Will personal accounts increase pensions saving?
Seminar 22 November 2007

The Pensions Policy Institute has conducted a series of seminars exploring outstanding issues in personal accounts. The final seminar in this series was held on 22 November, chaired by Jeannie Drake, and explored whether the Government's private pension reforms will increase pensions saving. The seminar was hosted by the Nuffield Foundation, and the Foundation also funded the research. The PPI is grateful for their support. The seminar was attended by 50 people representing the range of interest areas across the pensions sector.

Two earlier seminars in this series were also hosted by the Nuffield Foundation. They focused on options for the charging structure in personal accounts (held 19 March 2007), and the roles and objectives of the personal accounts delivery authority and the personal accounts Board (held 2 May 2007).

PPI research findings
Niki Cleal (PPI) presented findings from the PPI's latest discussion paper, ***Will personal accounts increase pensions saving?***

The PPI research assesses the possible aggregate impact of the introduction of the Government's private pension reforms on:

- The flow of total annual pension contributions;
- The split of those contributions between existing pension products and personal accounts;
- The total funds under management in personal accounts and in existing pension products.

The research uses 'what if…?' scenario analysis to asses the overall impact of the Government's private pension reforms if employers act in a variety of ways. The scenarios are deliberately stylized and are intended to illustrate the possible range of outcomes that could occur from the reforms. No judgement is made about the relative likelihood of each scenario actually occurring. The scenarios are:

- All employers auto-enrol on existing terms: employers already contributing greater than 3% into an existing pension auto-enrol their employees on existing terms. Those not currently offering a 3% contribution auto-enrol at the minimum 3% level either into a personal account or into an existing scheme.
- Employers control costs: employers who currently contribute more than 3% reduce their average contributions to hold their total pensions costs constant.

Employers currently not contributing are assumed to contribute the 3% minimum level.

- Modelled employer response: employers respond in a way that was informed by their responses to a survey of 750 private sector employers conducted by Deloitte in April to May 2006.
- Employers auto-enrol on minimum terms: all employers are assumed to offer only the 3% minimum contribution to new members.

The research highlights that the success or failure of the Government's private pension reforms will depend crucially on the reaction of employers and employees. Key findings from the research are that:

- The reforms are likely to increase the number of people saving in a work-based pension, by between 4-9million; levels of opt out remain uncertain.
- The reforms may or may not increase the total amount being saved in pensions; employer responses will be very important in determining the final outcome.
- The reforms could change the shape of the pensions market, in terms of the split between existing types of provision and personal accounts.
- The amount of funds in personal accounts could grow to reach significant levels by 2050.

Discussants

Mike O'Brien (Minister of Pensions Reform) welcomed the PPI research, which he said sets out the parameters for the possible outcomes of the reforms. He stressed that while debate around the details of the reforms is necessary, it is important to keep focused on the overall goal of the reforms to give millions of people access to work-based pension saving with an employer contribution for the first time.

Rachel Vahey (AEGON) presented an industry response to the PPI research. She stressed that reforms need to be not just about increasing the number of people saving, but also about increasing the number of people who are saving more. Rachel said that it will be important to test the effects of the reforms and understand any unintended outcomes before the reforms are fully rolled out. She argued that it is important that the reforms do not disturb current pensions saving. She said that employees could receive significantly less if they saved in personal accounts rather than their existing Group Personal Pensions (GPP) arrangements if it meant their employer contribution was less. Rachel proposed that solutions to these issues will lie in designing an effective employer compliance regime, a simple test for qualifying schemes and steps to ensure a level playing field for existing exempt provision and personal accounts.

Tim Jones (PADA) introduced the role and set up of the personal accounts delivery authority. He stressed that the communications challenge of the reforms (to employees and employers) should not be underestimated. It is not the intention for personal accounts to compete with existing provision. PADA's role is to champion personal accounts and to argue for simplicity in order to keep the charges / costs for members as low as possible.

Questions and discussion

The following points were raised by speakers or members of the audience and do not reflect the views of the PPI.

Attendees generally agreed that if the reforms only broaden the number of people saving, this will not be a successful outcome. The ***goals for the reforms*** need to include:

- increasing the number of savers, and
- increasing the amount saved in the target group, and
- increasing the aggregate amount saved overall.

It is important not to lose sight of the ultimate goals of the reforms when debating the policy details.

Personal accounts will be designed to be clear and simple, and this is critical for keeping costs / charges to members low. Personal accounts and the 8% contribution rate should be seen as the default option, and could provide an 'onramp' to better pension products and higher pension saving.

The policy intention of the ***contribution cap*** is to minimise the extent that personal accounts compete with existing provision. However, some attendees dispute whether the cap will discourage employers from choosing personal accounts. Other attendees felt that the reforms present a marketing challenge for industry to differentiate existing pension products from personal accounts.

Some attendees suggested that auto-enrolment may not be the only factor that drives ***participation rates,*** and that the support and communications surrounding auto-enrolment and the work-place culture will also be important.

Some attendees pointed out that the interaction of personal accounts with means-tested benefits means that some people are at risk of personal accounts being unsuitable for them. ***Suitability*** remains an outstanding issue and more research is needed to quantify how many people fall into each of the "at risk" groups. There is a risk that people will be auto-enrolled when it is not suitable for them. But there is also a risk that negative messaging about suitability may mean that people are 'scared off pension saving' when they could benefit from it. This should be avoided. The PPI has analysed and costed two proposals, one to increase the trivial commutation limit and another to introduce a limited pension income disregard. Further debate about options to improve suitability is welcomed.

There is currently a trend away from trust-based schemes, and towards contract-based schemes. EU rules prevent contract-based schemes from operating automatic enrolment. All of the scenarios in the PPI research assume that contract-based schemes will be able to qualify as ***exempt schemes*** and to operate ***automatic enrolment***. If this is not possible, the outcomes from the reforms could be a lot more pessimistic than the scenarios show. The Government is working to find a solution to overcome this issue. A number of attendees stressed that a workable solution needs to be found.

The ***communications*** challenge for the reforms and for personal accounts should not be underestimated. Even if personal accounts are kept simple and clear, it will operate within a complex pensions system.

The PPI research does not take into account ***displacement / substitution*** from other forms of saving, but does account for some displacement from individual personal pensions. More research is needed to understand better the saving habits of the target group and the potential for personal accounts and the reforms to displace non-pension and pension saving.

Careful consideration needs to be given to ***how the effects of the reforms will be measured***. The roll out of the personal accounts scheme, and of the reforms more generally, needs to be phased in such a way that the impacts can be effectively evaluated and ongoing improvements can be made.