



Department for
**Social
Development**

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Pensions (No. 2) Bill

Regulatory Impact Assessment

November 2008

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Introduction

1. The Pensions Commission published its second report *A New Pension Settlement for the Twenty-First Century*¹ on 30th November 2007. The report concluded that the current voluntary private funded system, combined with the current state system, was not, looking forward, fit for purpose.
2. One of the key issues to emerge was that people were not making sufficient provision for their retirement. Results from the *Family Resources Survey 2006/07*² show that 3.6% of the Northern Ireland workforce (25,780 people) has no provision for state pension, 48.5% of (343,680 people) has no provision for private pensions and 2.9% (20,790 people) has no provision for either state pension or private pensions.
3. The Pensions Commission proposed a simple, low-cost system of personal accounts for those who did not currently save for retirement. It also recommended that workers should be automatically enrolled into either a company pension scheme or a national pensions saving scheme.
4. This Impact Assessment sets out the pension reform provisions contained in the Pensions (No. 2) Bill. The aim of the provisions is to encourage and enable more people to save towards their retirement. They represent the second part of a package of reforms to the pensions system.
5. These were initially set out in the White Paper *Security in Retirement: towards a new pensions system*³ published in May 2006 (“the May 2006 White Paper”). The first part, a fairer and more generous State Pensions system, was taken forward by the Pensions Act (Northern Ireland) 2008.
6. The Pensions Act 2008 makes provisions for the establishment, on a United Kingdom-wide basis, of Personal Accounts, a simple, low-cost pension saving scheme aimed at moderate to low earners who currently

¹ Copies of the Pension Commission’s First and Second Reports are available at www.pensionscommission.org.uk or from The Stationery Office

² http://www.dsdni.gov.uk/index/stats_and_research/stats-publications/stats-family-resource.htm

³ Command Paper 6841 – ISBN 0-10-168412-6

do not have access to a workplace pension scheme. This includes the framework within which the personal accounts scheme will operate. This framework will be developed further in regulations and will draw on advice and recommendations from the Personal Accounts Delivery Authority. In addition it contains provision to allow for a broadening of the Personal Accounts Delivery Authority's remit and powers to enable it to oversee the establishment of the personal accounts scheme.

7. In summary, the reforms contained in the Pensions (No. 2) Bill are:
 - a duty on employers to automatically enrol jobholders into a qualifying workplace pension scheme and to offer a minimum pension contribution equal to 3 per cent. of eligible earnings;
 - a proportionate compliance regime for the new employer duties, such as automatic enrolment, based upon a strategy of education, enablement and enforcement;
 - strengthening existing workplace pension provision by reducing burdens imposed by rules governing private pensions; and
 - further simplification of the state pensions system to give people a better understanding of the State Pension they are accruing and to support people in planning their retirement.
8. The proposals for automatic enrolment, a minimum employer contribution and a system of personal accounts are substantively the same as those set out in the May 2006 White Paper and the subsequent White Paper *Personal accounts: a new way to save*⁴ published in December 2006 ("the December 2006 White Paper").
9. In addition to the above changes, the Bill makes provision for:
 - the definition of 'earnings' and 'jobholder' to which the automatic enrolment requirement will apply;

⁴ Command Paper 6975 – ISBN 0-10-169752-X

- the framework for a proportionate, risk-based compliance regime that underpins the policy and minimises burdens on employers;
 - simplification measures relating to private and state pension; and
 - pension compensation sharing on divorce or dissolution of a civil partnership.
10. The proposals in the Bill together with those in the Pensions Act 2008 should help people save for their retirement. They are considered a balanced and affordable package of reform making private saving easier and more accessible for moderate to low earners; minimising the burden on employers; and creating significant opportunities for the private pensions industry.
11. The Westminster Pensions Bill contains a number of provisions that extend to Northern Ireland. This is because, for example:
- they deal with excepted matters that are outside the legislative competence of the Northern Ireland Assembly;
 - they amend Westminster legislation that already extends to Northern Ireland; or
 - it is more cost effective to implement the provisions on a United Kingdom-wide basis.
12. The measures in question relate to:
- the Pensions Regulator;
 - information for private pensions policy and retirement planning;
 - the power to establish a pension scheme (Personal Accounts);
 - provision for persons working on vessels and offshore workers;
 - the Personal Accounts Delivery Authority;
 - the Pension Protection Fund;

- the Financial Assistance Scheme;
 - pre-consolidation amendments to pensions legislation; and
 - pre-1948 insurance affecting German pension entitlement for certain refugees who came to the United Kingdom in the build up to World War II.
13. Measures relating to the setting of the Upper Accrual Point, which will be included in the Assembly Bill, are contained in the National Insurance Contributions Act 2008 in respect of Great Britain.
14. This Regulatory Impact Assessment presents the costs and benefits of the proposals. A separate Equality Impact Assessment carried out by the Department assesses the impact of the proposed reforms on each of the groups mentioned in section 75 of the Northern Ireland Act 1998 and can be accessed at www.dsdni.gov.uk/index/consultations.
15. The provisions in the Pensions Bill correspond to provisions in the Westminster Pensions Bill and the National Insurance Contributions Act 2008. They are in keeping with the long-standing principle of parity between Great Britain and Northern Ireland in the field of social security and pensions and the commitment under section 87 of the Northern Ireland Act 1998 to secure a single system of social security and pensions across the United Kingdom.

Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

A handwritten signature in black ink that reads "Margaret Ritchie". The signature is written in a cursive style and is positioned to the left of a vertical line.

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16. Copies of this Regulatory Impact Assessment have been laid in the Business Office and placed in the Library of the Northern Ireland Assembly. Additional copies are available from:

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Chapter 1: Overview and summary of costs and benefits

Objectives

1. The proposals set out in the Pensions (No. 2) Bill are intended to increase private pension saving. They form part of a reform package designed to ensure that there is a pension system fit for the 21st century which provides security for pensioners.
2. The proposals meet the five tests for pension reform set out in the May 2006 White Paper. These were to support personal responsibility and deliver fairness, simplicity, affordability and sustainability.
3. This document explains how the measures contained in this Bill will meet those five tests and how they will impact on individuals, employers, the Department and existing pension provision.

Background

4. In December 2002, the Pensions Commission was established to consider the long-term challenges faced by the pensions system.
5. In its Second Report, published in November 2005, the Commission concluded that, whilst there was no immediate pensions crisis, the existing system had to be reformed to ensure that it would meet several long-term challenges:
 - *demographic and social change*: increasing life expectancy and lower fertility rates mean that the number in society of State Pension age is set to increase to almost 15 million by 2031⁵. The Commission concluded that without an increase in saving, State Pensions or working lives, future pensioners would be, on average, worse off than those today;
 - *undersaving for retirement*: the Commission estimated that between 9.6 and 12.1 million people in the United Kingdom are

⁵ National Statistics: www.statistics.gov.uk/pdffdir/pproj1007 - figures are for the UK

not saving enough to deliver the pension income they are likely to want, or expect, in retirement. This has since been refined to 7 million by the Department for Work and Pensions⁶;

- *inequalities in the State Pensions system*: the State system was rooted in the society of the 1940s and no longer reflected the way people live their lives, especially as it failed to fully recognise the contributions of women and carers; and
- *complexity*: the Commission described the pensions system as the most complex in the world, hindering people's ability to make informed decisions about whether, when and how much to save.

6. The May 2006 White Paper, building on this analysis and the Commission's recommendations, set out proposals for pension reform. In summary, these were:

- a simpler, fairer and more generous state pensions system, funded by a gradual increase in the State Pension age;
- a duty on employers to automatically enrol eligible jobholders into a workplace pension scheme;
- a national minimum employer pension contribution;
- a scheme of Personal Accounts to give moderate to low earners access to a simple and low-cost pension; and
- measures to strengthen existing provision by simplifying the rules governing occupational pension schemes.

7. The first part of this reform package, a fairer and more generous State Pension system, was implemented by the Pensions Act (Northern Ireland) 2008. The measures in that Act will provide a firmer foundation upon which people can plan for their retirement and improve their retirement incomes.

⁶ See Security in retirement: towards a new pensions system – pages 36, 37 and Annex A

8. The Pensions (No. 2) Bill builds on this firm foundation through a set of reforms, primarily to the private pension system, that will enable and encourage more people to build up a private pension income to supplement that received from the State.

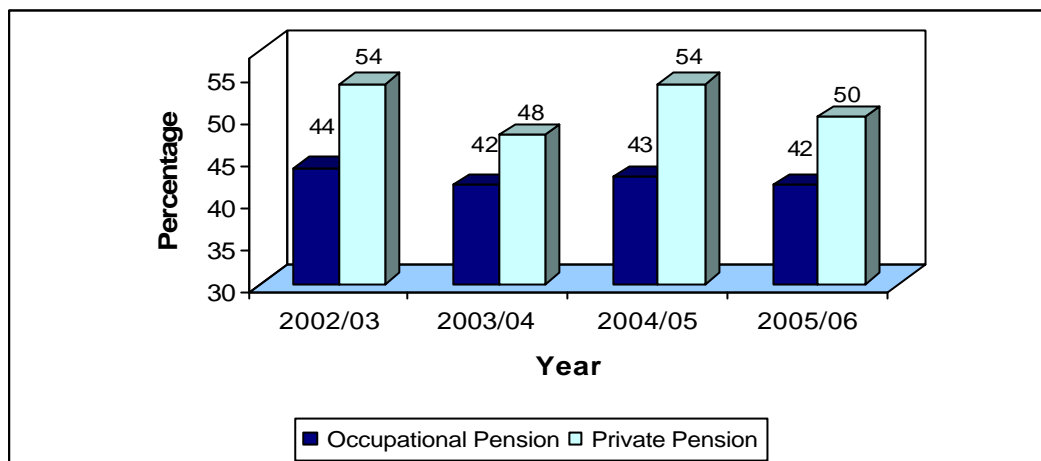
The case for reform

9. As already outlined, the Pensions Commission concluded that while the pensions system works well today, demographic change coupled with a continuing decline in private pension provision would lead many individuals to have inadequate incomes in retirement.
10. Although the changes to the State Pensions system introduced through the Pensions Act (Northern Ireland) 2008 make significant progress in addressing this challenge, many individuals will still need to make their own provision over and above that provided by government if they are to enjoy the kind of retirement income they want and expect.
11. Even with the improvements introduced by the Pensions Act (Northern Ireland) 2008, a median earner⁷ retiring in 2055 can expect to achieve a replacement income well below the rate of 45 per cent which the Pensions Commission used as a benchmark to broadly indicate an adequate level of income in retirement for a median earner. To reach this level, a median earner would need to save around 8 per cent of their gross earnings for around 40 years.
12. As already stated, the *Family Resources Survey 2006/07* shows that 25,780 people (3.6% of the Northern Ireland workforce) have no provision for State Pension, 343,680 people (48.5% of the workforce) have no provision for private pensions and 20,790 people (2.9% of the workforce) have no provision for either State or private pensions.
13. Furthermore the proportion of the working age population saving in an occupational pension in 2005/06 was 42% compared with 44% in 2002/03. This fall has not been offset by a significant expansion in personal pension provision. This is demonstrated in the Chart below.

⁷ Median weekly earnings in April 2007 were £401.90 – see <http://www.detini.gov.uk/cgi-bin/downdoc?id=3224>

The percentages are taken from the *Family Resources Survey* reports from 2002/03 to 2005/06⁸.

Percentage of people contributing to an occupational pension or private pension.



14. The May and December 2006 White Papers explained why intervention to increase the number of people saving was needed. In particular four barriers to saving for low to moderate earners were identified:

- many people have a poor understanding of pensions and the benefits of saving for retirement;
- inertia which prevents people from saving even though they may be aware of the need to do so;
- traditionally the route to retirement saving has been through a pension scheme offered by an employer. However the provision of such schemes has been in long-term decline; and
- although significant elements of the pensions market work well, it is failing many of those on moderate to low incomes who work in small firms.

15. Taking no action now will mean that millions of people across Great Britain and Northern Ireland will not save in a pension and, as a consequence, future generations will face disappointment in retirement.

