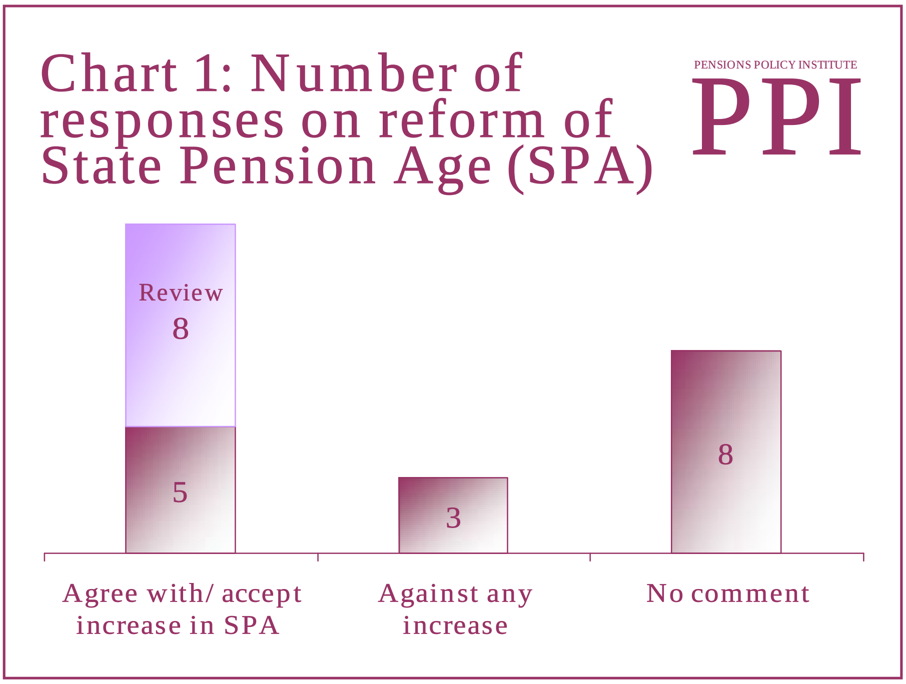
Pension reform: is there consensus?



Introduction

The Government set out its plans for pension reform in its May 2006 White Paper ***Security in retirement***[1]. The consultation period closed last month. The PPI has taken stock of the level of consensus in the pensions policy community on the Government's proposals.

Proposals on the table

The PPI has mapped 24 organisations' responses to the Government's White Paper[2]. These include charities, unions, pension providers, and representative bodies for consumers, business, and the pensions industry (the organisations are listed and more detail is provided in a presentation available on the Briefing Note 34 page of the PPI website[3]).

This analysis provides a partial snapshot and should not be over-interpreted: it is intended to highlight the current state of opinion on pension reform and how this has shifted since the last PPI stocktake, taken a year ago in October 2005[4].

Working longer

Most of the organisations that commented on the Government's working longer proposals now accept that, due to increased longevity, people may need to work longer. The majority of organisations recognise that a logical first step is for the Government to increase State Pension Age (SPA) (Chart 1).

However, more than half of these organisations have concerns that the proposed increases are too prescriptive. They point out that future longevity is very uncertain, and have called for SPA increases to be regularly reviewed.

Those that disagree entirely with increasing SPA have concerns regarding health inequalities. They claim that less well-off people, particularly manual workers living in deprived areas, will be disproportionately affected by increased SPA.

State pension reform

Three-quarters of the organisations comment on at least one element of the Government's state pension reform proposals (Chart 2).

Of those organisations that have commented, all support linking the Basic State Pension (BSP) to earnings. However, the majority want to see Government proposals go further by increasing BSP from £84 a week to a higher level, possibly to the current level of the Guarantee Credit (£114 a week).

A majority of the organisations who commented do not believe the proposed reforms will adequately reduce the extent of means-testing. To achieve this, they suggest either increasing the BSP to the level of Guarantee Credit, or more immediate moves to index the BSP with earnings.

