

3 January 2008

ACCA's (the Association of Chartered Certified Accountants) response to the Pensions Bill

Comments are split into: 1) general comments and 2) comments on specific clauses in the Bill

General points about the new scheme

1 Suitability of the scheme for the target market

ACCA has considerable doubts as to whether the new scheme has the potential to achieve the objective of ensuring that those who do not currently save for a supplementary pension save enough through the new scheme to make them better off in retirement than they would be if they did not save at all. For the proposed new scheme to achieve this objective on behalf of its members, those members will need to invest material amounts of their own money over a long period of time, those investments will need to perform well on the markets, and at retirement the saver will need to purchase an annuity able to offer a stream of income which represents a material supplement to the basic state pension.

ACCA feels that the new scheme is being based on assumptions that are too optimistic, especially since the scheme is being aimed at workers that are, in the main, comparatively low-paid and who cannot therefore be expected to have the level of disposable income that will make it possible for them to divert enough into their scheme to be worthwhile in terms of future retirement income.

Our overriding fear in this respect is that comparatively low-paid workers will be directed to divert part of their income towards a scheme that may not be in their best financial interests, bearing in mind the various uncertainties that surround the whole process. There is no suggestion that individuals will be offered any professional advice before joining the scheme and, as a money purchase scheme, any person's pension in the new scheme will depend to a definitive extent on how much he or she pays into it.

To avoid causing large numbers of individuals to effectively waste their money, the Government will need to ensure that the benefits system does not operate to penalise people for saving (as it can do at present). If people are to see this new scheme as something positive, they will need to have a high degree of confidence that they will be better off financially in retirement for having saved for a pension than they would be they had not saved; and they must feel that it is in their interest to defer their income rather than to spend it on immediate consumption. The uncertainties surrounding investment returns and annuity rates cannot be counteracted. But the Government must do as much as it can to ensure that pension income under the new scheme will act as a supplement to state benefits and not as a substitute for them.

Unless strong assurances are given on these matters, we fear that the scheme may not be in the best financial interests of many in the target market and the opt out rate may turn out to be higher than the DWP is estimating.

2 Implications for employers

The DWP admits that the scheme will depend to a great extent on employers to administer it, by enrolling their staff in the scheme, deducting and paying employer and employee contributions and keeping records. The DWP's estimate of the administrative costs to employers are set up costs of around £230 million and on-going annual costs of around £90 million.

These figures are somewhat higher than the initial estimates provided in the White Paper 'Security in Retirement' in May 2006. Research carried out by Manchester Business School (MBS), however, using compliance cost data for the PAYE system, has estimated that on-going costs alone could result in an annual additional compliance cost of £1.3 billion for the UK's SME sector. Even that estimate does not take into account internal staff time and professional fees that businesses will incur in learning about the personal accounts scheme and deciding whether or not to opt out of their current arrangements, if any.

MBS estimates that an on-going burden of this level would further reduce the profitability of SMEs and lead to an overall reduction in corporation tax revenues of £397 million. We appreciate that the MBS figures are only

estimates, as are the DWP's. But an increase of anything like this amount in SMEs' administrative burdens – fifteen times the DWP's own estimate - at a time when the Government is officially committed to cutting red tape and business compliance costs, would be an unacceptable price to expect SMEs to pay. There need to be more assurances that the new scheme will not place disproportionate burdens on SMEs.

The creation of the new scheme should from the outset avoid unnecessary bureaucracy. All stakeholders need to be convinced that it was necessary to create an entirely new system when employers could, instead, have been required to contribute to an employee's stakeholder pension.

Comments on specific clauses in the Bill

Clause 1

This clause says that every person who works under 'a contract' is a jobholder. This would mean that employers would assume responsibilities under the Bill in respect of those providing services on a self-employed/consultancy basis, i.e. via a contract for services. We believe that, in the interests of minimising the burden on employers, there should be no requirement for the automatic enrolment of persons in this position – they should be able to opt in but there should be no presumption that they should be enrolled. Clause 1 also says that where a person has more than one employer or a succession of employers the provisions of the Bill apply separately to each employment. Surely this must not mean that a process of enrolment must be undertaken in each case – this would certainly result in superfluous administration. It should be the case that enrolment (and if appropriate re-enrolment) should be the responsibility of the job holder's first employer. Thereafter, once a person has been enrolled in the scheme, the employer should have responsibilities to deduct and pay over contributions and to keep records.

Clause 3

There needs to be more clarity on when the automatic enrolment date / employee eligibility for the scheme commences. The assumption is that it commences on day one of employment in a new job.

