse the state pension age (SPA) with retirement dates, but of course many stop working before the SPA – sometimes through choice, sometimes involuntarily - and increasingly people are working beyond the SPA.

Raising the SPA withdraws state pensions from a cohort of older people, but does nothing to increase retirement ages. The burden will fall disproportionately on lower socio-economic groups who have a lower life expectancy and are less likely to have access to workplace pensions at present. Inevitably many workers in this group who find themselves unemployed will want to start taking any workplace pension they have before SPA. This is an argument for increasing workplace pension saving rather than reducing it.

5. Other changes such as the further increases in life expectancy and further decline in private sector pension coverage

These are somewhat different issues. Increased life expectancy is of course to be welcomed, but does present a challenge to the whole pensions system. The most obvious effect for the workplace pensions reform package is that it will be one of the factors bearing down on annuity rates. This means that people will need to save more for their retirement. The TUC will certainly press for higher minimum contributions when the system is reviewed in 2017 as one response. We recognise that this falls into the category of a “consensus-buster”

in this review, but we would welcome the review team's support for a consideration of options to phase in higher contributions at that date.

However, we do believe that the review should look at whether there are obstacles to employers and employees who will want to increase contributions voluntarily. We are attracted by schemes that allow staff to allocate in advance part of future pay increases to higher pension contributions and welcome employer support for such approaches, particularly by matching or otherwise incentivising extra saving. However, the current upper limits on contributions to NEST pensions can restrict the coverage of such schemes. While we see no principled reason for any limit we recognise that others differ. We would therefore call for an increase on the upper limit that can be made to NEST pensions in any one year to £5,000.

Probably the most significant changes that do have implications for the workplace pensions reform package are the changes that have taken place in the provision of private pensions.

The further decline in employer supported pensions in the private sector is stark. ASHE figures show that two out three staff in the private sector are now “unpensioned”. This makes the Pensions Commission's reform recommendations even more necessary.

6. Other changes – higher charges for deferred pensions

There have also been significant changes in the shape of private pension provision for those lucky enough to have it. While the further decline in DB and its replacement by DC is well known, less remarked has been the move away from trust-based occupational DC schemes to contract-based GPPs (which are excluded from occupational pension statistics, but captured by the ASHE pensions series). ASHE figures show that in 1999 8.1 per cent of all employees were members of trust-based DC schemes and 3.6 per cent were members of GPPs. In 2009 the respective figures had changed to 6 per cent and 6.5per cent.

In trust-based schemes, members know that their savings are being managed under trust rules with a clear duty on trustees to work in the members' interest. This is not the case in GPP schemes. Undoubtedly some represent a good deal for savers, but there are significantly fewer safeguards.

It is not surprising that many consider pensions provision a case-study of market failure. Much work in behavioural economics has considered pension savings. GPPs illustrate many of these issues. They are sold to employers, not to those who will rely on the scheme to provide them with a retirement income.

Employers have no interest in the deferred pensions of former staff. They are no longer contributing to them and have no concerns about the retention or morale of staff who no longer work for them. We can already see the pensions

'market' reacting to this. Santander now requires former staff to withdraw their savings from their pension scheme and transfer them elsewhere. Unless they have a new employer scheme willing to accept transfers, this means that they have to use a personal pension and are unlikely to be charged less than the limits set for stakeholder pensions.

Other schemes are introducing differential higher charges for deferred members, compared with active members. We have been reliably informed by industry figures that this practice is expected to spread rapidly, and is now receiving media coverage. (See <http://www.dailymail.co.uk/money/article-1295529/JEFF-PRESTRIDGE-The-stealth-charge-pension.html>).

This makes sense for employers, but is extremely bad news for employees who can certainly expect to change employer several times in their working lives. Indeed labour mobility is an objective of government policy.

Higher charges on a deferred DC pension pot built up early in someone's working life will seriously reduce the benefits of compounding. Classic market theory may suggest this provides an incentive for people to transfer this pot to a new employer's scheme; practical experience suggests that inertia is more likely to win out, even if such a transfer is available.

This is a major change in the pensions landscape. One of the great advantages of NEST to its members is that it does not have deferred members who are treated differently from active members. Whether or not you are making contributions you are an active member of NEST.

This is particularly valuable for low to median earners who change their jobs frequently. It will mean that they do not build up many small pension pots, increasingly looking likely to be subject to higher charges.