In the last stocktake, nearly all respondents opted for either a reformed contributory system or a new residency system as the basis of eligibility for the BSP, with over half in favour of residency. This time round, only one-third commented, with responses roughly split between the two.

In the White Paper, the Government proposes reform of the contributory system and improved coverage of the BSP through reforms to the credit system.

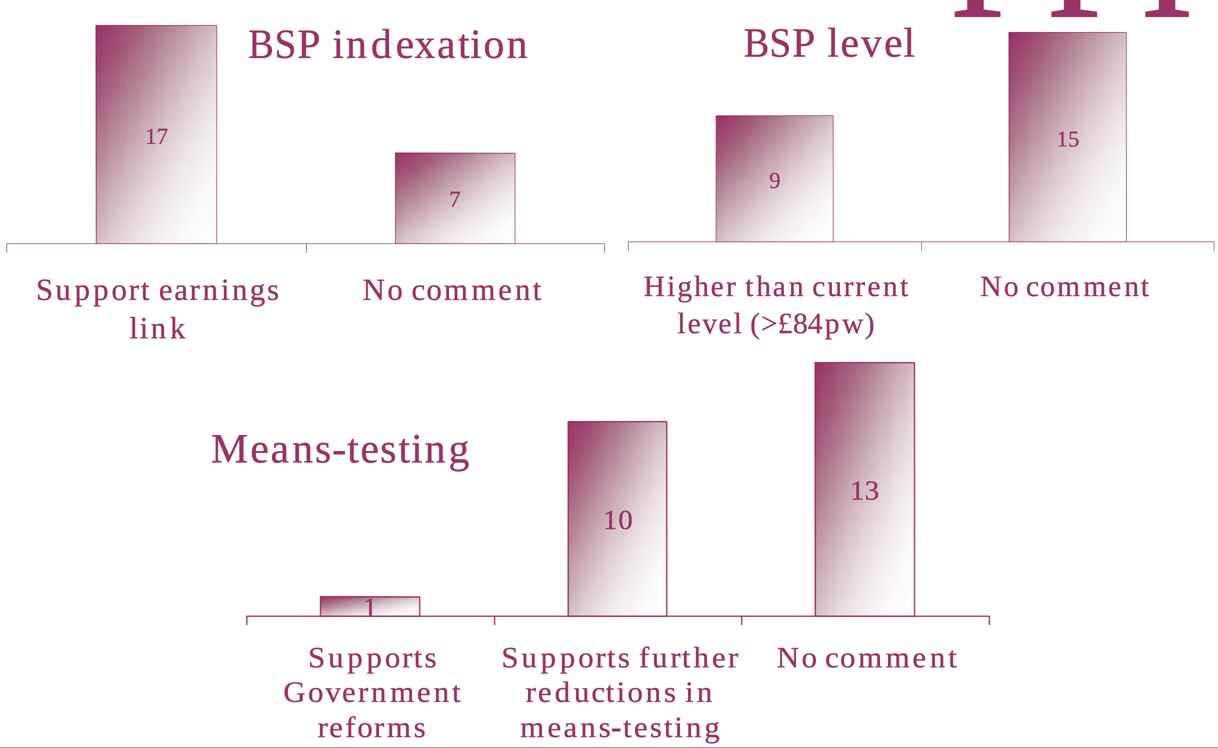
Three-quarters of the organisations that commented on reforms to the credit system believe they do not go far enough to protect carers and low earners. They suggest ways to further increase coverage, for example, by further reducing the number of hours of care required to qualify for a credit.