⁸ www.dsdni.gov.uk/index/publications/family_resources.htm

16. In addition, taking no further action now may lead to future pressure to increase the level of the State Pension. The projected growth in the number of people of pension age compared to that of working age would make the cost of any increase prohibitive.

Projected population by age - United Kingdom 2004 – 2044

	2004	2011	2021	2026	2031	2036	2041	2044
<i>Thousands</i>								
Under 16	11,646	11,231	11,399	11,487	11,483	11,360	11,246	11,219
Working Age	37,064	38,478	40,588	41,381	41,040	41,568	41,594	42,526
Pensionable Age	11,125	12,182	12,740	13,134	14,491	14,838	15,513	14,911
<i>Percentages</i>								
Under 16	19.5	18.1	17.6	17.4	17.1	16.8	16.5	16.3
Working Age	61.9	62.2	62.7	62.7	61.2	61.3	60.9	61.9
Pensionable Age	18.6	19.7	19.7	19.9	21.6	21.9	22.7	21.7
<i>Support Ratio</i> (working age/ pensionable age)	3.33	3.16	3.19	3.15	2.83	2.80	2.68	2.85

Source: Government Actuary's Department Population Projections database (population by age by single year of age).

Note: Working age and pensionable age population based on State Pension Age for given year. Between 2010 and 2020, State Pension age will change from 65 years for men and 60 for women to 65 years for both sexes. It will increase from 65 to 68 for men and women between 2024 and 2046.

Summary of Measures

17. The measures being introduced by this Bill and the corresponding Westminster Bill are the most effective way to encourage and enable people to save more in private pensions. They are designed to tackle barriers to saving by making it easier and more attractive to save, extending provision to those not covered by the market, strengthening existing provision and simplifying the decision to save.

18. In summary the measures include:

Making it easier and more attractive to save

- automatic enrolment into a qualifying workplace pension scheme - Personal Accounts will be one option;
- an employee contribution of 4% on earnings between £5,035 and £33,540⁹, a minimum employer contribution of 3% and 1% from the State in the form of tax relief;
- a minimum total overall level of contribution of 8%;
- phasing-in employer and jobholder contributions; and
- a straightforward qualifying test for existing schemes.

Personal Accounts - extending access to low-cost saving

- establishing the Personal Accounts scheme as a trust-based occupational scheme;
- a broadening of the Personal Accounts Delivery Authority's remit and powers to enable it to oversee the establishment of the personal accounts scheme; and
- an annual contribution limit of £3,600 and a ban on transfers in and out of the personal accounts scheme in order to limit the impact of the reforms on the market.

Compliance

The Pensions Regulator will be responsible for the delivery of a proportionate and effective compliance regime which protects individuals while minimising the burdens on employers. The regime will include:

⁹ These earnings bands are expressed in 2006/07 earnings terms and will be updated by annual earnings growth.

- a requirement for employers to register how they will meet their new duties;
- automated processes to follow up on employers who fail to register;
- smaller-scale interventions, such as risk-based investigations;
- new employee rights to protect against unfair dismissal or detriment on the grounds of pension membership; and
- enforcement of payments in a way that reflects the importance to savers.

Strengthening existing pension provision

- a reduction in the cap applying to the revaluation of deferred pensions (to take effect from January 2009 and applying only to rights accrued after that date);
- repealing the rules on safeguarded rights to remove unnecessary complexity from pension sharing on divorce or dissolution of a civil partnership; and
- removing the requirement for an employer to designate a stakeholder scheme from 2012 when automatic enrolment and Personal Accounts are introduced.

Improving confidence in private pensions

- enabling compensation paid by the Pension Protection Fund to be shared on divorce or dissolution of a civil partnership;
- improving the operation of the Pension Protection Fund;
- enabling the Pension Protection Fund to charge interest to schemes for late payments of the Pension Protection levy;

- giving the Pensions Regulator the power to direct the actuarial assumptions used in the calculation of a pension scheme's liabilities;
- updating and strengthening the Pensions Regulator's anti-avoidance powers; and
- ensuring that the Pensions Regulator has the flexibility to identify the best value for money approach to delivering the compliance regime.

Further simplification of the State Pension system

- enabling the consolidation of existing rights to the additional State Pension;
- introducing an indefinite Assessed Income Period for some Pension Credit claimants; and
- setting the Upper Accrual Point for State Second Pension.

Pre-consolidation amendments to pensions legislation

- updating existing legislation to include recent amendments in the list of legislation that can be amended by a pre-consolidation Order.

Pre-1948 insurance affecting German pension entitlement

- remove an anomaly created by the interaction of pre-1948 United Kingdom legislation, European Law and German pension provision.

Summary of main impacts

Impact on individuals

19. The introduction of automatic enrolment will lead to an increase in the number of people saving in a pension. It will help combat people's tendency not to act when faced with difficult financial decisions by creating a presumption in favour of saving and making it easier to do so. In addition, the minimum employer contribution of 3% and tax relief on normal pension savings will make savings more attractive.
20. Personal Accounts will mean that those working for small employers or with moderate to low earnings will benefit from the low charges that up to now have only been enjoyed by those in large occupational schemes or those able to make large contributions.
21. As a trust-based occupational pension scheme, there will be a legal duty on trustees to act in the best interests of members, whose views will be represented by a members' panel.
22. There is inevitable uncertainty about the number of people who will be brought into pension saving as a result of the reforms. The precise impact will depend on changes to the pensions landscape between now and 2012 as well as the choices made by individuals and employers over how to exercise their new rights and responsibilities.
23. Past changes to pensions legislation have helped improve scheme members' benefits and protection within occupational pension schemes. However, combined with increasing longevity, this has meant that, in some instances, the cost of running a scheme has risen above what the sponsoring employer originally intended. Some employers have responded by closing schemes or reducing members' benefits.
24. A number of measures in the Bill are intended to reduce the regulatory burdens on employers and reduce the cost of running schemes in order to encourage the continued provision of good pension schemes. A review of the rules governing private pensions was announced in May 2006 and a report, *Deregulatory Review of Private Pensions*, was

published on 25 July 2007. The Government response to the review was published on 22 October 2007.

25. Measures to encourage greater saving will be supported by further steps to simplify the State Second Pension. This will provide individuals with greater clarity around their State Pension rights, enabling them to make more informed decisions about their private pension saving.

Impact on Employers

26. Many employers already support their employees in saving for retirement by providing a workplace pension and making contributions towards it. Measures to reduce the legislative burdens governing private pensions will support this, for example, there will be a saving to employers from the reduction in the revaluation cap on deferred pensions.
27. However, if the challenges identified by the Pensions Commission are to be met, those employers not currently providing pensions need to play a role. The introduction of automatic enrolment, including into Personal Accounts, will lead to both administrative and contribution costs for employers. The majority of these will fall on employers who currently do not currently provide a pension for their employees.
28. The majority of firms expected to automatically enrol their workers into an existing scheme already run an occupational scheme. They will therefore face lower costs than those who are new to pension provision, many of whom will use Personal Accounts.
29. A number of measures in the bill seek to minimise burdens on employers. These include:
 - a commitment to phasing in both employer and jobholder contributions;
 - designing a straightforward qualifying test for existing schemes;
 - a proportionate but effective compliance regime;

- choosing a delivery model for the personal accounts scheme that minimises burdens on employers; and
- for the longer term, establishing an employer panel to represent employers' views within the scheme.

Impact on the Department for Social Development

30. Automatic enrolment into workplace pension schemes or Personal Accounts will lead to an increase in the number of people saving in a pension and to increases in retirement incomes. It is expected that increased private pension income will lead to reduced reliance on means-tested benefits among people of pension age.
31. The Department for Work and Pensions estimates that by 2050 this will lead to a reduction of around 4% of projected expenditure on Pension Credit and 3% on Housing Benefit and Council Tax Benefit. This equates to a reduction in Northern Ireland of £12.6m for Pension Credit and £13.3m for Housing Benefit (2007/08 rates).
32. Costs associated with establishing the Personal Accounts scheme, the provision of information to employers and setting up the compliance regime will be borne by the Department for Work and Pensions.
33. There may be a small increase in benefit expenditure as a result of the introduction of an indefinite assessed income period in Pension Credit. However, this should be offset by a reduction in administrative costs.

Chapter 2: Making it easier and more attractive to save

Automatic enrolment and mandatory employer contributions

Objectives

1. The introduction of automatic enrolment and a minimum employer contribution will make it easier and more attractive for individuals to save in a pension. The objectives of the reforms are to:
 - increase private pension saving by overcoming the inertia that stops many workers from starting to save, even when they recognise the need to do so;
 - increase the attractiveness and amount of saving through a minimum 3 per cent employer contribution and normal tax relief on pension savings; and
 - enable employers to maintain the existing good pension provision that many of them already voluntarily provide.

Rationale

2. Without intervention to increase the number of people saving in a private pension, the problem of inadequacy of retirement savings identified by the Pensions Commission will continue to grow.
3. This Chapter sets out how the Department intends to introduce an employer duty to automatically enrol jobholders into qualifying workplace pension arrangements. This is needed to tackle the inertia that can exist in private pension saving, whereby many individuals do not make the decision to start saving even when they are aware of the need to do so.
4. The Department will encourage workers to continue saving in a pension through mandatory minimum employer contributions, which will provide a clear incentive to save and help those on moderate to low incomes to build up their pension entitlement.

5. Employers are crucial to achieving the desired outcome of the reforms. The proposals will balance the overarching objective of increasing pension saving among workers on moderate to low incomes with the need to minimise the burdens on businesses and support the continuation of good existing pension provision.

Summary of proposals

Employer duty to automatically enrol

6. In order to overcome inertia, responsibility will be placed on employers to automatically enrol jobholders into qualifying workplace pension arrangements, of which the Personal Accounts scheme will be one option. The decision whether to save or not will remain with individuals, who will be free to opt out should they wish.

Who will be automatically enrolled?

7. Workers will be eligible for automatic enrolment if they are aged between 22 and 75 and earn at least £5,035 per annum. Contributions will be made on earnings between £5,035 and £33,540¹⁰ per year.
8. Those outside this age range will not be automatically enrolled. However, workers between the ages of 16 and 22, and between State Pension age and 75 may apply to join their employer's pension scheme and receive an employer contribution on eligible earnings.
9. The lower earnings threshold will avoid the automatic enrolment of people on very low incomes for whom income replacement rates from State Pensions are likely to be relatively high, especially if they have consistently experienced lower earnings during their working lives. Those earning below this level may apply to join their employer's pension scheme if they want to, but employers will not be obliged to provide a contribution.

¹⁰ 2006/07 earnings terms. The lower and upper earnings limits updated by annual earnings growth

Re-enrolment

10. Workers who opt out of saving will have the opportunity to review that decision. Employers will be required to re-enrol them into a qualifying scheme at regular intervals. A minimum period of three years during which employers will not be required to re-enrol jobholders will be set.

Enrolment in other cases

11. In addition, those who opt-out of automatic enrolment or who cancel their membership of a scheme will be permitted to apply to re-join. People's circumstances change and it is not reasonable to prevent those who wish to start pension saving from doing so until "re-enrolment". It will, therefore, be possible to opt-in at least once in every 12-month period.

Voluntary members

12. It is also important to provide an accessible pensions saving product for self-employed people and for members of the Personal Accounts scheme who wish to continue to save during periods out of paid work, for example, during a career break or because of caring responsibilities. Regulations will be introduced to provide these groups with access to the Personal Accounts scheme.

Minimum contribution level

13. There will be an overall minimum contribution of 8% of eligible earnings into defined contribution schemes. At least 3% will be funded by the employer. The default 5% employee contribution includes a contribution from Government in the form of tax relief on pension savings.
14. Some employers and workers may wish to contribute more. A higher employer contribution may be used to take the total contribution rate above the 8 per cent minimum or offset some or all of the cost to the worker of contributing to the default rate.

Pay components

15. The components of pay on which both worker and employer contributions will be calculated are: basic earnings, monetary payments of commission or bonus, overtime and specified statutory benefits.