We therefore believe that the review should recommend that the current ban on transfers into NEST should be lifted. This may go against the consensus built up in the past, but is justified by this very recent development. Ideally we would prefer unlimited transfers, but the requirements of maintaining consensus may indicate a need for a cap of some kind on transfers in, although it has to be said that as NEST has to meet the costs of its public duties from its own charges, it is hard to see any rationale against such transfers in a market economy.

7. Other changes – The trust based DC pension loophole

We have recently been reliably informed that some significant employers are considering setting up new trust-based DC schemes to accept the minimum possible contributions from their staff when they start their jobs before they become eligible for a better occupational scheme with a waiting period.

The motivation for this is that unlike NEST, GPP and stakeholder pensions it is possible to refund contributions if staff only stay a short time with their employer. While the staff member may be attracted by a lump sum of this kind

when they leave, it also means that the employer will get a refund of their contributions. This could effectively be a giant loophole open to employers with a significant section of their workforce that churns fairly regularly to avoid the cost of many of their pension contributions. The review should recommend that this loophole should be closed. Such workers would be better served by NEST as it is ideal for employees who change jobs frequently.

8. Changes in the labour market

We would also draw attention to one further development since the Commission was doing its work. This is the rapid increase in the number of migrant workers in the UK from the rest of the EU. Many are likely to find themselves building up a small pension pot in NEST before returning to their home country. While this could probably wait for the 2017 review, we think that there is a strong case for allowing transfers out of such small pots. This would not be a substantial change and the review team may wish to either recommend action now or flag this up as an issue for consideration as part of the 2017 process.

9. Changes in state support for pensioners

The most controversial part of the discussions about how best to take forward the Pension Commission's recommendations was the “pays-to-save” question. At issue was whether savers could build up enough pension to lift them sufficiently free of means-tested benefits to ensure that their saving had been worthwhile. Both the DWP and the Pensions Policy Institute carried out separate modelling exercises to examine this.

Such modelling exercises are worthwhile. They can help inform the wider policy debate and suggest ways of minimising the number of losers. But they cannot be relied on as accurate predictors of the breakdown of gainers and losers in the future, particularly the future in which those starting work today will retire into in decades' time.

Some participants in the debate, including the TUC, pointed out that state support for the retired through pensions and means-tested benefits has changed frequently. Not only have different governments and ministers had different views about how best to structure support, the Treasury has also inevitably had concerns about affordability. Indeed future governments may change their views about safety-net provision given the existence of auto-enrolment and much wider saving from 2012.

Even the changes in the 2010 emergency budget will have a considerable impact on whether it “pays-to-save”. Over time the triple-lock that matches the increase in the basic state pension to the higher of 2.5 per cent, CPI or average earnings will produce a bigger pension than the current system. On the other hand some will lose out from future indexing of S2P to CPI. We suspect that over time, taking these changes together, they will produce a somewhat

bigger increase in the non-means-tested element of pensioner state income than the previous system.

On the other hand there has been some reduction in means-tested benefits that will impact on pensioners. We assume the review team will want to look again at the modelling conducted during the pays-to-save discussions (although further changes in the benefit system are always possible). Changes to housing benefit are likely to be of particular significance given both the ambitious savings target announced by government and the big impact that the means-testing regime for housing benefit had on at least the Pensions Policy Institute “pays-to-save” model.

One factor sometimes forgotten in the pays-to-save debate is the impact of the tax credit system on the contributions of active members. The income figure used in the means testing calculations for tax credits is after pension contributions. In other words people who make contributions who receive tax credits will increase their tax credit eligibility, thus effectively making it cheaper to make a pension contribution in the same way that higher-rate taxpayers effectively pay 60p to make an extra pound of contributions to their pension scheme. Tax credits were reduced in the budget for the higher paid but there were also some improvements lower down the income scale. We are not clear whether or how these changes affect the lower paid who are the normal focus of the pays-to-save debate. While the review will no doubt want to model these issues, the number of changes in the emergency budget alone show that it would be quite wrong to assume that the benefits system today will be identical to the system prevailing when even someone in their 50s today comes to retire.

This is one reason we always thought that the pays-to-save debate was somewhat overheated. As well as assuming a static or predictable benefits structure, those who believe that auto-enrolment is somehow akin to the mis-selling of personal pensions in the 1980s and 1990s:

- underestimate the attraction to savers of building up their own pensions pot as an insurance against declining state support for pensioners;
- expect savers to make "rational" decisions about saving for the future, even though the behavioural economics evidence suggests that this is not how people behave, however much effort is put into educating or persuading them to act in their own self-interest;
- fail to understand that more savers would mean a smaller bill for means-tested benefits - a worthwhile policy objective in itself, especially if savings are used to finance greater levels of non-means tested support.

