PENSIONS POLICY INSTITUTE PPI

Personal Accounts: is there consensus?

Introduction

The Government set out its plans for Personal Accounts in its December 2006 White Paper, ***Personal Accounts: a new way to save***[1]. The consultation period closed in March 2007 and Government is expected to publish a summary of responses in June 2007.

The PPI has conducted an independent stocktake of stakeholder's views regarding four key issues in Personal Accounts:

- The suitability of Personal Accounts in the context of auto-enrolment.
- The charging structure for Personal Accounts.
- The appropriate level of any cap on combined contributions to Personal Accounts.
- The length of any waiting periods for automatic enrolment (and automatic reenrolment) into Personal Accounts and into exempt schemes.

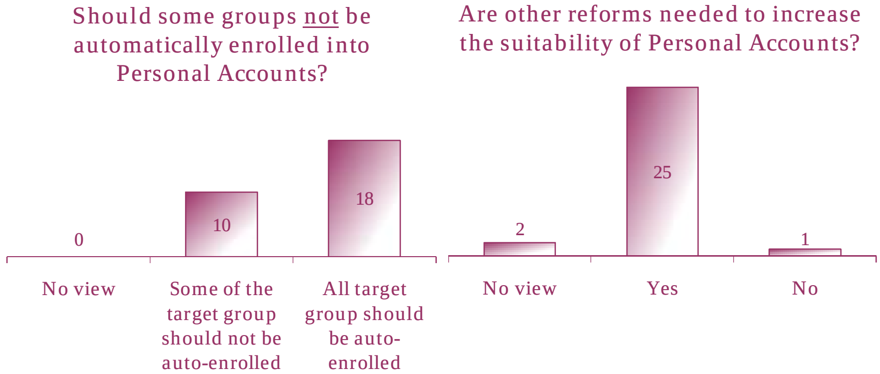
This Briefing Note represents the PPI's third stocktake, and offers an independent analysis of stakeholder views. Previous stocktakes[2] have explored the levels of consensus following:

- the Pensions Commission's recommendations in 2005; and
- the Government's first White Paper in 2006, which outlined proposed reforms to state pensions and the introduction of Personal Accounts.

Background

The PPI asked 43 organisations to respond to a short questionnaire that sought their views on key issues in Personal Accounts.

Chart 1: Suitability



28 organisations responded and their views are summarized here. A list of respondents and a sample questionnaire are published alongside this Briefing Note. Respondent organisations include charities, unions, pension providers, and representative bodies for consumers, business, and the pensions industry. 12 organisations are providers or representatives of providers from the insurance industry and where their responses create a bias this is noted.

This analysis provides a partial snapshot and should not be over-interpreted. It is intended to highlight the current state of opinion on specific issues in Personal Accounts policy and how this has shifted since the last PPI stocktake in October 2006.

Suitability (Chart 1)

The Government has proposed automatic-enrolment into a Personal Account (or an equivalent exempt scheme) for all employees aged over 22 and earning more than £5,035 a year, with the opportunity to opt out[3]. They argue that auto-enrolment is ***one of the most effective ways of combating people's tendency not to act when faced with difficult financial decisions***[4].

In 2006, we found that there was almost unanimous support for the principle of auto-enrolment but that many organisations had concerns about the suitability of Personal Accounts for some employees. Since then, the PPI has published research exploring issues of suitability and has identified that some groups of individuals may receive less favourable returns from saving in a Personal Account than others[5].

In this stocktake, respondents were asked if some people should not be auto-enrolled to mitigate the risk of saving in a Personal Account being unsuitable for them (Chart 1). 18 of the 28 organisations that responded to the questionnaire think that all of the target group should be auto-enrolled into Personal Accounts. Of the ten organisations that think some people should not be auto-enrolled, most are

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keen to exclude people who are at higher risk of Personal Accounts not providing good value from saving. Respondents suggest that this group includes people on low incomes, people nearing State Pension Age (SPA), and people nearing SPA with no prior savings. Respondents from the insurance industry did not show a bias in either direction on this question.

