Budget 2012 – Building Better Pensions

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Executive summary

The Coalition Government has been active on pensions since it came to office in June 2010. However, more work needs to be done to restore trust and confidence in the UK's pension system and meet the Government's commitment to reinvigorate workplace pensions. The impending "Pensions Spotlight" in the Government's Red Tape Challenge is a step in the right direction, but the Government must demonstrate that it takes seriously the burdens placed on pension schemes by excessive regulation and needs to use this as an opportunity to examine all aspects of pension regulation, including state pensions and automatic enrolment.

In this submission, the NAPF calls on the Government to build a better pensions system by taking bolder steps to reinvigorate occupational pensions. To provide the right foundation for saving, the Government must urgently press ahead with its **plans to reform the state pension system** into a single flat rate pension set above the level of means tested benefits. Radical reform will ensure that people who save into a pension can do so with confidence and ensure that auto-enrolment is a success.

Given the further change to the auto-enrolment timetable announced last year, the Government must **reaffirm its commitment to rolling out auto-enrolment for all employers**. Any further delays and changes to the coverage and timetable will only undermine confidence in pensions and the ultimate success of the reforms.

As a first step towards restoring trust and confidence in pensions, the Government must **abandon any plans to make further changes to the pension tax system**. There has been colossal upheaval to the pensions tax regime over the last few years – adding costs to business and schemes and damaging confidence in pensions as a way to save. The Government needs to stop tinkering with the system and provide stability so people can plan and save with confidence.

The Government needs to make **decumulation** work and ensure people shop around and achieve the best annuity value when turning their pension pot into an income. The enclosed report highlights the many problems with the current annuity market – a failure to act to solve these problems will mean thousands of people missing out on value income in their retirement further denting confidence in our pension system. The NAPF has also outlined a number of ways the Government could help to improve the way the annuities market works, if the industry fails to resolve the issues itself.

Historically pension funds have shied away from investing in i**nfrastructure**. We are hopeful that the work that the NAPF is currently undertaking, along with some of our largest scheme members, the PPF and IUK, will unblock this. But the Government needs to play its part and create the right environment and structures so deals can be provided that meet the needs of pension funds.

The Government should issue more **long-dated and indexed linked gilts** for 2012/13 – there is an insatiable demand from pension funds for these instruments given regulation and accounting has pushed pension funds down this route.

Recommendations

Recommendation 1: The Government should urgently press ahead with its plans to reform the state pension system into a single flat rate pension set above the level of means tested benefits. Bold and radical reform will ensure that people who save into a pension can do so with confidence and ensure that auto-enrolment is a success.

Recommendation 2: Given the further change to the auto-enrolment timetable announced last year, the Government should reaffirm its commitment to rolling out auto-enrolment to cover all employers – further delays and changes to the coverage and timetable will only undermine confidence in pensions and the ultimate success of the reforms.

Recommendation 3: There should be no further changes to the pension tax system. There has been colossal upheaval to the pensions tax regime over the last few years – adding costs to business and schemes and damaging confidence in pensions as a way to save. The Government needs to stop tinkering with the system and provide stability so people can plan and save with confidence.

Recommendation 4: The Government needs to make decumulation work and ensure people shop around and achieve the best annuity value when turning their pension pot into an income.

Recommendation 5: The Government must issue more long-dated and indexed-linked gilts for 2-12/13. There is an insatiable demand from pension funds for these instruments give regulation and accounting have pushed pension funds down this route .

About the NAPF

1. The NAPF is the leading voice of workplace pension provision in the UK. We represent 1,200 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. We represent both public and private sector schemes, including 75% of the local authority pension funds. Our members provide pensions for 15m people and collectively hold assets of £800bn, accounting for a sixth of investment on the UK stock market. Our main objective is to ensure there is a secure and sustainable pensions system in the UK.

Detail

Introduction

2. The Coalition Government has the ambition to build a better pensions system for the UK. Since coming to office, the Government has set out its blueprint for a better pension system and started the process of reinvigorating pensions. The Government has already:
    a. Laid the foundation for workplace pension saving by bringing forward proposals to reform the UK's creaking state pension system;
    b. Committed to plans to reinvigorate occupational pensions and to cut regulation on employers and schemes; and

c. Reviewed the detail of automatic enrolment and the new National Employment Savings Trust.