No convincing case for making major changes to meet pays-to-save issues has therefore been made, and the changes in the budget make these arguments even weaker.

Section three

Scope

The review has been asked to look at a series of possible changes to the groups who should be auto-enrolled. We now look at these in turn.

1. The earnings threshold above which automatic enrolment applies

pays-to-save

It has been argued that the threshold should be higher because very low-paid workers will not build up enough pension to lift them free of means-testing thresholds and they thus run the danger that they lose as much in benefits as they gain from their pension.

No pension scheme can be entirely risk free (unless the state guarantees it). It is probable that a relatively small number of savers will end up gaining little or nothing from their pension contributions.

However, changing the criteria for auto-enrolment – such as raising the threshold for the lower earnings band - does not necessarily reduce this risk. This is because a snapshot of any particular worker's pay-packet, or even a P60, does not provide a useful guide to the pensionable earnings that they will receive over their working life.

Only part time workers employed for less than half the week will earn below the current threshold. While the lower-skilled may find it hard to achieve big increases in their hourly rates, part-timers can clearly increase their income simply by working longer. Few people work part time for the whole of their working lives.

If the threshold for auto-enrolment were raised, this in turn would produce losers. These would be people who could have benefitted from saving and the employer contributions that this would trigger, but would now lose out. Consumer groups are sometimes pressed on why we support a system that might produce losers. Yet it is clear that raising the auto-enrolment threshold would produce a different kind of loser, but in a system that inevitably makes more demands on means-tested benefits, making it likely that they would be less generous.

Tax and NI thresholds

The Pensions Commission's recommended that the threshold should be set at £4,888 at 2005 prices as this was the then “primary threshold” - the point at which Income Tax and National Insurance (NI) became payable. As a worker who earns less than the NI threshold will not be building up a state retirement or state second pension, this is a logical position.

It may be suggested that the new Government's move to increase tax allowances - thus raising the income level at which Income Tax becomes payable – is also a reason to lift the lower earnings threshold.

We reject this argument. It is the link to the National Insurance lower earnings limit (lel) that gives the threshold a logic. This is the gateway to building up retirement pension and benefits. The effective tax threshold has no implication for benefits. Raising the income tax threshold is good news for people. It means they pay less tax.

Raising the lower earnings threshold for pensions contributions would in contrast be a detriment. It would mean that lower earners would no longer receive pension contributions from their employer on as much or even any of their wages, so would build up a smaller pension.

The implications of raising the auto-enrolment threshold

The present plan is that contributions will be paid on every pound earned above the threshold, up to the upper contribution limit. If this threshold is raised it will have two effects. Firstly people earning less than the new threshold will no longer be auto-enrolled or receive any employer contributions.

Just as importantly, it would have a significant effect on those earning above the new higher threshold. They will of course still be auto-enrolled, but contributions will now be paid on a smaller part of their pay. This will mean that they will save less, and the system will no longer produce the retirement income replacement targets envisaged by the Pensions Commission.

We are aware that at least one pensions company has suggested a new threshold of £10,000. If adopted this would obviously exclude the large group of workers currently earning between the currently planned threshold and £10,000.

But it would also mean that people earning more than £10,000 would only receive contributions on their income above £10,000. Someone earning £11,000 would thus receive contributions on just £1,000 of their salary, as opposed to over £5,000 on current plans. In other words raising the earnings threshold to £10,000 would cut their pension contributions by more than 80 per cent compared with what they would get if current plans go ahead unchanged.

The plans for auto-enrolment set out in the Pensions Act 2008 are based on using the same figure for *both* the threshold that triggers auto-enrolment *and* the lower limit on the earnings band on which contributions are paid.

A variation on the plan to raise the threshold would be to de-couple these two figures. Contributions would still be payable on the same band of earnings, but auto-enrolment would only operate once earnings were significantly higher than the bottom of the earnings band. (A small difference between these two figures – a *de minimis* – is discussed later).

A big gap between the bottom of the earnings band and the auto-enrolment threshold would introduce a cliff-edge that would have some unfortunate side-effects and make the system much more complicated and difficult to understand.

