

Work and Pensions Committee Inquiry: Personal Accounts

Introduction

Scottish Widows, as one of the UK's leading providers of pensions and long-term savings, welcomes the Select Committee's decision to undertake a short inquiry into the delivery of the new Personal Accounts. The Government and industry will face major challenges in the coming 5 years as we look to develop a framework which is able to encourage new target groups into long-term savings whilst limiting the scope for negative impacts on existing pension arrangements.

1. Pensions Bill debate

- The forthcoming Pensions Bill forms an opportunity to fully scope out the features of the NPSS and provide a framework for delivering and administering the new personal accounts.
- The details of these discussions will of course determine the success of the scheme and it will be important that the primary legislation provides as much certainty as is possible, rather than delegating responsibility to the Personal Accounts Delivery Authority (PADA). The role and scope of PADA needs to be very clearly defined in law.

2. Level playing field

- Scottish Widows has previously welcomed the Government's acknowledgement that the NPSS must be viable in its own right, by signaling that there will be no public subsidy of the new scheme.
- It is important to remember that the pensions industry will continue to offer high-quality provision alongside the Personal Accounts and it is essential that there is a level playing field for all types of pension provision.

3. Limiting contagion effects

- There should be a strong imperative for policymakers and PADA to ensure that the Personal Accounts are additive rather than substitutional. The Government has claimed that between £4-5bn will be saved into the new scheme every year. This needs to be in the form of new savings rather than recycling existing savings, with steps to minimise any negative impacts on alternative or existing pension provision.

Reducing possible contagion before 2012

- Throughout our dialogue with Government we have consistently called for steps to limit any disruption to existing pension provision during the transition towards Personal Accounts between now and 2012.
- We would take this opportunity to restate our view that any exemption criteria for existing GPP schemes should not be so onerous as to cause employers to favour Personal Accounts. This is a particular concern given the very real potential for levelling down, discussed in more detail below.
- The Government needs to give particular consideration to the likely break even period for GPPs, which will take several years, and the fact that any decisions taken now in respect of exemptions may cause providers to withdraw from the market well before 2012.

Possible levelling down beyond 2012

- The introduction of Personal Accounts may lead some employers to 'level down' contributions to 3%, creating potential employee detriment. We have previously stated that 75% of employers who contribute to an existing scheme pay more than 3%.
- **Deloitte research in 2006, which was co-sponsored by Scottish Widows with other leading providers, found that less than one-quarter (23%) of employers may retain their current pension contribution rates for new and existing employees after 2012. (Pensions reform; making it work – Scottish Widows, p.2, 2006)**
- The Government has already made an important step towards defining the parameters of the NPSS in announcing that the contributions cap will be set at £3,600 per year with indexation to 2012. This is significant and we very much welcome this announcement. However, we continue to have concerns that allowing higher contributions in the first year or large one-off contributions later could undermine the attempt to target NPSS at lower earners.

Hitting the Personal Accounts target market

- Whether the NPSS will hit its target market is still very much open to question. With the Government highlighting a potential target market of 10 million savers, and potential opt-out rates of up to 50% it is not entirely clear who will opt-out, or what steps can be taken prior to 2012 to minimise this likelihood.
- Scottish Widows research findings reveal that those social groups which are least likely to be saving in any form of pension arrangement are most likely to say they will remain opted-in to the new Personal Accounts; for example 24% of women and 30% of those with young families. This includes many people not currently accumulating pension savings in other forms. However, given the huge gaps of under-provision amongst these groups it is likely that opt-in rates will need to be much higher than suggested by our findings. PADA will need to do much work in the coming years to ensure that Personal Accounts are properly targeted.

4. Resolving obstacles to automatic enrolment

- Scottish Widows has consistently raised concerns over the potential for current regulation, arising from the 'unsolicited services' provisions contained within EU Distance Marketing Directive (DMD), to prevent employers from auto-enrolling their employees into group personal pension schemes. This in turn, may restrict their ability to claim an exemption for their existing pension scheme. The ABI is considering options aimed at overcoming this barrier, including converting GPPs into a simple occupational pension scheme under a master trust arrangement. However, Scottish Widows believes there are some practical issues with this proposal which potentially make it unworkable:
 - With most Group Personal Pension & Stakeholder schemes being contract based, it would not be possible to restructure them into a master trust in a seamless manner. This would present some administrative challenges including the need to seek employee consent before converting the scheme from contract to trust status.
 - There is a risk that if employers are forced into changing the structure of an existing scheme in order to qualify for an exemption, they may decide to abandon the existing arrangement in favour of a new replacement Personal Account vehicle. With average contribution rates into existing private contract-based schemes being broadly double the minimum proposed for Personal Accounts, there would also be a clear fiscal incentive for Employers to take such a radical course of action.
- An alternative approach which avoids such unintended consequences is to look at how we can simplify the exemption of contract based schemes. Scottish Widows would like legislators to consider if a "broadcast" presentation to those employees where geography or other practicalities prevent physical attendance at a staff presentation would satisfy the "meaningful contact" definition and so avoid the provisions of the DMD. Developments in technology could provide additional safeguards to ensure that the employee actually received the presentation and could ask questions to confirm/support their understanding of the offer being made. If this was deemed acceptable, then Scottish Widows believes it would be possible to design a communications programme which enables auto enrolment into contract-based schemes thereby enabling them to be treated on a level playing field. This presentation could be supplemented by pre-specified, proactive communications from the employer on a pre-determined frequency to offer additional protection to employees. If it is concluded that the approach outlined above doesn't fully satisfy the requirements of the DMD, then we would like to see other "streamlined" joining techniques where the employer can evidence regular, pro-active communications with each employee qualifying for the exempt schemes test. The Distance Marketing Directive refers to 'simultaneous physical presence' – note 'physical' differs from 'meaningful contact'. We would suggest that exploring (widening application of) the guidance contained in COB 1.10 re: non-face to face sales which are not distance sales might be more appropriate].
- Finally, the EU Commission is currently undertaking a wide-ranging review of the DMD and this would form an opportune moment for the UK Government to raise these concerns at the EU level with a view to exempting GPPs in such

a way which continues to offer protection to consumers from unsolicited financial promotions whilst enabling auto-enrolment to take place.

5. Impact of means tests and claims of possible "mis-selling"

- Certain groups of target savers may not benefit as intended as a result of deciding to remain opted-in to Personal Accounts. In particular, people over the age of 50 and nearing retirement with small pension pots, and especially those living in rented accommodation, will almost certainly find themselves in receipt of means tested benefits in retirement (Pensions Credit or Housing Benefit). The loss of benefit could be greater than the amount added through tax relief and employer contributions.
- **Our research from November 2006 - Pensions reform; making it work - revealed that an individual who opted-in to Personal Accounts later in life (as will be the case with anyone in their mid-40s when the new scheme comes into affect by 2012) can expect to build up much smaller pension pots through Personal Accounts, which will as a result fail to float them off of means tested benefits. Means testing will continue to be applied to large amounts of retirement incomes – including that which is generated through Personal Accounts - for modest savers over the age of 45.**
(Pensions reform; making it work – Scottish Widows, p.20, 2006)
- Work by the Pensions Policy Institute (PPI) has also shown that these groups of savers could be worse off as a result of savings, which can only dent consumer confidence not only in Personal Accounts, but also in long-term savings more generally.
- While the Government needs to further address the concerns over the interaction between state benefits and private pensions savings, PADA should also be required to ensure that 'at risk' groups understand that any pension income derived through Personal Accounts savings could result in withdrawal of means tested benefits. Failure to communicate these risks could present reputational issues for the Personal Accounts Board.