Clause 7

This suggests that every job holder will be automatically enrolled in the new scheme but will then have the right to opt out. We agree that all should have the right to opt out after joining, but the administrative implications for employers of dealing with this should be recognised, especially since the rate of opt-out can not be known in advance (but may turn out to be high if the level of scepticism about the new scheme is substantial).

It may help to minimise employer burdens if, instead of there being automatic enrolment into the scheme from day 1, new job holders were only required to be enrolled by the employer AFTER they had worked for the employer for a reasonable period – 3–6 months say - and AFTER they had been given the information about the mechanics of the scheme referred to in clause 8 of the Bill. This would help to ensure that employees entered into the scheme with a degree of fore-warning about what the scheme was about.

It should also be borne in mind that it is common for employees to be required to work a probationary period before being given a full-time contract, and also that, in occupational schemes, it is not uncommon for individuals to be required to work for an employer for a period before being eligible to join the scheme.

In addition, where a worker enrolled in the new scheme moves to an employer which has opted out, but operates a qualifying occupational scheme, it is unclear what the implications would be for the employer. If that employer were to be expected to make separate arrangements to deduct contributions from a worker's salary and to pay these – along with the employer's contributions – to the personal accounts authority, and to keep separate personal accounts records, then this would amount to another time-consuming and expensive burden on the employer. The prospect of facing this dual pension obligation will no doubt be considered by employers when they go through the process of deciding whether or not to seek exemption.

ACCA recognises the argument for automatic enrolment, *viz* that it counteracts the factor of employee apathy/indifference towards pensions by ensuring that everything was done for him or her without any action required on their part. Our suggestion would not, we think, affect this – it would only delay the

employer's obligation (but might in the process help to minimise the rate of subsequent opt-out by ensuring that employees gave some thought to whether joining the scheme might be in their best interests).

Clause 7 also states that if an employee opts out they will be treated as if they have never been a member of the scheme and all contributions collected to date must be refunded. This flexibility could potentially create a two-tier pensions system, as if an employee after two years' membership of an existing pension scheme chooses to move their pension, all contributions made have to be transferred directly into another pension scheme and cannot simply be 'refunded', for the recipient to use as they wish. More clarity is needed here.

Clause 8

Our own view is that individuals will not be in a position to make a sensible decision as regards their membership of the new scheme unless they take financial advice. We consider that, as well as informing job holders about the mechanics of the new scheme, employers should also be required to recommend that individuals seek information and/or advice about the scheme and its implications for them personally. It is not clear whether a direction of this kind is envisaged under the broad terms of clause 8 but we believe that it is crucial for the point to be made.

Clause 11

Another area requiring further explanation is the reference to what earnings will be considered to calculate job holder and employer contributions to the new scheme. Those stated include wages / salary, commissions, bonuses and overtime. Currently, pensions contributions normally only take into account basic wages / salaries. If additional income categories are to be included in the calculations for the new scheme, this again risks creating a two-tier pensions system, as these categories would presumably be subject to tax relief, which is not permitted for employers and employees in existing schemes.

The potentially heavily burdensome administrative implications of making contributions calculations based on all these supplementary sources of income must also be taken into consideration.

Clauses 32, 33 and 37 – sanctions for failure to comply

Fixed penalty fines of up to £50,000, escalating penalty notices with a prescribed daily rate of up to £10,000 and / or potential imprisonment of up to two years are materially high sanctions for what will be mostly small businesses. There appears generally to be ‘more stick than carrot’ for businesses affected by this Bill.

In addition, the potentially serious implications of failure to comply makes it crucial that information for employers and employees about the new scheme is highly publicised, understandable and widely available in a range of formats. Government agencies’ ICT systems and monitoring arrangements must also minimise the potential for error, on both government and employer sides. This is particularly crucial at a time when confidence in the security and effectiveness of Government ICT systems is at an all time low.

Clause 69

It is not clear to us how the definitions in clause 69 correspond with those in clause 1. Clarification is needed.

Clause 82

The principle involved in pension sharing in the case of divorce may be indisputable. But the effect of pension sharing for low value funds should be borne in mind. At the very least, individuals should be made aware of this aspect in the information they are provided with under clause 8.

CONTACTS FOR FURTHER INFORMATION

June Deasy, ACCA Public Affairs Manager: 0207 059 5751 / 07736800393
june.deasy@accaglobal.com

John Davies, ACCA Head of Business Law: 0207 059 5972
john.davies@accaglobal.com