If the earnings band was kept as planned, but the auto-enrolment threshold raised to £10,000, it would mean that someone earning £9,999 would not be auto-enrolled. But if their pay went up by £1 they would. Going over this cliff-edge would reduce their pay by about 2 per cent and may well make them more likely to opt-out. The employer would also have to pay contributions on all pay above the lower band, and thus have a strong incentive to keep staff pay at less than £10,000 a year.

Furthermore, if the worker's income was to oscillate around £10,000 this would create real administrative difficulties for the employer. Any threshold figure causes some problems for staff whose pay varies, but when crossing the threshold triggers a sizeable contribution on pay below the threshold, this clearly causes far more difficulty.

Equality impact

We are also extremely concerned about the equality impact of a raised threshold. ONS ASHE statistics suggest that women are likely to be a majority of those who would become losers. The review team will have access to DWP modelling and data sources that will be more accurate. (These published ASHE tables do not exclude the under-22s and only provide figures for earnings bands at £5,000 intervals. We are sure the review team will look closely at this, and we would expect this analysis to be published.)

We have not therefore done any detailed analysis as the review team will have access to these more accurate data sets and more sophisticated analysis and modelling tools. However, this must be an essential part of any consideration of these proposals.

There may well be legal implications under both domestic and EU equality law if changes are made to the Pensions Act 2008 and subsequent regulations that have already become law that disproportionately affect women or minority groups. These will need to be carefully considered by the review group, with the assistance of the EHRC.

The problems inherent in a threshold

While we accept the rationale for an earnings threshold, it does cause problems. Low-paid workers who earn a little above the threshold will receive contributions on a very small part of their earnings. This is not a reason to stop auto-enrolling them, but we would favour a system that would require employers to pay three per cent of earnings below the threshold if the worker opted-in to paying contributions from the first pound of their earnings. As this would be voluntary it would avoid cliff-edge effects, but would provide a good incentive for employees to increase savings. We would not argue for this change to be introduced from 2012, and is more appropriate for the 2017 review, but the review team might wish to flag this suggestion up as one worth considering as part of the 2017 process.

Redefining pay

While this is not explicitly within the terms of reference, we are concerned that some interest groups may try to reopen the issue of what constitutes pay. We welcome the comprehensive approach taken by the Act to definitions of both pay and worker. Experience suggests that a less-than-comprehensive approach will result in some employers playing “hunt-the-loophole”. We would not want to see the pay definition reopened.

We are aware that there are some difficulties for employers who have staff whose earnings fluctuate. But these are not very different from the issues they already face in ensuring that they are paying the right tax and National Insurance. Most such calculations will be handled by computers, and the software suppliers will have no difficulty in updating their products to handle auto-enrolment.

If only basic pay, rather than bonuses and overtime, were to be taken into account in calculating contributions, this would reduce the contributions received by many workers. It would also introduce a strong incentive to employers to reverse the trend of recent years to simplify pay systems, and start defining a large part of pay in categories not subject to pension contributions. The danger would be that many staff would end up on the minimum wage, and receive pay in excess of that as non-pensionable bonuses.

2. The introduction of a de minimis level for contributions before auto-enrolment applies

We assume that this is a proposal to auto-enrol at a slightly higher threshold than the bottom of the earnings band, but still collect on all earnings above the bottom of the band. This would introduce a "mini cliff-edge" that was small enough to avoid the problems identified in the discussion of decoupling the auto-enrolment threshold and the bottom of the earnings band above.

If the de minimis level was low, this does not raise huge issues of principle. But we are not convinced that it is a particularly helpful suggestion as it makes the system needlessly complicated.

The proposed system is admirably simple. You pay a fixed percentage of your pay above a threshold. The introduction of a de minimis system threatens to make this much more complicated. There will always be issues about people whose earnings fluctuate around the limits, but this will equally apply to a de minimis system.

3. The age group to which auto-enrolment should apply

We understand that some people are arguing that the age limit for auto-enrolment should be reduced from the state pension age to, say 60, as older workers will not have enough time to build up a big enough pot to provide a decent pension or even purchase an annuity.

We are not sure whether this proposal has been fully thought through. There would be two very different ways of doing this with very different implications. The choice would be to either end auto-enrolment for over 60s in perpetuity; or to introduce it at first but then phase it out, for example by setting the first year's upper age limit at 60, the second at 61 and so on, until the state pension age is reached.

The former approach does not make sense. Someone who has already been auto-enrolled into pensions saving could well change jobs once they were 60, but not be auto-enrolled by their new employer. This would simply deprive them of pension savings. The second approach, phasing out, adds a further degree of complexity to the system which we think will not be welcomed by employers.