Respondent's overwhelmingly agreed that other reforms are needed to increase suitability of Personal Accounts. They suggested (in order of preference):

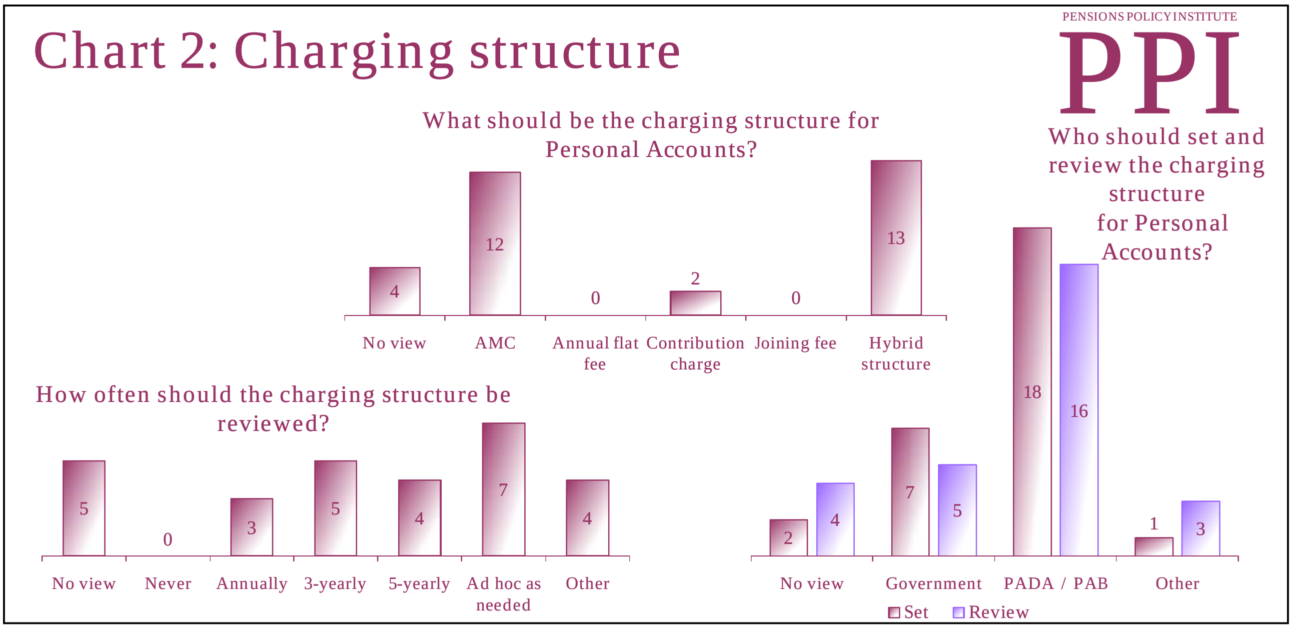
- Increasing the capital disregard limit for means tested benefits and the trivial commutation limit, so that more people with relatively small pension saving can withdraw it all as a lump sum.
- Allowing some or all private pension income to be taken without reducing means-tested benefits.
- Further reforms to the state pension system, particularly with the goal of reducing the level of means testing.
- Delivery of comprehensive unregulated generic advice to enable people to make informed decisions about saving in Personal Accounts.

Charging structure (Chart 2)
The Government has stated that ***through Personal Accounts the Government aims to provide people with a simple low-cost way of pension saving*** and that charges should be fair, especially to lower earners[6]. On this basis, they have sought views on what charging structure is most appropriate for Personal Accounts.

The PPI published a discussion paper and held a seminar in March 2007 regarding options for the charging structure of Personal Accounts[7]. The paper explored the impact of different charging structures on the size of the final pension fund for individuals with different work and savings profiles. It found that no single charging structure, or combination of charging structures has all the desirable attributes, and there are trade-offs that need to be made. Discussion at the seminar suggested that there was little consensus about what the charging structure for Personal Accounts should be.

This lack of consensus was confirmed by the current stocktake. 24 organisations expressed a view on the charging structure for Personal Accounts. Of these, 12 think it should be an Annual Management Charge, 13 support a hybrid of different charging structure options, and two organisations think charges should be based on contributions (three organisations expressed support for more than one option). Insurance industry respondents that expressed a view are mostly in favour of a hybrid structure. The most common suggestions for a hybrid charge structure are:

- AMC and contribution charge
- AMC and monthly/annual flat fee
- AMC and joining fee.