Seafarers and offshore workers

16. Initially, seafarers and offshore workers will be excluded. These groups raise difficult issues of international and European law that require further consideration.
17. However, the requirement for employers to automatically enrol eligible employees into a qualifying workplace pension scheme and the Personal Accounts Scheme do not come into operation until 2012. It is intended that they will be available to all workers, including appropriate seafarers and offshore workers, from the same date in 2012.
18. The Bill contains a power enabling the application of the relevant provisions, and any corresponding Northern Ireland legislation, to appropriate categories of seafarer and offshore worker when the outstanding issues have been satisfactorily resolved.

Qualifying test

19. Employers can choose to automatically enrol their workers into a qualifying scheme providing the scheme meets specified qualifying criteria. Qualifying tests for occupational defined contribution and defined benefit schemes based on a simple set of key criteria have been designed. Regulations will specify when an actuary will be required to confirm that the scheme meets the test.
20. The test will help employers to choose the form of pension provision that suits them and their workers, while ensuring it meets minimum standards. It will also ensure that the personal accounts scheme complements, rather than replaces, existing workplace pension provision.

Defined contribution occupational schemes

21. A defined contribution scheme is one where the scheme member receives a pension based on the contributions made and the investment return that their pension fund produces. These are also referred to as 'money purchase' schemes.
22. The minimum contribution levels, definitions of earnings bands and pay components outlined above will set the minimum benchmark for contributions in the qualifying test for defined contribution occupational schemes. Where employers calculate contributions using different rates, earning bands or definitions of pensionable pay, they will still be able to register their scheme as one which qualifies, providing scheme rules ensure that contributions do not fall below the cash equivalent of the minimum level.

Workplace personal pension arrangements

23. A workplace personal pension arrangement is any personal pension, or collection of personal pensions, to which the employer makes a contribution. This includes group personal pensions and group stakeholder pensions. An eligible worker who is already in a workplace personal pension arrangement which broadly meets the quality requirements set for defined contribution occupational schemes can stay in that arrangement and need not be automatically enrolled into an occupational scheme.

Defined benefits schemes

24. A defined benefits pension scheme is an occupational scheme where the pension is related to the member's salary or some other value fixed in advance. Defined benefits schemes contracted out of the State Second Pension which hold a contracting-out certificate will qualify to be used for automatic enrolment.
25. Contracted-in schemes and formerly contracted-out schemes which provide a minimum accrual of 1/120th (on each year's pensionable

service), based on the simplified principles of the reference scheme test, will also qualify to be used for automatic enrolment.

Hybrid schemes

26. Hybrid schemes contain elements of both defined benefits and defined contribution schemes. Employers with hybrid schemes will be directed to the test which most closely matches their scheme (whether defined benefit, defined contribution or an appropriate combination). Guidance will be provided to help employers apply the appropriate test.

Deferral periods

27. Where employers offer a defined benefits scheme, or make contributions higher than the minimum employer contribution requirement for defined contribution schemes, they will be allowed to defer enrolment. The Bill will limit the deferral period to three months to ensure that those who remain in work will quickly make up forgone savings. The deferral period is designed to support employers in maintaining higher value provision.
28. The level of contributions required to qualify for the deferral period will be defined in secondary legislation. The expectation is that the level will be set such that it:
 - rewards employers offering contributions significantly above the minimum; and
 - enables individuals to accrue, relatively quickly, equal or better savings than if they had saved in the Personal Accounts scheme.

Phasing-in of contributions

29. The proposals set out in this chapter will lead to some employers offering pensions for the first time. For those who already offer pensions, it may mean enrolling more workers into their schemes and increasing participation. To help employers and workers adjust to the new requirements, contributions will be phased in over the first three years as shown in the table below.

Illustration of the three-year phasing option

	Year 1	Year 2	Year 3
Employer Contribution	1%	2%	3%
Employee Contribution (including tax relief)	2%	3%	5%

30. Phasing contributions should bring benefits to both employers using defined contribution pension schemes, including Personal Accounts, and their workers. Phasing will give employers time to adjust to the impact of making pension contributions for all or some of their workforce for the first time. It will also give workers time to adjust to the impact of pension contributions being deducted from their earnings. This should help reduce any concerns about affordability and result in greater overall participation.

Costs and Benefits

Impact on Individuals

31. Automatic enrolment is one of the most effective techniques for combating people's tendency not to act when faced with difficult financial decisions. It creates a presumption to save and will make it easier for workers to do so, while retaining the opportunity for them to opt out.
32. Automatic enrolment has the greatest impact among groups where participation rates are low. Evidence from the introduction of automatic enrolment into private pension schemes in the United States shows that automatic enrolment had the largest effect among people on low incomes, including people from minority ethnic groups and women¹¹.
33. The combination of a minimum employer contribution of 3 per cent, existing tax relief and low charges in the personal accounts scheme will

¹¹ Madrian and Shea, 2002, in Munnell and Sunden, 2004: *Coming up short: The challenge of 401(k) plans*, *The Brookings Institute*

make saving more attractive than ever before for moderate to low earners.

How many new savers?

34. These reforms are expected to generate a substantial increase in the number of people saving for a pension. However, there is inevitable uncertainty about the exact size of this effect. It will depend on the choices made by millions of individuals and employers when these reforms are introduced, as well as changes in the pensions landscape between now and 2012.
35. However the Department for Work and Pensions estimates that, across the United Kingdom, there will be:
- 6-9 million people newly participating or saving more in workplace pensions;
 - 4-8 million new savers in workplace pensions;
 - 4-7 million individuals participating in personal accounts; and
 - 1-2 million additional people saving or saving more in existing pension schemes.

Other pension savers

36. Although not automatically enrolled into their employer's pension scheme, those earning below £5,000, aged between 16 and 22 or above State Pension age will be able to apply to join their employer's scheme should they wish to do so. Currently, pension participation among these groups is very low.
37. The self-employed will be able to join the personal accounts scheme to take advantage of its low charges. However, they will not benefit from an employer contribution and many may already be contributing to a personal pension.

Impact on lifetime incomes

38. Automatic enrolment is expected lead to millions more people saving in a pension, enabling them to transfer income from their working life to boost their income in retirement.
39. The table below shows aggregate annual pension contributions from individuals participating in workplace pension schemes following reform. This is based on Department for Work and Pensions modelling of the current United Kingdom pensions landscape and reflects projected changes in the population and employment as well as earnings growth over time.

Individual contributions in future years (£billion)				
	2020	2030	2040	2050
Individual contributions	5.3	6.5	7.9	9.6

*Source DWP – figures are for the United Kingdom
Costs are expressed in 2007/08 prices*

40. As well as benefiting from a higher pension income, individuals will also benefit from their own default contribution being matched through a combination of the employer contribution and tax relief. This will help people to build up their savings more quickly and make saving more attractive than before for many moderate to low earners.

The decision to save

41. Most people aspire to a higher retirement income than the State alone can provide, yet many millions of people are currently making insufficient provision for their retirement. The proposed reforms will mean that, subject to factors such as investment returns, annuity rates and length of retirement, individuals can generally expect the net increase in their retirement income to be greater than the total value of their contributions, plus inflation. This means that people can generally expect to get back more in real terms than they put in.

42. If individuals decide not to save for retirement they will lose out on their employer contributions and potential investment returns, and are highly likely to have a lower income in retirement than if they had saved.
43. However, saving in a pension will not be the right thing for every individual all of the time. Some may already have made sufficient provision for their retirement. Others may have other priorities, such as reducing debt. Some individuals may require more help from the state than others through income-related benefits.
44. The state benefit system provides a safety net, guaranteeing a minimum level of income for those unable to build up sufficient state entitlement or who need extra support such as the disabled or those with caring responsibilities. Most people will aspire to have more than the minimum provided by the state, while anyone who chooses to rely on income-related benefits is making assumptions about what the benefit system might look like 20, 30 or 40 years from now.

Impact on employers

45. Many employers are already making a substantial contribution to pension schemes and are supporting their workers to save for retirement. However, in order to meet the challenges identified by the Pensions Commission, those employers who do not already support pensions also need to play a role.
46. The duty on employers to automatically enrol jobholders into a qualifying workplace pension arrangement and make minimum contributions will lead to an increase in aggregate contribution and administrative costs. The majority of additional costs will be incurred by those employers who do not currently provide a workplace pension with an employer contribution.
47. At this stage, the precise costs to employers of these reforms are difficult to estimate. This is partly because the number of workers brought into saving is itself subject to a considerable degree of uncertainty.

Contribution costs

48. Modelling carried out by the Department for Work and Pensions estimates that, if employers were only to make the minimum 3 per cent contribution for their eligible workers, the value of additional employer contributions would be approximately £2.9 billion once contributions have been fully phased in. This represents about 0.7 per cent of total labour costs.
49. Nearly half of the cost of employers making a minimum contribution will fall on micro and small firms, because they are most prevalent and are less likely to currently offer a pension with a contribution of 3 per cent or more. However, even for the very smallest firms, the estimated increase in contributions will be equivalent to only 1.1 per cent of total labour costs.
50. Employers will have several ways of managing these additional costs. Research in Great Britain suggests that employers would be most likely to absorb the increase as part of overhead costs (28 per cent), through increased prices (21 per cent), or through lower wage increases (14 per cent). Depending on the mechanism chosen by the employer, some of these headline costs could be dampened by either a reduction in corporation tax paid or lower employer National Insurance contributions than would otherwise have been payable.

Administrative costs

51. The estimate of the employer administrative burden takes into account the range of processes and functions that employers will need to perform to fulfil their legal obligations. These can be categorised into four discrete processes:
 - preparing for start-up: includes setting up internal systems and adjusting IT and payroll processes;
 - registration and qualification which includes staff training and deciding how the employer will meet its new legal duties;

- worker enrolment: includes registering workers with the qualifying scheme; and
- collection and administration of contributions which includes the monthly collection process and adjustments to payslips.

52. Each of these processes involves a number of tasks which employers will need to carry out. The cost of each will depend on:

- the time taken to carry out the task;
- the person carrying out the task and their effective wage per hour, or the cost of outsourcing the task to a specialist organisation; and
- the number of eligible workers in the firm.

53. The administrative cost to employers will also depend on the way they choose to fulfil the new duties. This could be via the Personal Accounts scheme or via another qualifying scheme, which could be the employer's existing scheme or a new one. The table below shows the Department for Work and Pensions' estimate of costs across arrange of employer types.

Total additional administrative cost to all firms, by firm size (£ million)

	Year 1 cost	Ongoing cost in future years
Large firm	37	6
Medium firm	34	6
Small firm	105	28
Micro firm	167	59
Single person director firm	8	2
Totals:	350	101

54. Those employers who choose to fulfil their new duties by extending their existing scheme will have lower administrative costs than those setting up a new qualifying scheme. This is because the majority of employers

setting up a new scheme will not benefit from having pre-existing systems and experience of dealing with pension contributions. It is anticipated that the majority of employers setting up a new scheme will use the Personal Accounts scheme.

55. A key feature of the proposed reforms is minimising the costs for employers. A number of measures are, therefore, being proposed to help employers adjust to the new requirements being placed on them. These include:

- a commitment to phasing in both employer and jobholder contributions;
- designing straightforward qualifying tests for existing schemes;
- allowing employers offering higher contribution schemes to operate deferral periods; and
- a proportionate but effective compliance regime.

Impact on existing pension schemes and products

56. Personal Accounts are designed to complement rather than replace existing workplace schemes. However, the existing pension market suffers from a number of failures. People who are aware of their need to save for retirement do not save due to inertia and a short-term approach to saving and consumption. By introducing automatic enrolment and a minimum employer contribution, the number of pension savers will increase.

57. Some firms currently providing good pension schemes could reduce or 'level down' their contribution levels to the minimum requirements as a way of managing the cost of these reforms or because the minimum employer contribution level comes to be seen as the 'norm'. If this were to be widespread, it would reduce the increase in pension incomes.

58. A number of measures will be taken to mitigate this, including a deferral period for employers offering higher contributions and simple qualifying

tests for existing schemes. The Personal Accounts scheme will be targeted at the part of the market not well-served by existing schemes. The reforms should be viewed against a long-term trend of employers retreating from workplace pension provision.