In either case we do not see the argument for excluding the over-60s. If they do not have any existing pensions savings, then the new system will allow them to build up a pension pot that they will be able to trivially commute into a lump sum when they retire.

Given the high proportion of the UK population with little or no savings, this will be extremely useful for many as they start their retirement. It may allow them to pay off a mortgage or fix their roof, even if it cannot provide them with a sustained retirement income. If used in this way it would be unlikely to affect their means-tested benefit entitlements. Even without any growth in their pension fund, a saver can double their money (less charges) in building up a pot, because of the employer contribution and tax relief they will attract.

Of course many 60 year olds who are not currently contributing will have built up some pensions saving in the past. They will have been members of the workforce in past decades when there was much stronger and comprehensive

employer support for pensions. Many will welcome the opportunity to add to their pension in the final years of employment.

Rather than reducing the upper age-limit we would prefer to see debate about the lower age limit. Twenty-two seems to have been chosen firstly because it is the year that many people who go through higher education start working and secondly because it was the age at which the adult rate for the minimum wage started.

In the private sector, graduates are much more likely than non-graduates to save in a pension and to have earnings that will take them above the target group for reforms. There is therefore a strong argument for focussing auto-enrolment on the life pattern of non-graduates. This would suggest an earlier age for auto-enrolment.

As the qualifying age for the adult rate of the minimum wage has now been reduced to 21, we think the lower age limit for auto-enrolment should now be moved to 21.

4. The size of firm to which automatic enrolment should apply

We have already set out why we think employers have been set a relatively modest requirement to contribute. Not only is the employer contribution affordable, but it is phased in on a relaxed timetable.

Our strong view is that exempting some employers would do severe damage to the post-Turner consensus.

The aim of the Turner settlement was to construct a new pensions system. The first tier would be a more generous state pension system. On top of this people would be given the opportunity to build up a second tier pension through the workplace, with the expectation that auto-enrolment would mean that a big majority of workers would do so, many for the first time.

This was designed to be a comprehensive new pensions settlement. Exceptions to this broad picture, such as restricting auto-enrolment to those earning above the lower earnings band threshold, were introduced purely in the interests of the saver.

Introducing new exceptions based on criteria other than the interests of the saver, would mean the reforms were no longer a comprehensive pensions system. An exception based on the accident of the size of someone's employer could seriously damage this idea of universality. Instead of a new comprehensive approach, we would have a complex mix of the new and the old.

The new system, as set out in the Pensions Acts 2007 and 2008, is based on a fundamental right to minimum pension entitlements for all employees. It is

analogous to the minimum wage, the basic right to a safe workplace and paid holiday rights under the Working Time Directive. They all apply to everyone at work whether or not they work for a big or small employer and whether or not their legal relationship to their employer is via an agency, a traditional employment contract or a contract for services.

Auto-enrolment, and the contingent employer contributions that this triggers, add up to a new minimum workplace standard and should apply to everyone at work, as these other rights do.

A small firm exemption is therefore wrong in principle. It would also be impractical as it would introduce perverse incentives for both employers and employees that would not serve wider policy objectives, and would make small firm employees second-class citizens.

They would lose in a number of ways. Not only would they not build up a pension, it is entirely possible that a future government would reduce means-tested benefits on the argument that everyone has had the opportunity to save through auto-enrolment. It would also make small firms less attractive as employers, and thus run against Government policy of encouraging labour mobility.

There could be two types of small firm exemption – *either* dropping the requirement to auto-enrol staff but continuing employer contributions if staff opt-in *or* a complete exemption from both auto-enrolment and the requirement to make employer contributions. In practice we would expect them to have similar effects, as few will opt-in without auto-enrolment - and would oppose both approaches equally strongly.

If a limit was set at ten staff, small businesses would have a very strong incentive not to take on an 11th member of staff, as they would suddenly lose the exemptions for their other staff.

Many small businesses employ part-time staff and an exemption would have to be framed in an inevitably complex way to take account of this. It would be extremely perverse for public policy to introduce such a strong incentive against taking on new staff and for small firms to remain small.

Would such an exemption encourage small firms over the limit to artificially split themselves into units below the limit? If this was not allowed, how would the regulations be framed? Who would police them?