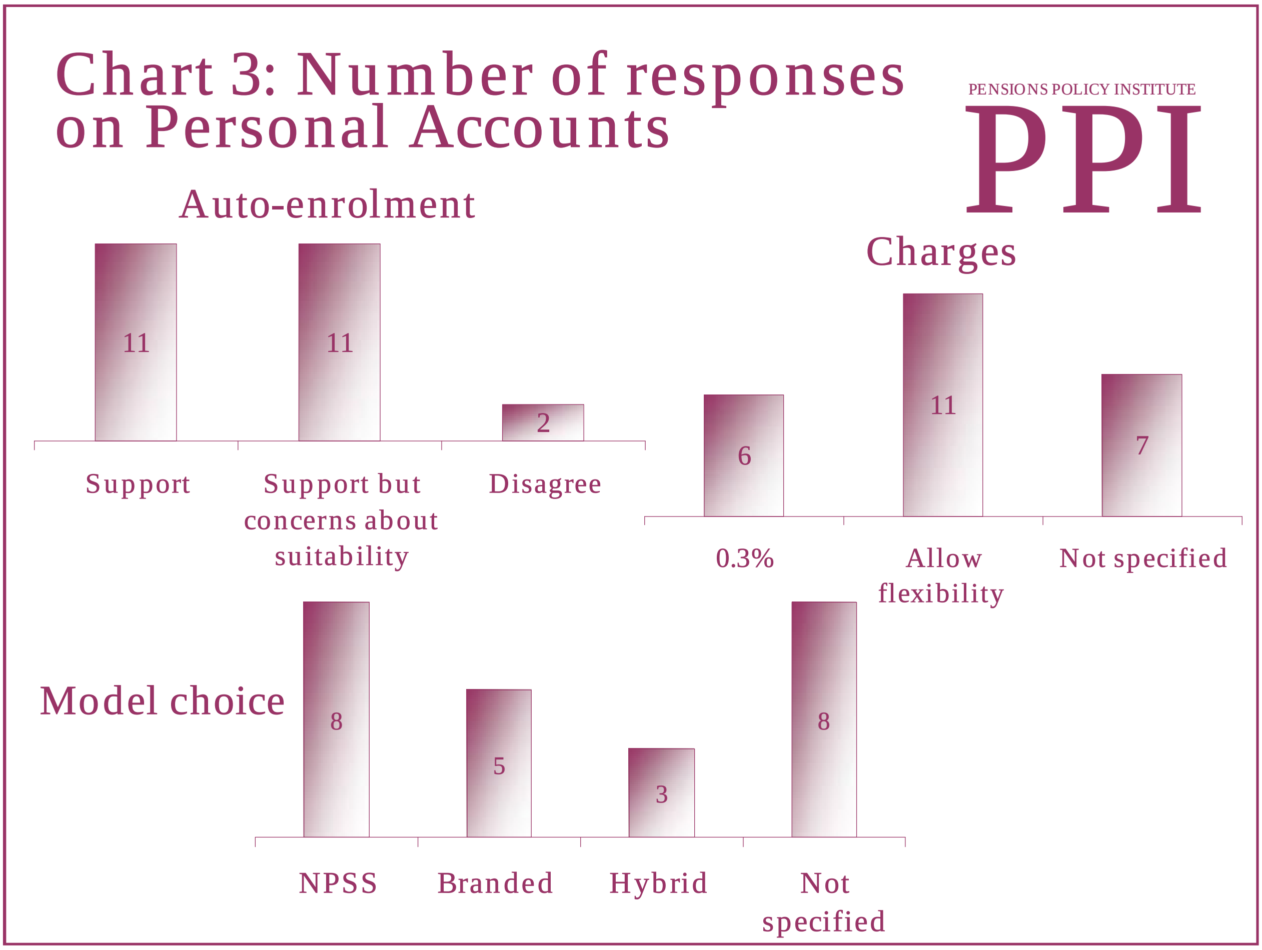
The picture regarding State Second Pension (S2P) is less clear. Of the 14 organisations that commented, 5 support Government proposals to gradually flatten the earnings-related state scheme, 6 would rather increase the coverage and level of S2P, largely to benefit low earners and carers and 3 want S2P abolished.

The issue of contracting-out was less prominent than in the last stocktake. Of those that responded, most support abolition of contracting-out for Defined Contribution schemes. The justification for this was largely based on calls for increased simplicity.

As with the last stocktake, the majority of responses call for further simplicity in the state pension system. Various proposals have been made to reduce complexity, for example, by consolidating the current two-tier system (BSP and State Second Pension) into a one-tier system.