Impact on income-related benefits

59. Individuals whose income falls below a certain level may be entitled to income-related benefits. For these individuals, support is provided through Pension Credit to ensure a guaranteed minimum income for those currently aged 60 and over and to reward those who have been able to make small amounts of private savings.
60. Automatic enrolment into workplace pension schemes or Personal Accounts will lead to an increase in the number of people saving in a pension and to increases in retirement incomes. It is expected that increased private pension income will lead to reduced reliance on means-tested benefits among people of pension age.
61. The Department for Work and Pensions estimates that by 2050 this will lead to a reduction of around 4% of projected expenditure on Pension Credit and 3% on Housing Benefit and Council Tax Benefit. This equates to a reduction in Northern Ireland of £12.6m for Pension Credit and £13.3m for Housing Benefit (2007/08 rates).

Implementation and delivery plan

62. The successful implementation of this policy requires employers to know their duties and ensure access to a qualifying pension scheme. The compliance regime will act as the safety net that ensures employers meet their duties, without imposing unreasonable burdens upon compliant employers in the process.
63. An effective marketing and communication strategy will be used to ensure that employers and employees know and understand what is required of them, and when.

64. Pension providers will receive information and guidance to help them prepare for the reforms, so that they are able to provide a qualifying pension scheme if they wish.

Chapter 3: Extending access to simple, low-cost saving: Personal Accounts

Objectives

1. In order to ensure that all workers, particularly the target group of moderate to low earners, have access to a simple, low-cost pension scheme, the Secretary of State for Work and Pensions will set up a defined contribution occupational pension scheme: Personal Accounts. This is catered for in the Pensions Act 2008. The scheme will extend to Northern Ireland.
2. There are five key principles that continue to drive this work:
 - simplicity: the Personal Accounts scheme must simplify the decisions people are asked to make about their retirement provision and provide an easy way to save;
 - independence: the Personal Accounts scheme will be delivered using private sector expertise, independent of outside pressures;
 - working for members: building a Personal Accounts scheme which commands the confidence of its members and is designed with their needs at its heart;
 - minimising the burden on employers: ensuring that the impact on employers is considered at each stage of development of the Personal Accounts scheme; and
 - supporting good existing provision: focusing the Personal Accounts scheme on those without access to good workplace schemes.

Rationale

3. The reforms outlined in Chapter 2 will make it easier and more attractive for individuals to save in a pension. This will help to tackle the problem of insufficient demand that exists within the current pensions market.

However, without further reform, there would still be a supply gap in the current market which means that a significant number of moderate to low earners and those working for small employers would not have access to low-cost pension saving.

4. The nature of these groups means they are less able to make large pension contributions and less likely to save for a prolonged period due to uneven employment patterns. This can make it difficult for pension providers to cover the high upfront costs of marketing and selling pension products. As a result, providers tend to actively target those with higher earnings or who work for large employers, where the higher revenues and economies of scale they require can be more easily achieved.
5. The Personal Accounts scheme will address these supply side failures by ensuring all employees and employers have access to a simple, low-cost pension scheme.

Summary of proposals

The Personal Accounts scheme

6. The Westminster Pensions Bill provides for the Personal Accounts scheme to be established as a trust-based defined contribution occupational pension scheme. It also provides for the establishment of a trustee corporation to administer the scheme. This approach offers protection for members, through the combined weight of trust law and existing pensions legislation, and places a legal duty on the trustees to act in members' interests. It also gives trustees, rather than government, responsibility for the scheme's strategic direction.
7. The Secretary of State for Work and Pensions will establish the Personal Accounts scheme by Order. The Order will set out the main provisions of the scheme.
8. Following the creation of the Personal Accounts scheme, the trustees will be required to set up a members' panel and an employers' panel. The trustees must consult with these panels about the operation and development of the scheme. This includes the trustees consulting with

both members' and employers' panels before proposing or consenting to any changes to the scheme order or rules. The intention is that these panels will act as a conduit for gathering opinion and will ensure that both members' and participating employers' interests are taken into account in the running of the scheme. It is also the intention that the members' panel will nominate one third of the trustees.

9. The scheme will be regulated by the Pensions Regulator. Scheme members will have access to the normal routes of redress in the event of a complaint.

Personal Accounts Delivery Authority

10. Personal Accounts will be established in three stages:
 - stage 1 – setting up a Personal Accounts Delivery Authority (“the Authority”) to provide expert advice to government on the operational implications of the policy and to develop a commercial and procurement strategy to inform policy development;
 - stage 2 – extending the remit and powers of the Authority so that it can take on responsibility for implementing the personal accounts scheme (including the commercial and procurement strategy, designing, building and testing systems, and securing people and premises) within a framework set by legislation; and
 - stage 3 – handing over the day to day running and strategic management of the personal accounts scheme to the trustee corporation. In practice there will be a period of overlap between stages 2 and 3 to ensure continuity during the transition and to ensure the trustees can take responsibility for strategic decisions such as investment.
11. Powers taken in the Pensions Act 2007 and the Pensions Act (Northern Ireland) 2008 implemented the first stage.
12. The Authority’s main functions in the second stage will be:

- overseeing the establishment of the Personal Accounts scheme;
and
 - supporting the Pensions Regulator in establishing the processes to maximise compliance with the new employer duties.
13. In discharging its functions, the Authority will be required to have regard to the following guiding principles:
- encouraging and facilitating participation in qualifying schemes;
 - minimising burdens on employers;
 - minimising the impact on other qualifying pension schemes;
 - minimising the cost of membership of the Personal Accounts scheme;
 - ensuring, as far as possible, that preferences of prospective members are taken into account in making any provision about investment choice in the Personal Accounts scheme; and
 - respecting diversity among members and future members.
14. In addition, the Authority will be required to take any steps it considers appropriate to promote links, discussion and the exchange of information with stakeholders.
15. It is important that in taking forward the Personal Accounts scheme, the Authority and trustee corporation are given the flexibility to deliver and run a low-cost scheme that is commercially sustainable whilst meeting the needs of its members. This means not taking detailed decisions now that these organisations will be better placed to make in the future. Instead, the proposals ensure that there is a framework within which these decisions will be made.

16. Responsibility for implementation of Personal Accounts will be delegated to the Authority. Its skills, knowledge and expertise will be used to oversee the specification, design, procurement and build of the infrastructure for the Personal Accounts scheme. This will include the fund management and administration systems necessary for the trustee corporation to run the scheme. In these areas, the Authority will have independence and autonomy.
17. The Authority's role will also be to provide advice to the Secretary of State and to the Department.

Charges

18. The Personal Accounts scheme aims to provide people with a simple low-cost way of saving for a pension. However, decisions on charges should generally be for those responsible for running the scheme. This will ensure charges are both sufficient to cover scheme costs as well as being attractive to both existing and future members. The Authority will make recommendations on the charge structure and levels.

Investment

19. Investment decisions are a key consideration for any pension scheme. Like other trust-based occupational pension schemes, investment decisions in the Personal Accounts scheme will be the responsibility of the scheme's trustees. Investment funds offered by the personal accounts scheme will be chosen in the best interest of future members and after consultation with those in the target group.
20. Personal Accounts scheme members who do not wish to make a fund choice will have their contributions automatically invested into a default fund. Personal Accounts funds will be managed by professional, independent, fund managers recruited in line with industry practice.

Decumulation

21. The Personal Accounts scheme will be subject to the same decumulation rules as other tax registered pension schemes. Most members will be

able to take up to 25 per cent of their personal accounts savings as a tax-free lump sum and convert the remainder to an annuity which will provide them with an income for life.

Supporting existing pension provision

22. The Personal Accounts scheme will have a number of features designed to ensure that it remains targeted at moderate to low earners who do not have access to good quality workplace pension provision. Targeting the scheme in this way will help to ensure that employers who currently provide good quality pensions will continue to do so.

Annual contribution limit

23. The amount of contributions will be subject to an annual upper limit of £3,600¹². This will strike a balance between targeting Personal Accounts at those parts of the market currently under-served and providing individuals with sufficient flexibility to achieve their retirement goals. Consideration is being given to the setting of a higher limit for the first year to help encourage saving prior to the introduction of the scheme in 2012.

Transfer policy

24. There will be a general prohibition on the transfer of pension funds between Personal Accounts and alternative pension products. This will help ensure that the scheme is focused on serving the needs of its target group and limit the impact of the reforms on the wider pensions market.
25. Transfer of funds into and out of Personal Accounts will be permitted in specific circumstances. One such circumstance is where an individual moves jobs from an employer who offers a qualifying scheme to an employer offering Personal Accounts before their rights under the first scheme have vested¹³. In this situation, individuals will be allowed to

¹² 2005 earnings levels, to be up-rated in line with average earnings

¹³ Many occupational pension schemes require a member to be in pensionable service for a period of time before their rights vest. Legally this period cannot be longer than 24 months, although schemes can decide to have shorter periods or none at all. During this period contributions are collected and invested. If a person leaves a scheme before their rights vest,

transfer their accrued funds into Personal Accounts. These funds are known as 'cash transfer sums' and will not count towards the maximum amount that can be contributed.

Costs and benefits

Impact on individuals

Increase in saving

26. As outlined in Chapter 2, it is estimated that around 4-7 million people will save in a Personal Account once the scheme is fully up and running. This will lead to a significant boost to these individuals' retirement income.

Low charges

27. The aim of the Personal Accounts scheme is to provide its target market with a low-cost way to save for their retirement. Low charges can be achieved in the Personal Accounts scheme because it will benefit from economies of scale, lower marketing costs due to automatic enrolment, and because members can continue making contributions to the scheme even if they change jobs or have periods out of employment. As a result the scheme will offer members low charges, currently only available to those in large occupational pension schemes or those who are able to make high contributions.
28. Lower charges can make a significant difference to a person's final pension income. For example, an annual management charge of 0.5 per cent compared to 1.5 per cent over an individual's working life could mean a 25 per cent increase in the eventual size of their fund¹⁴.
29. There are a number of different charging structures in the current pensions market. There is no quantitative information on which structure is the most prevalent, although anecdotal evidence suggests that the approaches include:

they are entitled to receive a full refund of their contributions. Once rights have vested, those funds cannot be accessed until retirement.

¹⁴ DWP modelling

- annual management charges;
- contribution charges;
- joining charges;
- flat fees; or
- a combination of any of these.

30. The Authority will consider what charging structure is appropriate for the personal accounts scheme and has consulted on the issues raised¹⁵.

Investment

31. The introduction of automatic enrolment and the Personal Accounts scheme will mean that many people become involved in long-term investment for the first time. In order to make this transition as easy as possible, the Personal Accounts scheme will have a default investment mechanism for those individuals who do not wish to make a choice of investment.

Decumulation

32. The costs and benefits from the decumulation of members' pension savings will not differ in type from the costs and benefits experienced by other pension savers. The Personal Accounts scheme will be subject to the same tax rules as other pension schemes and members will be entitled to access the annuity Open Market Option.

33. As a result of the recommendations from the recent Open Market Option review¹⁶, it is expected that more pension savers, including those in Personal Accounts, will make more informed decisions about their annuity purchase and consequently achieve better outcomes from their

¹⁵ <http://www.padeliveryauthority.org.uk/consultations> The Authority published responses to the consultation in July 2008.

¹⁶ http://www.hm-treasury.gov.uk/pbr_csr/documents/pbr_csr07_pensions.cfm

pension savings. Some people may be able to improve their annuity rate by as much as 30 per cent by exercising their Open Market Option¹⁷.

Impact on employers

34. The Personal Accounts scheme will set up an employers' panel with a remit to advise the trustees on the administrative impact on business and to act as a conduit for employers' views. There will also be ongoing consultation with employers during the design phase.
35. Personal Accounts will be one option that employers can use to fulfil their new duties. The latest estimate is that employers using personal accounts will face a total administrative cost of £350 million in the first year of set-up and £101 million in subsequent years.

Annual contribution limit

36. In order to keep the Personal Accounts scheme focused on its target market and to encourage employers to continue with existing arrangements, there will be a limit on annual contributions into the scheme. As the contribution limit is a fixed amount, it will mostly constrain those with higher earnings or in receipt of a generous employer contribution.