There will no doubt be a lobby to exempt domestic workers such as nannies. Yet nearly all the same objections set out apply. It would be quite wrong to exempt a group of workers on the basis of the characteristics of their employer rather than their own circumstances. Similar arguments for special cases have been rejected for the minimum wage, holiday rights and health and safety rights.

5. Whether employees should be automatically enrolled on the day that they start work or some other date

We are strongly opposed to any move to introduce a “waiting-period” for auto-enrolment. Some sectors of the economy have high rates of casual, seasonal, agency or short term employment. If the reform package under review is intended to construct a comprehensive new pensions system then this would introduce a fundamental design flaw.

Our objections are very similar to the proposal to exempt small employers. It would treat different kinds of workers with the same income in different ways.

Similarly it would introduce some perverse incentives. Staff only gain the right to protection against unfair dismissal after a year. If staff also only gained their pension rights after a similar or shorter period it would introduce an incentive to sack staff before they gained unfair dismissal rights. While the Act does provide some protection against pension-related dismissal, in practice this will be hard to prove.

Public policy should encourage a high-productivity economy. This is hard to achieve in casualised short-term sectors where there are few incentives to train and little opportunity to develop and build teams among staff. Introducing incentives for short-term employment would be self-defeating.

Section four

Effectiveness

The review team is asked to consider its conclusions against some criteria for the effectiveness of the reform package. The obvious point about these criteria is that they are to some extent mutually exclusive.

The great success of the Turner Commission is not that they produced a perfect system, but that they struck a skilful balance between different objectives and interest groups, producing a system where all could see that important parts of their own objectives and preferences had been accommodated, even if not in the way that they had envisaged. They championed the interests of groups who have not traditionally been well-served by our pensions system such as women and the low-paid.

As we have argued, we do not believe that this review is the right place to reopen the fundamental building blocks put in place by the Commission's work and developed through the consensus building work conducted by officials, ministers and PADA that informed the two Acts of Parliament and subsequent regulations that set out the detail of the reform package.

Many of the proposals that have been advanced for major changes threaten this consensus, and often do so at the expense of the groups that have been ill-served by the pensions industry.

We would like to conclude by briefly evaluating the reform package – and our suggested changes - against the effectiveness criteria.

a) tackling pensioner poverty as quickly as possible, including among women pensioners

The workplace pensions reform package was not designed to deal with current pensioner poverty, and while it will provide real benefits for older workers as we discuss above when considering the age limits, it will not start to provide sustained decent pensions for some years.

Naturally we would like to see this speeded up. We are unhappy with the way that staging and phasing work together, and deplored the slower timetable announced by the previous government for completing the introduction of that process. However, we recognise that it may no longer be easy to speed this process up. Higher contributions and a faster timetable would more quickly tackle pensioner poverty and be enthusiastically greeted by the TUC, but we are aware that other interests in this debate would not agree.

In the short term the only way to relieve pensioner poverty is by increased state support. While we welcome the introduction of the triple lock, this will not make a significant impact over the next few years. Changing the indexing to CPI rather than RPI for S2P and some benefits widely claimed by pensioners will reduce pensioner incomes, particularly poorer pensioners who do not have significant occupational or personal pension income.

We would stress the importance of women to this whole debate. We welcome the recognition of this in the terms of reference for the review. The pensions system has traditionally neglected women. The position of many women pensioners today reflects views about the role of women that were prevalent when they were of working age but now seem hopelessly antiquated. The Pensions Commission was very clear that women had to be major gainers from the new system, and that the system therefore had to work in the interests of women and the pattern of their working lives, rather than that of the traditional model of a full-time male bread-winner with an unbroken record of work through their working lives, building up both state pension and occupational pension for his wife as well.

Changes to the state pension system recommended by the Pensions Commission have won wide support for their emphasis on helping women. What has perhaps been less recognised is that the proposals for auto-enrolment were also carefully designed to help women by understanding the different pattern and lower incomes of their working lives. We are deeply concerned that many of the proposals for reform attack the parts of the system that particularly benefit women.

Of course it is not just women who benefit from auto-enrolment at the earnings levels of part-timers, contributions from day one of employment, the creation of what is now NEST with its low charges, suitability for those who change jobs more frequently than average and investment strategy that suits low to moderate earners; but changing any of these elements runs a big risk of disproportionately affecting women.

The review will therefore need to carefully assess the equality implications of any changes that it considers. Even where there are not legal considerations, it would still be wrong to reverse the advances for women's pensions made by the Turner Commission.

b) maximising voluntary private savings and the speed by which this objective can be achieved.