Although a lot of the groundwork has already been done, we now need to turn these blueprints into something that will last for generations of UK savers.

3. The UK used to have a pension system that was the envy of the world. However, excessive regulation, fluctuations in recent stock market performance, improvements in longevity and changes in accounting standards have all contributed the decline of DB pensions.

4. Unless the Government demonstrates that it is serious about its commitment to reinvigorate occupational pensions, there is a risk that trust and confidence in the UK pensions system will be damaged beyond repair. Urgent action is needed to fix our pension system and we hope that the Budget 2012 will be one that can build a pension system we can be proud of.

5. The NAPF looks forward to the launch of the Government's 'Pensions Spotlight' later in the spring, and has already begun a Call for Evidence with our fund and business members to shape our own deregulatory proposals in this area[1]. We understand that the Red Tape Challenge is unlikely to include within its scope the regulation around state pensions and auto-enrolment, but would ask the Government to be open to proposals from our members in this area that could genuinely reduce regulatory burdens by cutting back on unnecessary processes.

6. There are also likely to be areas raised by our members, including simplification of the pensions tax regime and administration, EU and international regulation and accounting standards, and areas of overlap between the remit of the Pensions Regulator (tPR) and the Financial Services Authority (FSA), where a joined up response across DWP, HMT and BIS will be required. The NAPF is keen to work with DWP, HMT, BIS and No 10 in developing evidence based proposals that can reduce unnecessary red tape and reinvigorate occupational pension saving.

State Pension Reform

7. The NAPF has been arguing for a simpler, more generous Foundation Pension for some time. We believe a Foundation Pension, combining the Basic State Pension and State Second Pension set above the means tested benefits threshold, is absolutely fundamental to changing people's attitudes towards saving for retirement and to making automatic enrolment a success. The introduction of a Foundation Pension would mean that people can save for their retirement with confidence, knowing their savings will not be eroded away by means tested benefits.

8. This is why we were extremely pleased when the DWP published its Green Paper *A state pension for the 21st century* last spring. With the introduction of automatic enrolment only a few months away, it is imperative that people understand what "the deal" is before they make decisions about whether to remain automatically enrolled or whether to opt out. The benefit of a Foundation Pension is that it complements the introduction of auto-enrolment, ensuring that people know it "pays to save" in workplace pensions.

[1] http://www.napf.co.uk/PolicyandResearch/CFE_Better_Regulation.aspx

9. In July the DWP published a summary of responses to its Spring 2011 Green Paper *A state pension fit for the 21st century* which showed widespread consensus amongst respondents that the UK's current state pension system is too complex and needs to be reformed. The majority of respondents to the Green Paper argued for combining the Basic State Pension and State Second Pension (Single Tier) option. We call on the Government to make statement of progress at the Budget.

10. This is not to say the Foundation Pension is without difficulties. There will be complex transitional issues, especially for contracted out DB schemes. Ending DB contracting out as required by the Foundation Pension will have significant implications for employers and schemes. This is why it is vital that the Government provides measures to help employers and schemes cope with the ending of DB contracting out. In particular, the Government must provide employers with a statutory override to help them manage the loss of the contracted out rebate. We also believe the Government should relax the consultation requirements when employers make changes directly resulting from the ending of DB contracting out. In combination, these measures will give employers the help they need to make ending DB contracting out a success.

11. Giving certainty to schemes is one way the Government can help make the process of ending DB contracting out easier. Schemes will need at least five years to prepare for the ending of contracting out, so we encourage the Government to publish its response to the Green Paper as soon as possible.

Recommendation 1: The Government should urgently press ahead with its plans to reform the state pension system into a single flat rate pension set above the level of means tested benefits. Bold and radical reform will ensure that people who save into a pension can do so with confidence and ensure that auto-enrolment is a success.

Automatic Enrolment

12. In the year of the London Olympics, we must not forget the other reason why 2012 is so important. The introduction of automatic enrolment in October 2012 will be a huge step forward for the UK pensions system and will mean that millions of people who would otherwise be consigned to poverty in retirement will be saving in a pension.