Transfers

37. Without a restriction on transfers into the Personal Accounts scheme, there would be a risk of a substantial movement of funds from existing schemes. This could affect the financial position of other pension providers, for example, it could make it difficult for them to recover costs already incurred in establishing and marketing existing pension products.
38. A restriction on transfers into and out of the Personal Accounts scheme may also provide an important signal for employers and individuals that it is targeted at moderate to low earners currently without access to a good workplace pension scheme. This could be an important safeguard against the 'levelling down' of existing provision.

¹⁷ <http://www.hm-treasury.gov.uk>

Implementation and delivery plan

39. Implementing the proposals will be a major challenge. The Personal Accounts Delivery Authority will bring in expertise from the private sector to work with stakeholders to develop and deliver the proposals. The Authority will be expected to:

- consider best practice and lessons learned in other large-scale projects, including National Audit Office and Office of Government Commerce guidance recommending that the implementation of major programmes is broken down into manageable steps;
- build on the existing consensus around pension reform and the Personal Accounts scheme by consulting with stakeholders to inform implementation proposals;
- understand the delivery capability and capacity of potential suppliers who will need to manage implementation risks;
- develop a supporting communications and marketing strategy to ensure awareness of the proposals and that specific information is delivered and understood; and
- take account of the principles for guiding pension reform proposals.

Chapter 4: Compliance

Objectives

1. The reforms to the private pension system will introduce important new rights for workers and requirements for employers. The main objectives of the compliance regime will be to ensure that:
 - those rights are effectively safeguarded while imposing no unnecessary burdens on business;
 - there is a level playing field for employers so that those who fail to comply with the requirements do not achieve a commercial advantage over those who do comply; and
 - the need to take compliance action is kept to a minimum by developing an effective communications strategy so that employers know what they are required to do and when to do it.

Rationale

2. The policy proposals have been developed to manage the following three key risk areas of potential non-compliance:

Risk 1 – risk to automatic enrolment:

- employers might fail to correctly register how they will automatically enrol their eligible workers; and
- employers might fail to provide access to a pension scheme that meets the qualifying criteria.

Risk 2 – risk to the opt-out process:

- employers might interfere with the opt-out process by pressurising workers or prospective workers into opting out.

Risk 3 – risk to payments:

- employers might fail to make payments due for members of qualifying schemes at the correct time.

Risk 1 - Automatic enrolment

3. Employers may fail to meet the new requirement to provide access to a pension scheme that meets the qualification criteria. It is, therefore, important that risk 1 is proactively managed. Three options were considered for dealing with the risk to automatic enrolment:
 - option 1: employee enforcement through an Industrial Tribunal;
 - option 2: use the National Minimum Wage compliance regime as a model; and
 - option 3: use registration and automated administrative processes to support compliance.
4. Options 1 and 2 are largely reactive, and do not include a registration process. They rely on workers taking action when their employer fails to meet the new duties. Option 3, is more proactive.

Option 1: There is no registration process and enforcement is left to the worker. The information strategy would be designed to maximise initial compliance but where employers do not meet their responsibilities, workers would have the right to take a case to an Industrial Tribunal.

Benefits:

- inexpensive – costs include responding to queries and the burden on industrial tribunals; and
- very few employers would be affected.

Drawbacks:

- workers are unlikely to take action because: it is costly; it provides no immediate benefit – the value of the employer contribution would only affect the individual after retirement; and there is considerable individual inertia in pension saving;
- high burden on some employers from vexatious claims;
- could mean very low compliance;
- eligible workers could miss out on correct pension access; and
- open to legal challenge on the grounds of ineffective enforcement.

Option 2: There is no registration process and compliance is still largely driven by the worker. Where an employer doesn't meet the requirements, workers can contact the compliance body which can investigate on their behalf. The compliance body can also conduct some risk-based investigation into possible non-compliance.

Benefits:

- builds upon a familiar approach used for the National Minimum Wage;
- fewer employers would face the expense of an Industrial Tribunal than under option 1, because the compliance body would resolve most cases before they reach that stage; and
- some flexibility to undertake limited proactive, risk-based activity to gain extra compliance.

Drawbacks:

- extra cost of running whistle-blowing hotline, investigating and resolving non-compliance, imposing penalties where necessary and a small amount of civil or criminal court action;
- workers are unlikely to whistle-blow for reasons similar to those discouraging action under option 1;
- could mean very low compliance; and
- expanding risk-based investigation to improve compliance would increase burdens on compliant employers. This kind of investigation is expensive to carry out and would be a costly way to gain extra compliance.

Option 3: Employers will be required to register how they will meet their responsibilities and those who fail to do so will be pursued by the compliance body. Investigation of other types of non-compliance will focus on high-risk employers highlighted by intelligence from other government departments, whistle-blowing, or other sources. These interventions will ensure that employers fully comply after the registration process.

Benefits:

- registration process allows the compliance body to clearly identify employers who have not engaged with their duties, and focus on those cases, minimising burdens placed upon the compliant majority;
- early intervention is expected to produce high compliance with registration and automatic enrolment.
- less reliant on worker action, though still an opportunity to whistle-blow.

Drawbacks:

- extra costs and some delivery risk from the web-based registration process and follow-up; and
- administrative burden placed on every employer by requirement to register.

Choice of Option 3

5. Option 3 has been chosen on the grounds that it strikes the correct balance between costs imposed on business and benefits from higher compliance. There will be an employer registration process which will inform automated compliance activity, as well as whistle-blowing and risk-based investigation.

Risk 2 - Interference with the opt-out process

6. Employers might interfere with the opt-out process by, for example, by requiring prospective workers to agree to opt out before offering them a job or, once employed, putting pressure on them to do so through inducements, such as one off payments, or through threats, such as withholding pay increases for those workers who do not opt out.
7. The decision whether or not to opt out of pension scheme membership should be freely taken by the individual. It is not anticipated that many employers will seek to pressurise their workers to opt out, but the risk that some might be tempted to do so means that doing nothing is not a viable option.
8. Non-compliance of this kind is more likely to be detected and successfully pursued where an individual actively complains about the situation. The creation of new employment rights enforceable via the Industrial Tribunal system will help manage this risk.

Option 1: Introduce new rights not to be unfairly dismissed or suffer detriment on grounds related to pension scheme membership. Individuals would, from day one of employment, receive protection from

the most blatant forms of pressure to opt out of pension scheme membership. That is, protection from being dismissed or being subject to various forms of detrimental treatment such as being unfairly treated in terms of pay, training opportunities or selection for redundancy.

Option 2: Introduce new dismissal and detriment rights and a restriction on agreements to limit or exclude the employer duty which will offer protection against employers offering inducements.

Under this option, in addition to the protection offered under Option 1 against the most negative forms of coercion, individuals would also receive protection against employers trying to encourage them to opt out by offering them positive inducements. This should deter employers from offering one-off payments or alternative salary levels or benefits in return for individuals giving up their right to a qualifying pension.

Option 3: Introduce new rights as above plus a pre-employment right not to be refused employment on grounds relating to pension scheme membership.

This option recognises that pressure on the opt-out decision could be applied before employment starts. It therefore proposes that individuals be given a right not to be refused a job because they want to become, or want to remain, a member of a pension scheme. The route to redress would be for individuals to take a case to an Industrial Tribunal if they feel they had been unlawfully refused employment.

Option 4: Introduce new rights as under option 1 plus a prohibition on screening out those who want to become pension scheme members during the recruitment process.

This option recognises that pressure on the opt-out decision could be applied before employment starts. But instead of giving individuals a right not to be refused employment on certain grounds it proposes that employers be prohibited from asking specific questions about pension scheme membership before offering a job, for example, in job advertisements, interviews, job applications and job offers.

Choice of Option 4

9. It is considered that option 4 will offer workers the most appropriate level of protection, both before a job is offered and once employment has started. The protection offered to individuals before employment starts should be as effective in practice as that offered under option 3, but without employers fearing the cost of vexatious claims for compensation by unsuccessful job applicants.
10. This package of new rights will present act as an effective deterrent.

Risk 3 – Late payment of contributions

11. Employers might fail to make payments due for members of qualifying schemes at the correct time.
12. The trustees of occupational pension schemes are currently required to draw up and agree the contributions employers will make to scheme members, to monitor the payments received and pursue any payments the employer misses.
13. Trustees are required to report failures to make payments to the Regulator if they suspect that members' benefits are seriously at risk. This is not generally required until payments remain unpaid 90 days after the due date.
14. The Regulator takes a risk-based approach to late payments and takes action when members' benefits are viewed to be at serious risk. The Regulator has powers to fine employers for late payments, but prefers to assist trustees in getting any monies available into the pension fund. As the Regulator intervenes in only a small number of cases it is able to take an individual approach with employers. Overall the current regime appears to work well for existing schemes.
15. The reforms introduced through this Bill transform the pensions landscape, moving from a situation where pensions are provided voluntarily by employers to one where they must be provided for all eligible workers who do not opt out. Many employers will be new to

pension provision and late payments are therefore expected to be a significant risk.

16. The following criteria were used when judging the options for managing this area of compliance risk:

- protection given to members' contributions;
- costs for schemes and the compliance body;
- impact on confidence in personal accounts and other qualifying schemes;
- Article 6(1) of the European Convention on Human Rights considerations, and the need for new requirements to be adequately enforced;
- effectiveness for all qualifying schemes; and
- any adverse impact on existing schemes.

17. Option 1: pursue all unpaid contributions.

Whilst this approach would give greatest protection to members it was rejected as it would be impractical to administer and costly. It would mean pursuing small amounts of debt even where it was not cost-effective to do so. This would conflict with the overriding duty of trustees to act in the interests of their members as a whole. Equally, it would not be cost-effective for the compliance body to devote resources to pursuing small debts never likely to be recovered.

18. Option 2: pursue all unpaid contributions where it is cost-effective to do so.

This option would see the compliance body given powers to make debts more cost-effective to pursue. This could be done by, for example, using escalating penalties or amalgamating debt (taking action once several debts and penalties have accumulated).

Choice of Option 2

19. It has been concluded that option 2 would be the more effective in delivering the policy's aims. The details of how this approach will be implemented will be developed and agreed with the Pensions Regulator.

Delivering the compliance regime

20. The Pensions Regulator will have responsibility for the compliance regime. In addition, there will be secure gateways to receive relevant employer data from Her Majesty's Revenue and Customs. Other bodies were considered for the task of delivering the compliance regime and this is discussed below.

Options considered

21. The options considered for delivering compliance were:
 - Option 1: the personal accounts trustee body;
 - Option 2: the Personal Accounts Delivery Authority;
 - Option 3: The Personal Accounts Delivery Authority having sole responsibility for developing the compliance regime and handing over the responsibility to another organisation after 2012;
 - Option 4: Her Majesty's Revenue and Customs;
 - Option 5: the Pensions Regulator; and
 - Option 6: a mix and match approach, with responsibilities for both Her Majesty's Revenue and Customs and the Regulator.
22. Only organisations with current roles in the pensions landscape or employer compliance were considered. The options were assessed according to their strengths in the following areas:
 - legal and financial implications;

- organisational capacity and expertise to take on the role;
- fit with the Hampton Principles¹⁸ ;
- burden for employers, pension schemes and their members; and
- current involvement in pensions, regulation and employer compliance.

Option 1: Personal accounts trustee body

Benefits:

- links with the majority of employers required to comply with the new obligations.

Drawbacks:

- conflicts with the requirements on scheme trustees to act only in members' best interests and not to use trust assets for any other purpose;
- can only carry out activity relating to provision of retirement benefits; and
- does not have the power to impose penalties on employers.

Option 2: Personal Accounts Delivery Authority.

Benefits:

- new organisation could minimise risk that other bodies' existing activities are negatively affected by the new work.

Drawbacks:

¹⁸ The Hampton review sets out principles of inspection and enforcement, including: regulators should use comprehensive risk assessment; regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work; no inspection should take place without a reason; and businesses should not have to give unnecessary information. See Philip Hampton, Reducing administrative burdens: effective inspection and enforcement, March 2005.