We believe the new system can encourage extra private saving and at least some levelling up. Auto-enrolment will give a large majority of workers a pension, many for the first time. It will be much easier to encourage them to save a bit more each month, particularly through “sharing” pay increases with their pension.

We also believe that just as many employers do not want to have the label of being a minimum wage employer, many will want to do at least a little better than the bare minimum, perhaps by incentivising some additional saving. We believe our proposal to lift the limit on NEST contributions could help and encourage this.

c) minimising administrative burdens on employers and the impact on existing provision

We recognise that auto-enrolment does impose an administrative burden on employers, but we do not believe it is excessive. They do not need to actively choose a supplier as they can rely on the default option of NEST. Collecting contributions is analogous to the current responsibility to collect NI or tax.

Our experience suggests that a simple system that is easy to operate will win more employer support in the long-term than a more complex system with various exemptions and special treatments even if these reduce the cost for some employers. Other employers who do not enjoy the exemptions will be unhappy, and all employers will continue to complain of the complexity.

The minimum wage provides the model. Not only is it now widely accepted as an important protection for people at work, but its simple structure and universal coverage means employers find it easy to implement.

One of the complaints commonly made about the new system is that it will encourage employers to level down. Our response is that many employers have already levelled down and are continuing to do so. The decline in employer support for workplace pensions is too complex a subject for this response, but it is worth noting that it has been a fairly continuous process since the 1980s.

Employers in some non-unionised sectors have realised that they can get away with providing either no or very minimal pensions. While they will point to external factors, some legitimate, many less so, the truth is that even if they reduce their pension provision simply as a way of cutting costs, they will always look for an external scapegoat.

Some employers will inevitably therefore use the introduction of the reform package as an excuse to reduce their own provision. This is not to argue that all employers act in the same way. We recognise that there are many employers who recognise the value of good pension schemes in recruiting and retaining staff, or who see it as part of their responsibility as an employer to contribute to pensions. Indeed many such employers are strong supporters of the reform package as they do not wish to be under-cut by less responsible employers, and believe a universal system will make employees take more interest in the value of their pensions.

The introduction of minimum contribution levels may well provide an incentive for employers to do better than this minimalist benchmark, in the

same way that many employers do not currently wish to be seen as a minimum wage employer.

Even if some employers reduce their pensions and blame the new system, the net result will still be that millions of people will save more in their pension schemes and the overall level of saving will greatly increase.

The levelling down argument is therefore something of a diversion in our view. It is particularly hard to argue that weakening the requirements on employers in the reform package will reduce levelling-down. It will simply provide a lower level to which a small minority of employers can reduce their provision.

d) achieving an effective balance between the achievement of policy objectives, pace of implementation, value for money and risk

We do not have anything to add to our previous remarks about how and why the current balance has been achieved and the risks of disturbing it.

e) maximising value for money for the Exchequer

The collapse of pensions savings among private sector employers threatens a “means-testing” time-bomb for the Treasury as many more will retire with little or no workplace pension.

The short-term costs of providing additional tax relief for new pensions saving should be set against savings on future spending on benefits. The current structure of tax relief for pensions means that considerable sums are currently spent incentivising higher rate tax-payers who already have pensions that will lift them well-above means-testing levels to save even more. It is right to ask whether at least some of this could not be better spent helping low and moderate earners build up savings that would lift them clear of future reliance on benefits.

Section five

Conclusion

While there are some useful changes that can be made in response to recent changes in the wider pensions environment since the Pensions Commission completed their work, we think it would be a mistake to reopen the basic building blocks of the hard-won consensus that led to the development of the workplace pensions reform package.

There is a real danger of the consensus collapsing, and that would be disastrous for the widely established objective of establishing a comprehensive second pensions tier of workplace saving.

The law requires a fundamental review in 2017 of how the new system is working. That is the right time to spend some time on a thorough review using an evidence base developed from the practical experience of operating auto-enrolment.

Annex

22 February 2008

Commissioner Meglena Kuneva
DG Health and Consumer Protection
European Commission
B-1049 Brussels
Belgium

Dear Commissioner Kuneva,

Distance Marketing Directive and the Unfair Commercial Practices Directive: Impact on automatic enrolment into pension schemes

We write to express our support for the plans of the UK Government to introduce automatic enrolment into contract-based pension schemes provided via the workplace, and our view that this will be consistent with the EU consumer acquis.