Chart 2: Number of responses on state pension reform





Personal Accounts

Many of the responses focus on the policy of the Personal Account proposals. There is almost unanimous support for the principle of auto-enrolment (Chart 3). However, the majority of organisations have raised concerns about the suitability of Personal Accounts for some employees and / or the risk of a negative impact on existing pension provision.

11 organisations have specific concerns regarding the suitability of auto-enrolment into Personal Accounts for all employees. For example, organisations have expressed concerns about people with low incomes, high levels of debt and / or people over a certain age, say 45, whose accounts may not have enough time to mature.

The majority of organisations support the proposed minimum levels of contributions to Personal Accounts (4% employee contribution, 3% employer contribution and 1% from the Government through tax relief).

Employer bodies have called for the 3% employer contribution to be written in primary legislation to avoid the employer contribution rate creeping upwards.

In addition, one-third of organisations called for Government assistance for small businesses, claiming that even a 3% contribution rate would be a burden for small businesses.

On the design of the new system of Personal Accounts, the Pensions Commission proposed a National Pensions Saving Scheme (NPSS). In this model, a non-departmental public body would be responsible for the administration and fund management of personal accounts. The alternative ‘branded’ model would mean personal accounts are provided by a number of private pensions providers.

Of those organisations that responded, half opted for the NPSS model. The remaining responses opted for the branded model or some kind of 'hybrid' model, whereby the responsibility for administration and fund management is divided between the private and public sectors.

For the branded and hybrid models, the majority of organisations favoured employee choice of fund provider over choice by employers. Support was split between having a limit on the number of providers or free competition.

On the issue of charges, one-third of respondents want guarantees that annual management charges would not exceed 0.3%, and two-thirds call for more flexibility.

The threat of levelling down received considerable attention, with three-quarters of the organisations expressing concern. This is the risk that employers who currently offer a good occupational pension scheme and contribute more than 3% to their employees funds would reduce their level of contributions once Personal Accounts are introduced.

Many organisations offer policy proposals to reduce the risk of Personal Accounts undermining the existing occupational pension market. For example, putting a cap on contributions into Personal Accounts, limiting transfers into Personal Accounts, offering simple exemptions or financial incentives to employers who operate good schemes.

Other issues
Establishing an independent standing pensions commission is a popular proposal, with support from 14 organisations. Albeit there are differing views on the desired role and remit for such an organisation. The Government rejected this proposal in favour of periodic, independent reviews.

The last stocktake showed support for reforming the pensions tax system. However, this time round there was virtually no mention of tax reform.

Conclusion
There is now broad recognition among the majority of the 24 organisations that, given improvements in longevity, people may need to work longer than in the past to fund their retirement. The majority of organisations now accept Government proposals to increase SPA, although some remain concerned about the impact this may have on certain groups of people, and many would like the Government to keep the SPA changes under review.

There has been broad support among the respondents for a number of elements of the Government's state pension reform package. A majority of organisations support the re-indexation of the BSP to earnings and the improved coverage of the state pension for women and carers. But many would like the Government to go further. Many called for an increase in the level of BSP, a simpler state pension and/or to further reduce the extent of means-testing.

On Personal Accounts, the majority of respondents support the principle of auto-enrolment but there is concern about suitability for some individuals. There are also widespread concerns about the possible negative impact that auto-enrolment could have on existing occupational pension provision. The Government will need to take these issues into account when designing the new system of Personal Accounts.

The PPI Stocktake analysis of pension reform proposals is available in more detail on www.pensionspolicyinstitute.org.uk.

[1] DWP (2006) ***Security in retirement: towards a new pension system***
[2] This analysis has been drawn from organisations' responses to the White Paper and does not include previous policy statements. The PPI has analysed and categorised 24 organisations' responses. Any remaining errors or omissions are the responsibility of the PPI.
[3] PPI (2005) Briefing Note 18 ***Pension reform: An update***
[4] Available at www.pensionspolicyinstitute.org,uk

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