Several respondents suggested that the charging structure should seek to keep costs low for individuals with low and erratic contributions, possibly through a cap on charges for smaller accounts.

The questionnaire also sought organisations' views about who should set and review the charging structure. Most respondents think that the Personal Accounts Delivery Authority / Personal Accounts Board (PADA/PAB) should set and review the charging structure (18 and 16 respectively). Several respondents qualified this view saying that while the PADA/PAB should set and review the charging structure, Government should set parameters as guidance for them.

Around a third of respondents take an opposing view and think that the Government should set and review the charging structure (7 and 5 respectively). Some respondents said this could be on advice from the PADA/PAB.

Views are divided about how frequently the charging structure for Personal Accounts should be reviewed, and whether it should be reviewed on a periodic or ad hoc basis. On one hand, more frequent reviews may ensure that charges and therefore revenue are closely aligned with costs. However, on the other hand, frequent reviews could create uncertainty among members and potential future members if charges are seen to change too often or if changes are perceived to create unfairness between members joining Personal Ac-

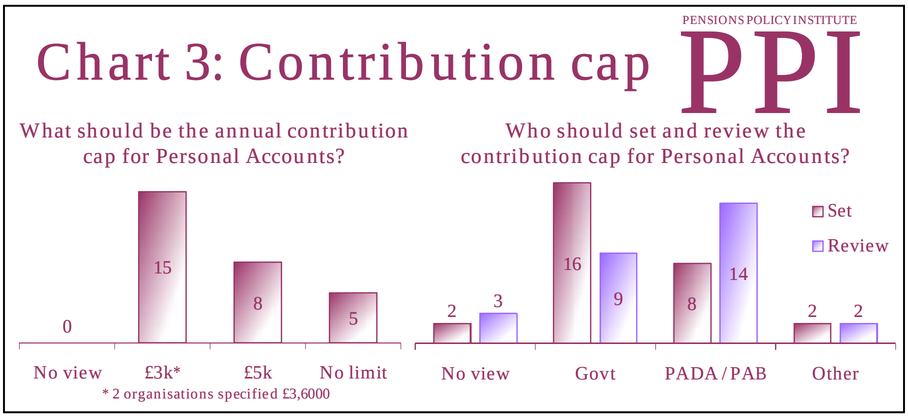


Chart 3: Contribution cap

counts at different times, for example, initial members pay higher rates in early years to meet the schemes start up costs.

Contribution cap (Chart 3)
In 2005, the Pensions Commission proposed that individuals should be allowed flexibility to make additional contributions to Personal Accounts (then called NPSS) above the default level so that they can reach their target replacement rates for income in retirement. They also argued that contributions should be capped, in order to minimise potential negative impact on existing provision[8].

On this basis, the Commission recommended an annual limit on combined contributions of twice the default level of contributions for a median earner. This amounted to around £3,000 in 2005. The Government has consulted on a proposal to set the contribution cap at £5,000, as they believe that a £3,000 limit ***would overly restrict the potential for voluntary saving***[9].

In the current stocktake, just over half of respondents (and nearly all of the respondents from the insurance industry) support a limit of around £3,000.

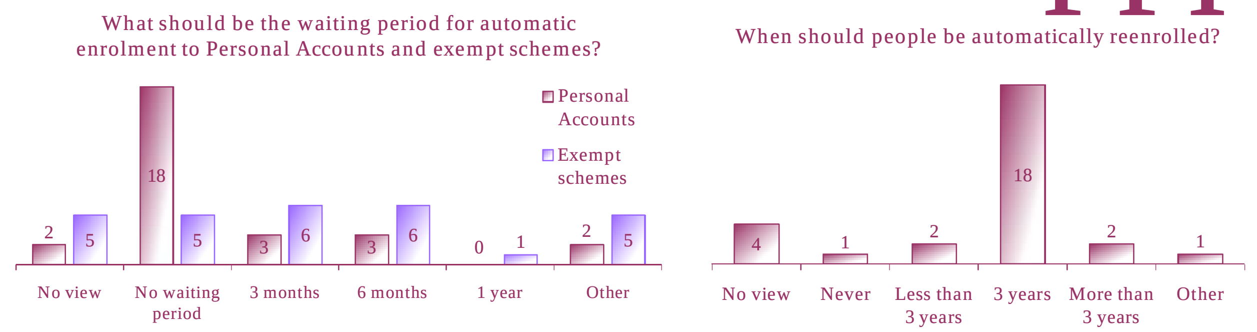
At the other end of the scale, five are in favour of there being no limit to Personal Accounts contributions, aside from the lifetime limits, and eight respondents support a limit of £5,000.