As a group of organisations we represent and reflect the views of UK employers, pension providers, employees, assets managers and consumers. We all support the Pensions Bill currently being considered by the UK Parliament. The Bill is the result of a broad-based national discussion on pensions which has taken place in the UK over the last four years and the measures included in it take account of the views of all parties.

We share the UK Government's objective of ensuring that all employees have access to a quality workplace pension scheme that helps them save for retirement. While the UK has a strong record on funded pension saving, around 12 million people in the UK are not putting enough aside for their retirement. The Bill is designed to address this by focussing on two "blind spots" in the current system – those who currently do not save in existing employer schemes through inertia, not choice, and those without access to a scheme with an employer contribution. Automatic enrolment is a vital part of the strategy to tackle both of these and it is essential that it can be used.

For those without access to a scheme currently, a new national scheme – personal accounts – will be set up. Employers will automatically enrol new employees into this with a right of opt-out for the employee. When enrolled, the employee will benefit from a mandatory employer contribution as well as their own saving.

Those with access to employer schemes currently – but who have not joined – will be opted into their employer's own scheme. Where the employer contributes, these schemes typically offer a higher rate of contribution than personal accounts, some significantly higher. Taken together, these changes will help to achieve a target of between six and nine million more workers newly saving in a workplace pension or saving more in an existing scheme.

The basis of these reforms, which has been widely accepted, is the use of auto-enrolment to overcome the problem of inertia in pension decisions. As pension saving is usually highly beneficial to employees where there is an employer contribution, the UK approach will be to change the decision made by employees to one of opting out of saving rather than opting in. If an employee takes no action, they will then be in the position that should be, on balance, most beneficial to them.

In developing this system, however, some questions of the scope for automatic enrolment have arisen. In particular, there is a concern that EU Directives on Distance Marketing and Unfair Commercial Practices might be interpreted as precluding automatic enrolment for certain employer-sponsored contract-based schemes. We do not believe that these Directives were designed to prevent the use of this approach where its use is a valid and widely supported social policy aim, and where informed choice and safeguards for individuals will be central.

Currently some 2.6 million people save in employer-sponsored contract-based schemes. Together these make up almost 40% of private sector employer pension provision where workers receive an employer contribution of 3% or more. The remainder are made up of trust-based occupational pension schemes. We are keen to ensure that these schemes can be preserved within the new system as they tend to offer higher employer contributions and better arrangements to employees than the national scheme will. Being able to continue with the same scheme will benefit both employer and worker – employers will not have to undertake a potentially costly and complicated review of pension provision, and workers will benefit from being able to continue to save in the same pension vehicle.

It is important to ensure savers get a fair deal. The legislation currently being discussed by the UK Parliament gives the UK Government wide powers to establish a quality threshold that can effectively protect consumers. The Government has committed to consult and seek consensus from all the stakeholders, including the Financial Services Authority, about this.

In conclusion, we support the UK Government's proposal and would ask you to give it whatever support you are able by either issuing a clear statement that the Directives do not prohibit the use of auto-enrolment for employer-sponsored contract-based schemes where their use is part of a nationally accepted social policy goal or – if such a move is necessary – by proposing to amend the Directives to allow the use of automatic enrolment. This is a once in a generation opportunity to reform the UK pension system, and the approach that is being taken could benefit other Member States in the future too. The proposals have wide support across the political parties and from consumer, employee, employer and pensions industry bodies. Millions of UK employees will be better off in retirement with a more sustainable system – a key European Commission aim – if we can deliver a new pensions settlement of this kind.

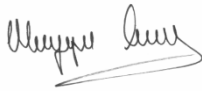
Yours sincerely,

A handwritten signature in black ink that reads 'John Cridland'.


John Cridland
Deputy Director-General
CBI

A handwritten signature in black ink that reads 'Kay Carberry'.

Kay Carberry
Assistant General Secretary
TUC



Maggie Craig
Director of Life & Savings
ABI



Doug Taylor
Which? Campaign Manager



David Yeandle
Deputy Director of Employment Policy
EEF



Andrew Harrop
Policy Manager
Age Concern England



Nigel Peaple
Director of Policy
NAPF



Christina Barnes
Policy Head
Equality & Human Rights Commission



R B Saunders
Mervyn Kohler
Special Adviser
Help the Aged



Chief Executive
Investment Management Association

CC: President Barroso; Commissioner Spidla; Commissioner Mandelson; Commissioner McCreevy; BusinessEurope; ETUC; Mike O'Brien MP, UK Minister for Pensions Reform



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