13. The NAPF has been supportive of automatic enrolment from the start. Despite the fact that the reforms will put a great deal of pressure on employers in terms of cost and administrative burden, we recognise that this is a once-in-a-lifetime opportunity to change the way people save for their retirement.

14. Over the past year, the Government has made a number of welcome improvements to the process of automatic enrolment to make it easier for employers and schemes to manage. The Pensions Act 2011 introduced measures such as waiting periods and a system of self-certification which means employers will have a bit more flexibility when it comes to how and when they automatically enrol their employees. But now that the detail has been finalised, it is imperative that employers are given certainty so they can carry on and implement these highly complex reforms.

15. This is why the NAPF was disappointed when the Government recently revised the automatic enrolment timetable. Whilst we understand the political reasons for giving smaller employers more time to prepare for automatic enrolment, it is vital that all employers – including small employers — are covered by automatic enrolment. It has now been almost a decade since the Pensions Commission first recommended the introduction of automatic enrolment and what the pensions world needs more than ever is confidence that the automatic enrolment regime will not undergo any further changes.

16. The NAPF has also been focussing on areas where employers' and individuals' confidence in pensions could be increased to help ensure automatic enrolment is a success and as few people as possible opt out of saving for their retirement. We believe it is important to be upfront about the "deal" – making sure people understand both the benefits of saving in a pension as well as the costs of doing so. This is why we are leading work on creating an industry-led Code of Practice on the disclosure of costs and charges in pension schemes.

Recommendation 2: Given the further change to the auto-enrolment timetable announced last year, the Government should reaffirm its commitment to rolling out auto-enrolment to cover all employers – further delays and changes will only undermine confidence in pensions and the ultimate success of the reforms.

Pensions tax

17. The UK tax system is designed to adequately incentivise people to save for their own retirement and for this reason pension contributions are treated as deferred income. The Coalition Government has already introduced restrictions on the annual allowance and lifetime allowance which are designed to better target pensions tax relief on those who it most. This system is more workable for both pension schemes and savers than the system of restricting higher rate relief proposed by the previous government.

18. What the system now needs is stability. The NAPF has in no uncertain terms called on the Government to abandon any plans to make further changes to the pensions tax regime. With the introduction of automatic enrolment only a few months away, it is vital that the Government sticks to its commitment to reinvigorate occupational pensions so employers can provide good quality pensions and so employees can save for their future.

19. By following a course of restricting higher rate relief or further limiting the amount that individuals can save into a pension, the Government would be fundamentally damaging pension provision. It would be a course of action that would cause future generations of employers and individuals to disengage with pension saving.

Recommendation 3: There should be no further changes to the pension tax system. There has been colossal upheaval to the pensions tax regime over the last few years – adding costs to business and schemes and damaging confidence in pensions as a way to save. The Government needs to stop tinkering with the system and provide stability so people can plan and save with confidence.

Decumulation

20. The choices people make as they approach retirement can have a significant impact on their income, for better or for worse. In a DC world, individuals must make a decision for themselves on how to turn their pension pot into the most suitable type of income. But throughout most of their retirement savings journey, decisions have been made for them. The introduction of automatic enrolment and the widespread use of default funds will depend on savings inertia and lack of engagement. It should come as no surprise that people exhibit the same inertia when it comes to making decisions about retirement income.

21. In an effort to improve the way people make retirement income choices, the DWP and HM Treasury tasked the longstanding OMO Review Group with finding a way to improve the Open Market Option (OMO). The OMO is supposed to encourage people to shop around for a better deal, but there is a general agreement that more needs to be done to improve the way the OMO works. The ABI statistics suggest that only 70% of people 'shop around' for their annuity, with only a subsequent 44% purchasing an annuity from a provider other than the one that provided their pension scheme

22. However, the definition of 'shopping around' used by the ABI only asks whether another provider was considered. It does not measure whether there was any real engagement in shopping around, whether other products and rates were investigated, or whether or not changing provider was the best outcome for the member. The presentation of the statistics also tends to imply that shopping around and not changing provider is evidence that it would not have been in the member's best interests to switch. Preliminary analysis that the NAPF has commissioned from the IFS suggests that shopping around is less prevalent amongst women, as well as those with lower income, lower wealth, lower education and lower numeracy. Worryingly, it also tends to be slightly lower amongst smokers than non-smokers, who are a group likely to benefit from shopping around due to eligibility for enhanced rates.