In the questionnaire we asked respondents what should be the <u>annual</u> limit on combined contributions, however at least three respondents commented that their organisation would prefer a lifetime limit instead.

Views are less varied as to who should set and review the contribution cap for Personal Accounts. Overall, respondents support Government setting the contribution cap but think that the PADA/PAB should have powers to review it. Several respondents commented that they think both PADA/PAB and the Government will need to be involved in the process to set and review the cap, with PADA/PAB providing advice to Government, who then take the final decisions.

Waiting periods (Chart 4)
The Government has proposed that there should not be a waiting period before new employees are auto-enrolled into Personal Accounts. However, they

Chart 4: Waiting periods



have sought views on whether exempt schemes, with an employer contribution higher than the minimum for Personal Accounts, may be allowed to operate a short waiting period before auto-enrolment as a way to encourage them to continue to offer high-quality schemes[10].

The PPI questionnaire found that respondents are mostly in agreement with the Government's proposal to not introduce a waiting period for Personal Accounts (18 out of 28). Views are, however, divided about the appropriate length for a waiting period for exempt schemes. Five organisations think there should be no waiting period for exempt schemes, six support a waiting period of 3 months, six support a waiting period of 6 months, and a further three (coded as 'other') specified it should be somewhere in the 3-6 month range. All of the respondents who support a waiting period of 6 months or higher are from the insurance industry.

Three respondents representing consumer and employee interests stressed that if there is a waiting period for exempt schemes, it should not disadvantage those employees. They suggested that employees could be automatically enrolled into Personal Accounts during the waiting period, or that combined contributions could be backdated when a waiting period has expired as ways to mitigate this risk.

Around two-thirds of respondents think that three years is about the right length of time before an employee is automatically re-enrolled into Personal Accounts or an exempt scheme. However, many respondents stated that reenrolment should be done on a set date each year, rather than on an employee's individual anniversary date, to minimise administrative burdens. Several respondents also raised concerns that other life changes and changes in circumstances may provide other triggers for reenrolment, but they recognise that reenrolment on this basis may be complex to administer.

Conclusions

Much has been made of the need for consensus regarding Personal Accounts. The PPI stocktake shows that there is consensus in several areas (such as the need for further reforms, not having a waiting period for Personal Accounts, and having a 3 year period before reenrolment), but views remain divergent on other specific aspects of the policy (including the charging structure for Personal Accounts and the level of the contribution cap).

However, Personal Accounts should be viewed as a package. Following further announcements about the design of the scheme, the PPI will take a holistic look at Personal Accounts, and the tradeoffs implicit in Government's design decisions. Our analysis will be presented later this year at a seminar on Personal Accounts sponsored by the Nuffield Foundation.

[1] DWP (2006 PA) ***Personal Accounts: a new way to save***
[2] PPI (2005) Briefing Note 18 and PPI (2006) Briefing Note 34
[3] See DWP (2006 PA) for detail of Government's proposals
[4] DWP (2006 PA) pg 51 para 1.6
[5] PPI (2006) ***Are Personal Accounts suitable for all?***
[6] DWP (2006 PA) pages 91 and 97
[7] PPI (2007) ***Charging structures for Personal Accounts***
[8] See The Pensions Commission (2005) ***A new pension settlement for the twenty-first century***
[9] DWP (2006 PA) pg 141 para 7.24—see also PPI (2007) Briefing Note 38 for analysis related to the contribution cap.
[10] DWP (2006 PA) pg 121 para 6.31