PENSIONS POLICY INSTITUTE

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PRESS RELEASE

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"People will need very clear information to help them decide whether to stay in or opt out of the new Personal Accounts" says Pensions Policy Institute

The Government has today published its White Paper on private pension reform. The White Paper sets out the Government's proposals to introduce a new scheme of Personal Accounts from 2012. Under the reforms, employers will be required to automatically enrol their employees either into an existing occupational pension or into the new Personal Accounts and to make contributions of 3 per cent of salary unless employees opt-out.

Niki Cleal, PPI Director said "The good news is that Personal Accounts could give access to a low-cost pension with an employer contribution to many people for the first time when they are introduced in 2012."

"The PPI's analysis has shown that today's young people are likely to get good effective rates of return if they contribute to their Personal Account throughout their working lives. However some self-employed people or those who rent in retirement may be at higher risk of Personal Accounts being unsuitable for them."

"The Government will need to ensure that people with low to median earnings have good incentives to save for their retirement and that people have access to clear information to help them to make informed decisions about whether they should stay in or opt out of Personal Accounts."

"The Government's decision to phase in the introduction of the compulsory employer contributions, to limit transfers into Personal Accounts until 2020 and to consider introducing a quality mark for good occupational pension schemes should help to reduce the potential negative impact on existing occupational pension provision. However, it remains to be seen how employers and individuals will actually respond to these proposals when they are introduced in 2012."

"The Delivery Authority will have a critical role in finalising the detail of Personal Accounts over the next few years, and ensuring that the final Personal Account framework works well for individuals, employers and the pensions industry."

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Notes for editors

The PPI is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions (state and private) through research and analysis, discussion and publication. It does not lobby for any particular issue, but works to make the pension policy debate better informed.

The PPI recently published a report *Are Personal Accounts suitable for all?* The report considers the interaction between the proposed system of Personal Accounts, state pensions, the tax system and means-tested benefits in detail in order to identify groups for whom Personal Accounts are likely to be suitable and those for whom they may not be suitable.

The full report is available on the PPI's website: www.pensionspolicyinstitute.org.uk. A summary of the report's conclusions follows.

Summary of conclusions: are Personal Accounts suitable for all?

The Government recently proposed a new system of Personal Accounts be introduced from 2012. Auto-enrolment into private pension provision has potential advantages and should lead to an increase in the number of people saving for retirement.

Personal Accounts could give many people access to a low-cost pension savings product with an employer contribution for the first time. As a result of the low charges and employer contribution, incomes from saving in Personal Accounts are likely to be higher than incomes from saving in Stakeholder Pensions for many people.

Inevitably, auto-enrolment raises questions about the suitability of Personal Accounts for the employees who are auto-enrolled. In this paper, Personal Accounts are defined as being 'suitable' if individuals do not lose out as a result of their saving. This is less a stringent definition than ensuring that saving in Personal Accounts is the right thing for all consumers, which would be more consistent with the FSA's definition of 'suitability'.

In this paper, individuals are categorised by being at low risk, medium risk or high risk of Personal Accounts being unsuitable for them, depending on the effective level of return that they are likely to receive.

No single definition of 'suitability' is likely to be appropriate for the circumstances of every individual. For some people, it may be rational to save even if they have a low return on their saving, for example, if they have a strong preference to smooth consumption over their lifetime. On the other hand, some people may require a high return, for example if they are very risk-averse or have high levels of debt.

People at <u>low risk</u> of Personal Accounts being unsuitable for them are likely to receive back the value of their individual contributions to Personal Accounts, together with a full investment return on their contributions. Examples are:
- Single people in their twenties in 2012 with full working histories.
- Single men in their forties and fifties in 2012 who have a full working history and large additional savings.

People at <u>medium risk</u> of Personal Accounts being unsuitable for them would receive back the value of their individual contributions, protected for inflation, and some investment returns on their contributions, although they may not receive full credit for the investment returns. This group includes:
- Single people in their twenties in 2012 with low earnings and broken working histories, whether because of caring breaks or unemployment.
- Single people in their forties and fifties in 2012 with low earnings and full working histories.
- Single people in their twenties in 2012 who stay opted in to Personal Accounts while employed, and then become self-employed at a later date.

People at high risk of Personal Accounts being unsuitable for them are likely to receive back less than the value of their contributions into Personal Accounts. This group includes:

- Single people who are likely to rent in retirement and have no additional savings.
- Although they would not be auto-enrolled, single people in their forties and fifties in 2012 on low to median incomes who are self-employed.

Other factors can affect whether or not Personal Accounts are suitable:

- Returns from saving in Personal Accounts could be higher for people who are married at some point in retirement, rather than always single as the above examples assume. The majority of pensioners are married at some point in their retirement, so this could improve suitability for many people.
- It may still be advisable for some people in the high-risk category to save. For example, they could have a strong preference to smooth consumption over their lifetime.
- Conversely, it may be not advisable for people in the low-risk category to save, for example if they have high levels of debt. Levels of both secured and unsecured debt appear historically high and a sizeable minority of people carry over credit card balances from month to month.
- Whether contributions are affordable will depend on individual preferences on current expenditure and saving.

If Personal Accounts are not suitable for everybody, then this does not necessarily mean that individuals should not be auto-enrolled. But it does have important implications for what information is needed to help people make informed decisions about whether they should opt out.

Some of the factors that affect the suitability of Personal Accounts could be more problematic than others to incorporate into a system of generic information. Clearly, no-one can predict with certainty all of their future life circumstances when making a savings decision. Some factors may be relatively straightforward to reflect in a system of generic information, such as current age, earnings and level of debt. Others may be more difficult, such as the affordability of contributions and likely future housing or marital status. However, these findings do suggest that people will need very clear information to help them make informed decisions about whether they should stay in or opt out of Personal Accounts.

Two further factors for the Government to consider are:

- The design of the information provided for Personal Accounts may need to change over time, to reflect the gradual transition to the proposed pensions system, which could affect today's younger and older workers differently.
- Trivial commutation may improve returns from saving in Personal Accounts. How the trivial commutation limit is uprated in future could make a large difference to some people.