- continuing the Authority post-2012 would create a new regulatory organisation;
- at odds with the Hampton principles, with potentially higher costs and employer burdens; and
- new organisation could mean higher burdens for some employers who might have to work with both the Regulator and the new organisation to resolve certain pension issues.

Option 3: Personal Accounts Delivery Authority, handing over to another organisation post-2012.

Benefits:

- flexibility to consider changes to the pensions and regulatory landscape between now and the handover date;
- makes use of the Authority's expertise developed during design of the personal accounts scheme; and
- compliance functions could eventually transfer to the most appropriate body, avoiding creation of a new, permanent compliance body.

Drawbacks:

- postponing decision about delivery until after 2012 would prevent the ultimate delivery organisation from having the maximum possible involvement in the design of the regime; and
- will create uncertainty for employers, trustees and the pensions industry.

Option 4: Her Majesty's Revenue and Customs

Benefits:

- experienced in employer compliance;
- existing relationships with employers;
- experienced in large-scale activity; and
- owns the PAYE data needed for the employer registration process.

Drawbacks:

- already committed to a substantial change programme as well as seeking to maintain delivery of its wide-ranging responsibilities;
- responsible for collection of more than 75 per cent of total government receipts. It would be difficult to take on an additional function and manage further change without risk both to delivery of the new function and to its existing commitments;
- would probably have to create compliance teams and IT systems to support this work, making economies of scale in costs and employer burdens unlikely;
- and could mean removal of responsibility for late employer contributions from the Regulator and have an impact on the Regulator's wider regulatory responsibilities.

Option 5: The Pensions Regulator

Benefits:

- good fit with pensions landscape; pensions compliance would be delivered by the Regulator;

- good end-to-end accountability;
- because the Regulator is a relatively small organisation at present, the new role could have a higher profile and priority within the regulator than might be the case in, for example, Her Majesty's Revenue and Customs; and
- successful delivery organisation.

Drawbacks:

- the Regulator lacks experience and infrastructure in large-scale activities;
- while the Regulator has some experience of employer compliance in relation to late payments, the new work will be on a much larger scale; and
- the Regulator would have to create compliance teams and IT systems from scratch in addition to improving links with employers.

Option 6: Mix and match of Her Majesty's Revenue and Customs and the Regulator

Benefits:

- potential for efficiency by building on each organisation's current activities; and
- could reduce delivery risk relative to one of the organisations taking on all the compliance activity.

Drawbacks:

- would add significant complexity to accountability and governance arrangements; and

- could require significant duplication of IT systems and more hand-offs across systems, increasing the cost and perhaps employer burdens.

Choice of the Pensions Regulator.

23. As described above, there are legal reasons that mean the Personal Accounts trustee body would not be suitable to run the compliance regime. Ongoing management of the compliance regime by the Personal Accounts Delivery Authority was rejected on the grounds that this would make the regulation of pensions more complex by involving an extra organisation, but without significant benefits.
24. The final decision was between Her Majesty's Revenue and Customs and the Pensions Regulator, or a combination of both.
25. Although a mixed approach could allow for the two organisations to specialise in those elements of the regime most relevant to their current work, this option was rejected on the grounds that it would be likely to increase costs.
26. It was recognised that if Her Majesty's Revenue and Customs were to run the regime, some costs might be marginally lower than under other options. However, it is very unlikely that this compliance work could be included with tax-related compliance activity; and new systems and teams would be needed. This suggests that, against the background of the overall costs involved, the costs are likely to be very similar whether the Regulator or Her Majesty's Revenue and Customs were to take on the role.
27. In other areas, which are not directly related to costs, the Regulator has some key advantages:
 - it is a successful pensions organisation;
 - the stewardship of the Department for Work and Pensions;

- potential to increase its capacity, make enforcement of the new employer requirements a priority and ensure effective delivery of the reforms.
28. It has been decided that the Regulator should be the compliance body. As well as extending the Regulator's objectives and powers so that it can take on this role, the Bill will take powers to allow the Personal Accounts Delivery Authority to work with the Regulator as it develops the compliance regime. This new work will be a major change for the Regulator and will present challenges. But the Regulator is considered to be a high-performing organisation and it should be able to adapt and grow to deliver a successful compliance regime.

Costs and benefits

Impact on individuals

29. A low level of compliance will result in fewer workers benefiting from their own savings and their employer's contribution when they reach retirement. There will also be less opportunity for qualifying schemes to achieve economies of scale and offer low charges to their members. Non compliance could lead to higher costs for workers across all schemes.
30. The compliance regime is designed to ensure that as few of these workers as possible miss out on their rights.

Impact on business

31. The compliance regime has been developed in line with the Hampton principles to ensure that it minimises the impact on business and concentrates resources on the areas of greatest risk.
32. The proposed regime will place three potential costs on business. The first will be the administrative burden of registering with the compliance body and setting out how they will meet their new duties. Every employer will need to do this once for each PAYE scheme that they operate. They will only have to notify the body again in the case of a decision to use a

different pension scheme or on the creation of a new PAYE scheme. The cost to employers from registration has been included in the overall administrative burdens presented in Chapter 2.

33. The second cost will only fall on employers who have further dealings with the compliance body. In most cases only non-compliant employers will be contacted. However, a small number of compliant employers may be contacted by the compliance body, for example, if they are selected for investigation on the basis of a risk profile determined by employer characteristics.
34. The third potential cost arising from the compliance regime could be from reporting requirements placed upon pension providers. Many schemes already complete an annual return to the Regulator and these requirements will build on those which are already in place but may involve collecting some additional information. This could mean that some extra costs fall on pension providers.
35. Effective compliance will help provide a level playing field for employers, with non-compliant employers being prevented from gaining an unfair commercial advantage over the compliant majority.

Chapter 5: Strengthening existing provision

Objective

1. The aim of these measures is to reduce the regulatory burdens on employers in order to encourage them to continue to provide good pension schemes for their employees, while balancing the need to protect members' interests.

Rationale

2. The present regulatory system governing occupational pensions has grown incrementally over the past thirty years. It is now lengthy, complicated and hard to understand. There is little doubt that the weight of regulation has contributed to a belief by some employers that the costs and risks of having their own pension schemes are becoming too great.
3. The number of active members of private sector defined benefit pension schemes has been falling steadily since the late 1960s; down from a peak of 8.1 million members in 1967 to 2.7 million in 2007¹⁹.
4. A review of the rules governing private pensions was announced in May 2006 and a report, *Deregulatory Review of Private Pensions*, was published on 25 July 2007. The Government response to the review was published on 22 October 2007²⁰.

Summary of proposals

Reduction in cap applying to revaluation of deferred pensions

5. Legislation currently requires schemes to protect the value of early leavers' deferred pensions against inflation by increasing the amount of pension payable from normal pension age by the increase in the Retail Prices Index over the period of deferment or by 5%, whichever is less.

¹⁹ Office for National Statistics, *Occupational Pension Schemes Survey*, 2006.

²⁰ <http://www.dwp.gov.uk/pensionsreform>

6. The Bill will reduce the cap applying to revaluation of deferred pensions from 5% to 2.5%. This is expected to take effect from January 2009 and will apply only to rights accrued after that date.

Abolition of safeguarded rights

7. When a divorcing couple, or civil partners dissolving their partnership, seek a financial settlement, the court may take into account the value of any pensions held by either party. In order to achieve a fair financial settlement, the court may make a pension sharing order requiring a proportion of the value of the shareable pension rights to be transferred to the former spouse or civil partner of the scheme member. That share is discharged into a pension arrangement as a 'pension credit' (not to be confused with the income-related benefit, State Pension Credit).
8. Where a pension credit includes contracted-out rights, those rights are known as safeguarded rights and are subject to a detailed regulatory regime which restricts the type of scheme that may hold the rights and the way in which they can be paid.
9. It is considered that the rules for safeguarded rights serve no useful purpose in ensuring that the former spouse or civil partner gets the full value of the pension share. Their abolition will remove an unnecessary layer of complexity for scheme administrators and provide individuals with more choice regarding the transfer of their rights. It will ensure that safeguarded rights will be treated in the same way as other shared rights.

Removal of the employer stakeholder designation requirement

10. From 2012, all employers will be required to automatically enrol eligible employees into a qualifying workplace pension scheme. This will make obsolete the current requirement that employers with five or more employees must, unless they provide alternative pension arrangements, designate a stakeholder pension scheme. However, employers may continue to offer stakeholder pensions as qualifying schemes or as an additional pension saving option.

11. Removing the designation requirement will contribute to the objective of introducing pension reform in a way that limits the impact on employers. It means that employers no longer have a duty to:
- designate a stakeholder pension scheme;
 - consult their workforce about their choice of scheme;
 - supply employees with information about the scheme;
 - supply information to the pension provider; and
 - permit representatives of the pension provider access to the workforce.
12. Where, at the point when the Personal Accounts scheme is introduced, employees are contributing into their stakeholder scheme, employers will continue to deduct and pay contributions to the pension provider. This transitional provision will apply until the individuals concerned stop paying contributions into the scheme or leave the employer's employment. Over time, employers will not have to comply with two sets of legal requirements – stakeholder pensions and Personal Accounts.

Costs and benefits

Impact on schemes/employers

Reduction of the cap applying to revaluation of deferred pensions

13. The reduction in the cap would deliver potential savings for employers. These are estimated to be up to £250 million (2007/08 prices) a year on average, although in the long-term they could rise to as much as £400 million (2007/08 prices) a year.

Abolition of safeguarded rights

14. There will be benefits for scheme administrators who have members with safeguarded rights in that they won't have an extra layer of complexity when dealing with pension credit rights.

Removal of stakeholder designation requirement

15. New employers with five or more employees will no longer incur the costs of designating a stakeholder pension scheme and setting up payroll collection facilities for their employees. Second, as people move jobs there will be fewer employees actively saving in existing stakeholder schemes through their employer, further reducing employer administrative costs.

Impact on individuals

16. The deregulatory measures contained in the Bill are aimed at supporting the continuation of defined benefit pension provision by generating savings for employers with defined benefit schemes.

Reduction of the cap applying to revaluation of deferred pensions

17. The reduction in the cap on revaluation will have very little effect on average private sector incomes from defined benefit schemes. The table below shows the percentage reductions in average private sector defined benefit pension income compared to the status quo. This assumes a long-term inflation rate of 2.9 per cent and a reduction in the cap from 2009.
18. Deferred pensioners are likely to have a number of different sources of pension income, reducing the impact of any fall in the value of any single deferred pension on their total pension income.

Percentage reductions in average private sector defined benefit pension income compared to the base case, assuming a long term inflation rate of 2.9 per cent and a reduction in the cap from 2009

	2.5% cap – 100% deferred pension affected by the change
2020	0.2%
2030	0.5%
2040	1.1%
2050	1.6%

Abolition of safeguarded rights

19. The benefits to individuals of repealing the requirements relating to safeguarded rights will arise through increased flexibility in transferring their pension credit rights, since the individual's choice of scheme will no longer be restricted to a scheme that will accept contracted out rights. It will also remove the restrictions on how safeguarded rights can be paid, giving the individual the same choice and flexibility to take their benefits as other pension credit members.

Removal of stakeholder designation requirement

20. Individuals who are active members of a stakeholder pension when personal accounts are introduced will benefit from a provision that will enable them to continue paying into their stakeholder pension via their employer if they wish to do so.

Implementation and delivery plan

21. It is intended to commence the reduced revaluation cap from January 2009.
22. Safeguarded rights will be abolished by commencement order after the Bill receives Royal Assent.
23. The removal of the stakeholder designation requirement is intended to coincide with the introduction of personal accounts from 2012.

Chapter 6: Improving trust in private pensions

Objectives

1. The Bill proposes a number of changes to the Pension Protection Fund and the powers of the Pensions Regulator to improve the administration of the institutions and enhance the services they provide. Both bodies operate on a United Kingdom-wide basis.
2. These changes are informed by the operation of the institutions since they opened for business in April 2005, and reflect the need to continue to build trust and confidence in private pensions as a means of saving for retirement, without placing undue burdens on the institutions' customers, including employers who provide occupational pension schemes and those who administer them.
3. The Pension Protection Fund is a statutory fund created by the Pensions Act 2004 to pay compensation to members of defined benefit pension schemes where the sponsoring employer is insolvent and the scheme is under funded. It is administered by the Board of the Pension Protection Fund, which is a public corporation.
4. The Fund is financed by a combination of:
 - a levy on eligible schemes;
 - the assets of failed schemes; and
 - investment returns.
5. The Pensions Regulator is the United Kingdom regulator of work-based pension schemes set up under the Pensions Act 2004 to:
 - protect the benefits of members of work-based pension schemes;
 - promote good administration of work-based pension schemes; and

- reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund.

Rationale

The Pension Protection Fund

6. The operation of the Pension Protection Fund has revealed a small number of areas where improvements to legislation will enable the Pension Protection Fund to operate more efficiently, and provide enhanced and more equitable treatment for its customers. These changes are necessary to ensure that recipients of Pension Protection Fund payments receive pension compensation which properly reflects the level of pension they would have received at that point in their life.
7. They will also ensure that divorcing couples are able to share compensation within a settlement in a similar way as they would if a scheme had not entered the Pension Protection Fund.

The Pensions Regulator

8. The Pensions Regulator replaced the Occupational Pensions Regulatory Authority as part of a new risk-based and proportionate regulatory regime, which applies greater scrutiny where it considers member benefits are most at risk. In the course of developing its role, functions and powers over the past two years, areas have been identified where an amendment to legislation will enable the Regulator to deliver its statutory objectives more effectively.

Summary of proposals

Pension Protection Fund compensation sharing on divorce

9. Currently, on divorce or dissolution of a civil partnership, any pension assets are valued and may be shared or transferred as part of the divorce settlement. The Pension Protection Fund is not a pension scheme, and therefore these provisions do not apply. It is intended that provision be made for valuing compensation, issuing court Orders in

respect of the compensation, and the implementation of those Orders by the Pension Protection Fund.

Costs and benefits

Public sector

10. Detail concerning the method of calculation of shares of compensation and the information that the Pension Protection Fund will need to provide will be contained in secondary legislation. The Pension Protection Fund does not expect that the administrative costs will be significant and, other than set-up costs the legislation will provide that the costs of implementing compensation sharing Orders for couples will be met by those couples.

Individuals

11. This proposal will enable couples undergoing divorce or dissolution of marriage or civil partnership to reach greater independence and fairer settlements by enabling the courts to share Pension Protection Fund compensation in the same way that they can currently share pensions. This will allow members of couples who have had less opportunity to contribute to their own pension, especially women, carers and disabled people, or those who have had lower earnings, to acquire a share of the compensation due to their ex-spouse where this forms one of the couple's more significant assets.

Employers

12. There will be no impact on employers.

Competition

13. There will be a requirement on some parts of the legal profession to familiarise themselves with the new legislation.

Operation of the Pension Protection Fund

14. The measures intended to improve the operation of the Pension Protection Fund and to improve the service it delivers are:

- to ensure that when the recipient of a pension sharing order becomes entitled to compensation from the Pension Protection Fund, the level of that compensation reflects revaluation to take account of inflation where appropriate;
- to ensure that the level of compensation due can be adjusted upwards and downwards to reflect increases and reductions in the level of pension payments had the scheme not entered the Pension Protection Fund;
- to ensure that compensation can be delayed where doing so would be in the interests of the member and would ease the administration of the Pension Protection Fund;
- to allow for the actuarial adjustment to enhance the value of delayed payments;
- to clarify the definition of “normal pension age”; and
- to clarify the meaning of “admissible rules” used to define the level of compensation paid.

Costs and benefits

Public sector

15. Taken together these measures will provide the opportunity for operational efficiencies within the Pension Protection Fund and will ensure that a lack of clarity in the legislation does not lead to additional burdens being placed on the Fund.

Individuals

16. These measures will ensure a more equitable distribution of compensation with a closer match between compensation being paid and the benefits the person would have got from their pension scheme if it had not entered the Fund.

Employers

17. The measures will help ensure there are no unforeseen demands placed on the administration levy.

Competition

18. The measures will help ensure there are no unforeseen demands placed on the administration levy.

Interest on late payment of the Pension Protection Fund Levy

19. The Pension Protection Fund is responsible for collecting the Pension Protection Levy – £675 million for 2008/09 – which is invested in order to fund compensation to members of eligible defined benefit occupational pension schemes whose employers have gone insolvent.
20. A significant amount of the Pension Protection Levy is paid late by schemes. At present, there is no power for the Board of the Pension Protection Fund to deter late payment. The Bill will therefore make provision to charge a prescribed rate of interest on late payment of the Pension Protection Levy and for the waiver of interest charges in certain circumstances.
21. Any interest payments received would be available for investment as part of the Pension Protection Fund, and compensate for the investment income foregone by the Fund. However, it is expected that the charging of interest will reduce the incidence of late payment. The rate of interest will be prescribed in regulations.

22. For similar reasons, the Bill will make provision to enable interest to be charged on late payment of the Fraud Compensation Levy, the Pension Protection Fund Administration Levy, the Pension Protection Fund Ombudsman Levy and the General Levy.
23. It is recognised that there will be circumstances where there are legitimate reasons for late payment of levies and regulations may provide for the waiving of interest charges in prescribed circumstances.

Costs and benefits

Public sector

24. It is anticipated that the Pension Protection Fund will collect interest relating to late payment of the Pension Protection Levy and the Fraud Compensation Levy. The set-up costs of implementing the administration of interest charging for these levies has yet to be determined.
25. It is anticipated that the Regulator will collect interest relating to late payment of the Pension Protection Fund administration Levy, the Pension Protection Fund Ombudsman Levy, and the General Levy. The set-up costs of implementing the administration of interest charging for these levies has yet to be determined. The set-up costs will be recovered through the General Levy which funds the administrative costs of the Regulator.

Employers

26. Pension schemes that are eligible for Pension Protection Fund compensation will only be subject to interest charges in the event of late payment of levies. They may also incur an administrative cost of paying interest in relation to the late payment of levies, but this would be negligible in terms of the total running costs of a pension scheme.

Competition

27. It is anticipated that there will be no impact on competition between businesses.

Powers of the Pension Regulator

Scheme's technical provisions improperly determined

28. The Pensions Regulator's scheme funding powers include the power to direct the actuarial assumptions to be used in the calculation of the schemes' technical provisions (defined as the amount required, on an actuarial calculation, to make provision for the scheme's liabilities).
29. There are specific circumstances in which these powers may be exercised. This includes a failure to comply with requirements relating to the preparation of a scheme's statement of funding principles, its schedule of contributions or any recovery plan. A breach of any of these requirements allows the Regulator to use any of its scheme funding powers.
30. Doubts have been expressed regarding the Regulator's power to intervene if the sole concern is that the actuarial assumptions used in a valuation do not appear to have been chosen prudently by the Trustees. This anomaly could, potentially, leave the Regulator powerless to intervene in such circumstances, increasing the risk to both the security of the scheme member's benefits and the Pension Protection Fund. The Bill will therefore introduce a legislative amendment to clarify the Regulator's powers.

Appointment of trustees

31. The Regulator's powers to appoint trustees to pension schemes are set out in Article 7(3) of the Pensions (Northern Ireland) Order 1995. These powers may be exercised where it is necessary to:

- secure that the trustees as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the scheme;
 - secure that the number of trustees is sufficient for the proper administration of the scheme; or
 - secure the proper use or application of the assets of the scheme.
32. At present, the Regulator may only appoint a trustee if it is satisfied that there is no other option available. The “necessary” test was introduced in the context of a different regulator and a different market environment and requires a high burden of proof which can inhibit appropriate regulatory intervention unnecessarily.
33. The Bill will introduce a new test which is intended to ensure that the Regulator has appropriate powers to allow it, in cases of concern, to be more effective in protecting the interests of members by appointing trustees to the scheme. Any trustee appointed by the Regulator will either be a scheme member or an independent trustee appointed from a register held by the Regulator.

Costs and benefits

34. The costs of the independent trustees would be borne by the scheme but this would not alter the total costs of providing the pension benefits promised by the scheme in the long term. The measure is not expected to have any impact on public finances.

Delegation of powers by the Regulator

35. Current legislation allows for certain functions of the Regulator to be contracted-out, provided suppliers are listed in regulations. It is proposed to remove the need to identify specific suppliers in legislation.

36. This proposal seeks to ensure that the Regulator has the flexibility to identify the best value for money approach to delivering the compliance regime.

Regulator's Anti-avoidance Powers

37. It is proposed to make amendments to the Pensions Regulator's powers to ensure they are adequate to address risks resulting from changes in the pensions market. Recent new business models offering alternatives to buy out with a regulated insurer have raised concerns about whether the current powers are adequate to address risks to scheme members and to the Pension Protection Fund, particularly where employer actions reduce the security of scheme benefits.
38. The proposals are designed to ensure that the Regulator's powers remain effective and appropriate and enable it to intervene where appropriate. They reflect the need to continue to build trust and confidence in pensions as a means of saving for retirement, without placing undue burdens on the employers who provide occupational pension schemes or the wider pensions industry.
39. The key proposals are:
- a modified legislative approach – the intention is to put the substantive changes to the anti-avoidance measures into primary legislation;
 - a new test for Contribution Notices based on material detriment – this new test would enable regulatory intervention where appropriate to address material risks to members' benefits, with safeguards, including a Regulator Code of Practice and a statutory defence, to guide its application;
 - removal of 'otherwise than in good faith' – this would allow intervention where appropriate, but would be circumscribed through a new mandatory requirement on the Regulator to consider the reasonableness of a person's actions;

- a new test for Financial Support Directions – a correction to an unforeseen anomaly in the sufficiently resourced test without extending the range of this power;
- bulk transfers – a new direction power to ensure that the Regulator can direct a contribution notice or a Financial Support Direction to the appropriate scheme but only where the test(s) for using those powers are satisfied;
- a clarification to the legislation – to make clear that a contribution notices can be issued in relation to acts or failures.

Costs and Benefits

Public Sector

40. The annual cost of running the Pensions Regulator is £27m. There may be a small but temporary increase in the Regulator's administrative costs arising from the proposals, however, these are not expected to be significant and would be met within its existing budget without any impact on the level of the General Levy.
41. The proposals will not require substantial alterations to the Pensions Regulator's guidance on clearance. This already provides professional advisers, employers as well as those who are associated and connected with pension schemes with information about when they might consider seeking assurance from the Regulator that it will not use its powers in relation to a corporate event. In addition, the Regulator proposes to issue a Code of Practice on the circumstances in which the Contributions Notice detrimental effect test will apply.
42. It is estimated that the number of clearance enquiries to the Pensions Regulator will increase initially before returning fairly quickly to current levels, as the application of the new legislation becomes more widely understood. It is not expected that many enquiries will translate into clearance applications.

43. The additional cost, when spread across all of the schemes liable for the General Levy, is not expected to increase the levy amounts.

Individuals

44. There would be no impact on individuals from these changes.

Business

45. The Regulator's summary of Corporate Risk Management activity, for the years 2006/07 and 2007/08, is shown in the table below²¹.

Clearances granted/ withdrawals approved	2006/07	2007/08
Clearances granted	149	143
Clearances refused	1	0
Enquiries received	874	494

46. The proposed amendments would not represent a general new burden on employers and businesses but would close loopholes that could otherwise allow unscrupulous employers to renege on pensions promises. The changes would also address those business models that remove a scheme from a sponsoring employer and leave members exposed to unacceptably high levels of risk.
47. The vast majority of employers/businesses do not engage in the behaviour addressed by the proposals and it is likely that very few pension schemes sponsors will be affected by these proposed changes.

²¹ The Pensions Regulator Annual Report and Accounts 2007-2008 (page 25) HC 731

Chapter 7: Further simplifying State Pensions

Consolidation of Additional Pension Rights

Objectives

1. The Pensions Act (Northern Ireland) 2008 introduced measures that help simplify basic State Pension and State Second Pension. The measures mark a step forward in helping people understand their pension entitlement. However, the three elements which make up pension income: basic State Pension, the State Second Pension schemes and Pension Credit still remain complex in some areas and further work needs to be done to simplify those.
2. The proposals outlined below will provide a further and significant simplification of the Additional Pension.

Rationale

3. The Bill proposes steps to simplify the three additional State Pension schemes that today's workers may have contributed to in the past (Graduated Retirement Benefit, State Earnings Related Pension and State Second Pension) and in which they will have a stake for many years to come. At present these pension accruals are only notional and cannot be given a firm cash value until a contributor retires.
4. Simplifying the additional State Pension will provide contributors with a better understanding of their future retirement income from the State and its value to them as a foundation for private saving.

Summary of proposal

5. The Bill proposes that the three schemes should be consolidated after the end of the 2011/12 tax year and given a cash valuation. This cash amount will be revalued by earnings until the contributor retires. This valuation will be based on the rules and calculations that would have been normally applied to the accruals in a contributor's account at the point they reached State Pension Age. As a result, the contributor will then know the amount of pension their past contributions have paid for

and will be able to estimate in a straightforward way the value of the pension they will be able to build up in the future.

Costs and benefits

Effect on the Department for Social Development

6. The proposal in effect rolls up calculations from three distinct pension benefits into a single cash sum. It will no longer be necessary for Social Security Agency staff to have a working knowledge of the complex rules of these benefits – Graduated Retirement Benefit (1961-1975), the State Earnings Related Pension Scheme (1978-2002) and unreformed State Second Pension (2002-2012).

Effect on individuals

7. The proposals will enable contributors to have a much clearer picture of their State Pension outcomes, both the value of pension accrued to date and projected forward. They will help provide a key element of information to contributors so that they can make fully informed savings decisions.

Implementation and delivery plan

8. Plans on implementing the changes have yet to be finalised. However, flexibility over the conversion window will be required, with commencement possible from the end of the 2011/12 tax year. We do not expect to bring forward the calculation for anyone who reaches State Pension age before 2020.

Pension Credit simplification – assessed income period run-on

Objectives

9. This proposal removes the need to review older pensioners' changes in circumstances in respect of their Pension Credit entitlement and is part of a package of simplification measures aimed at:
 - improving the customer experience;

- optimising operational efficiency;
- providing more accurate assessments; and
- reducing fraud and error.

Rationale

10. When Pension Credit was introduced in October 2003 the cases that migrated from Minimum Income Guarantee were set an automatic assessed income period of between five and seven years. During this period recipients of Pension Credit were not required to declare increases in capital and other changes of circumstances. The assessed income period on these cases will start to mature between October 2008 and October 2010. In addition all new claims with assessed income periods from October 2003 rolling forward will have an assessed income period maturing from October 2008 onwards.
11. This proposal will reduce the number of cases requiring a review after April 2009 thus reducing the administrative burden the Pension Service will experience. It will also reduce the level of intrusion and uncertainty that the customer experiences every five years with having to provide the same level of information and verification as at the outset of their claim.

Summary of proposal

12. An assessed income period is a specific period of up to five years during which time the Pension Credit customer's or partner's capital or savings are deemed to stay the same. Those customers aged 65 and over can have an assessed income period if they satisfy the relevant qualifying conditions.
13. The assessed income period is a fundamental part of the design of Pension Credit. It was introduced to reduce the level of intrusion normally associated with an income-related benefit. During the assessed income period the customer is not required to report changes to capital or savings.
14. When the assessed income period matures there is a requirement to then consider the setting of another assessed income period. At this point

the customer is asked to provide information and evidence of their current circumstances. This process is similar to what the customer would have needed to provide at the outset of their claim.

15. To reduce the level of intrusion further and to simplify procedures, we are proposing to remove the limit of five years on the assessed income period for those customers aged 75 and over and for those customers who have an assessed income period spanning their 80th birthday. This means that the assessed income period will continue to run-on and will therefore remove the need for the Pension Service to review the case and the customer to provide detailed information every five years.

Costs and benefits

Costs to Government

16. The financial impacts of this policy are relatively small. Currently, increases in the value of individual's capital holdings over the assessed income period are taken into account when their Pension Credit entitlement is recalculated at the end of an assessed income period. For those individuals affected by the policy this will no longer be the case and consequently the policy will incur a small cost to the Government in terms of benefit expenditure.
17. However, the policy will also alleviate the administrative burden on the Pension Service creating some savings for the Government. Under the current system, when an assessed income period matures the case is reviewed and the customer asked to provide detailed information regarding their income and capital. The policy removes the need for this process and will create administrative savings.

Individuals

18. Older customers will experience less intrusion. Additionally, an increase in capital over an assessed income period will not reduce their income.

Employers

19. This proposal is not expected to have any impact on employers.

Implementation and delivery plan

20. The change will be implemented in April 2009. The qualifying conditions that govern when an assessed income period is appropriate are set out in the State Pension Credit Act (Northern Ireland) 2002. Any changes to the qualifying conditions must therefore be enacted through primary legislation.

Setting the Upper Accrual Point

Objective

21. From 2012, the Pensions Act 2007 and the Pensions Act (Northern Ireland) 2008 introduce an Upper Accrual Point to replace the Upper Earnings Limit as the weekly upper cap on earnings for determining entitlement to the State Second Pension.
22. The level of the Upper Accrual Point will be determined by reference to the Upper Earnings Limit and frozen on introduction to facilitate the phasing-out of the earnings-related element of the State Second Pension by around 2030. State Second Pension will then become fully flat-rate.

Rationale

23. The effect of measures announced as part of the 2007 Budget was to raise the Upper Earnings Limit beyond its anticipated level. This would mean that, without adjustment, the Upper Accrual Point would be significantly higher than previously forecast and, as a consequence, State Second Pension would accrue on a higher level of earnings than intended.

Options considered

24. Two main options were considered in detail:-
 - Option 1 – do nothing.

- Option 2 - Introduce the Upper Accrual Point in April 2009 at the level of the 2008/09 Upper Earnings Limit (£770 per week) to achieve a flat rate State Second Pension in 2031/32.

25. Option 1: Do nothing.

Doing nothing would mean the State Second Pension outcomes for some groups of future pensioners, in particular higher earners (those earning above the 2007/08 Upper Earnings Limit of £34,840 in today's prices), would be higher than intended. In addition, it would take until 2034/35 to achieve a simplified flat-rate State Second Pension whereas the intention was for this to happen by 2031/32).

This option has been rejected on the basis that it would take longer to achieve a simplified State Second Pension.

26. Option 2: Introduce the Upper Accrual Point in April 2009.

Bringing forward the introduction of the Upper Accrual Point to 2009/10, and fixing it at the level of the Upper Earnings Limit in 2008/09 (£770 per week) would re-establish the original policy intention.

Summary of proposal

27. The Upper Accrual Point will, therefore, be introduced from April 2009 and set at £770 per week – equivalent to the Upper Earnings Limit for 2008/09. It will be frozen in cash terms and together with the flat-rate accrual amount provided by the Pensions Act (Northern Ireland) 2008, will re-establish the original policy intention.
28. The Bill will also contain provision to allow the Department to make regulations prescribing equivalents to the upper accrual point in relation to earners paid other than weekly were the Treasury does so for Great Britain.
29. In Great Britain these measures are contained in the National Insurance Contributions Act 2008.

Costs and benefits

Individuals

30. Bringing forward the introduction of the Upper Accrual Point to 2009 will only affect future rights to State Second Pension yet to be accrued. There is no impact on current pensioners or on State Second Pension rights already accrued.

Employers

31. All employers will need to be aware of the introduction of the Upper Accrual Point because the P11/ P14s will be changed to include an additional earnings column. If the employer has employees earning below the new Upper Accrual Point whilst the P11/ P14 will look different it will not have any material effect on what information the employer needs to record.
32. The introduction of the Upper Accrual Point will require changes to the current design of the P11/ P14s or electronic equivalents which, in part, is used by employers to record earnings for National Insurance contributions and contracted-out employment purposes. The changes are required because adjustments are being made to the maximum level of earnings on which contributory benefit entitlement and contracted-out rebates are available. Currently the maximum level is set at the Upper Earnings Limit but from April 2009 the maximum level will be set at the new Upper Accrual Point.

Chapter 8 – Other provisions

Amendment of Article 69 of the Social Security Pensions (Northern Ireland) Order 1975.

Objective

1. The proposed amendment is aimed at correcting a technical error in paragraph (5ZA) of Article 69 of the Social Security Pensions (Northern Ireland) Order 1975 and at extending the scope of that paragraph to cover surviving civil partners. Article 69(5ZA) deals with the interface between requirements to index public service pension schemes and requirements to index Guaranteed Minimum Pensions. Guaranteed Minimum Pensions accrued where a member contracted out of the Second State Pension between the years 1978 and 1997.

Rationale

2. Pensions from public service schemes are uprated under the provisions of the Pensions Increase Act 1971 and Article 69 of the Social Security Pensions (Northern Ireland) Order 1975. Paragraph (5ZA) of Article 69 was inserted to prevent an element of double indexation of Guaranteed Minimum Pensions in relation to the pension payable to widows and widowers by public service schemes.
3. Guaranteed Minimum Pensions are part of pensions accrued as a result of public service scheme member contracting out of the state earnings related pension between the years 1978 and 1997. Double indexation of Guaranteed Minimum Pensions can occur when they are increased by both public service pension scheme requirements and Departmental requirements for index-linking state pensions.
4. Widows and widowers of members of public service schemes inherit half of their late spouses' Guaranteed Minimum Pensions, but in the case of widowers only the Guaranteed Minimum Pensions in respect of service since April 1988.

5. Civil partners inherit Guaranteed Minimum Pensions rights similarly to widowers in public service schemes. As it currently stands, paragraph (5ZA) does not operate correctly because it does not recognise the differences in Guaranteed Minimum Pensions entitlements between widows and widowers and it does not cover surviving civil partners. This could result in some widowers not receiving full indexation on part of their pension and some civil partners being entitled to double indexation on part of their pension.

Summary of proposal

6. Article 69 of the Social Security Pensions (Northern Ireland) Order 1975 needs to be amended to bring uprating for widowers and civil partners in public service schemes in line with uprating provided for widows.

Costs and benefits

7. The amendment corrects a technical anomaly in existing legislation so that it correctly reflects the different Guaranteed Minimum Pensions entitlements of widows and widowers for the purpose of calculating pensions increases. It also extends paragraph (5ZA) of Article 69 to prevent an element of double indexation from applying to civil partners of public service scheme members.

Implementation and delivery plan

8. The amendment once in place will provide for widowers and civil partners to be treated on the same basis as widows in relation to the requirements to prevent double indexation of Guaranteed Minimum Pensions by public service pension schemes.

Disclosure of information relating to State Pension Credit recipients

Objective

9. The objective of this proposal is to allow the Department to share information with energy providers in very specific circumstances with a view to tackling fuel poverty.

Rationale

10. Tackling fuel poverty across the United Kingdom is a key priority for government; the overall objective being to ensure that no household in the United Kingdom lives in fuel poverty. A household is considered to be in fuel poverty if it needs to spend more than 10% of its income on fuel. A number of initiatives and measures exist to address the problem of fuel poverty and to provide help with fuel costs.
11. Identifying the fuel poor is a major challenge. The Department for Social Development holds data on pensioners receiving Pension Credit. The Bill proposes to create a regulation-making power authorising the sharing of this data with energy suppliers for the specific purpose of providing assistance with fuel costs – suppliers will also be able to share data for that purpose.

Summary of proposal

12. The Bill will provide the Department with a power to make regulations authorising it, or a person providing services to it, to supply information relating to pension credit recipients to energy companies in Northern Ireland.
13. The regulations will prescribe the energy companies and third-parties to whom information may be given, the purposes for which the information may be given and used, and create offences relating to the unauthorised disclosure of such information by the recipient.

Impact on individuals

14. Individuals may be concerned that when suppliers have been given information they may use it for purposes other than providing assistance with fuel costs. Each supplier will receive data only on their existing customers which may be used only for the purpose of providing assistance.

15. In addition to the legal safeguards already available through the Data Protection Act 1998, the regulations will create a new criminal offence for unlawful disclosure of the data.