23. In December 2011, the ABI launched a consultation on a draft Code of Conduct. The Code will require ABI members to remove the annuity application form from the communications they send to customers as they approach retirement. The Code also aims to improve the information customers receive as part of their pre-retirement wake-up packs.

24. The NAPF supports any efforts to improve the way people make retirement choices and we welcomed the ABI's Code of Conduct. But we believe the issues around decumulation go beyond the provision of information to individuals at the point of retirement. Some of the more fundamental issues around the structure of the annuity market, particularly around the pricing of annuities and access to specialist annuity advice, still warrant further investigation.

25. We believe a set of more radical reforms must be implemented alongside the ABI's Code of Conduct in order to develop an efficient, cost-effective and transparent default annuity process in the long term. Importantly, greater transparency and disclosure in the annuities market could drive change although regulatory intervention may be necessary if the industry cannot improve on its own. In particular, the Government must:

a. Signal its commitment to improving the annuities market by considering the merits of establishing a national advice service and/or an annuities clearing house to serve the needs of the lower end of the market if the industry cannot deliver good outcomes for this group;
b. Promote greater transparency by establishing a baseline to allow it to monitor improvements in shopping around, levels of engagement and outcomes in retirement; and
c. Consider whether regulatory intervention may be needed to improve member outcomes by automatically directing members to third party/whole of the market advice service where the scheme does not already have them in place.

Recommendation 4: the Government needs to make decumulation work and ensure people shop around and achieve the best annuity value when turning their pension pot into an income.

Infrastructure

26. Following the announcement in the autumn statement, the NAPF, PPF and HM Treasury have been working closely together to understand the issues around why pension funds have such a low investment allocation to infrastructure and whether we could create a vehicle or platform to facilitate increased investment.

27. Increasing private investment in UK infrastructure is a significant challenge and if we can successfully establish an infrastructure investment platform, owned by UK pension funds, then we believe this will go some way in delivering the much needed investment that is required. But the Government needs to play its part by creating the right environment for pension funds to have access to the types of investment that they want. Pension funds will only look to infrastructure as an investment if it has the right level of risk, is of long enough duration and provides the inflation linking that pension funds crave.

28. Discussions are currently on-going with IUK, but good progress is being made.

Gilt issuance

29. The decision by the Bank of England's Monetary Policy Committee to resume quantitative easing (QE) has further depressed returns on pension schemes' holdings of gilts and on other long-term assets. This has had a dramatic impact in widening pension fund deficits and reducing the returns that pension funds can get on investment of new money and reinvestment of maturing debt holdings and interest and dividends. Both reduce the affordability of providing decent pensions and undermine the sustainability of occupational pension provision.

30. Pension scheme liabilities are long-term and schemes need assets of the right duration to match liabilities. Over the past five years, DB pension scheme allocations to gilts and fixed income assets have risen from 28% to 40% of total assets (Purple Book, 2011). Today DB pension funds own around £75bn of government fixed income securities and £140bn of index linked securities. The

continuing trend to de-risking means that schemes will wish to increase their allocations to long dated, index linked assets, which better match their liabilities.

31. The 2011-2012 remit saw a welcome increase in index-linked issuance, up by 13.6 per cent, but we were disappointed that index-linked and long-term conventional issuance combined was little changed as a proportion of total from the previous year.

32. We continue to recommend a further sharp increase in long-term – and particularly long-term indexed – issuance in 2012-2013. Pension scheme de-risking and insurance company solvency requirements mean that there will be continued strong demand from pension schemes and insurance. We believe that there is pent-up pension fund demand for long-term conventional and indexed issuance that will become even more apparent when interest rates rise.

33. Long-term gilts remain extremely good value for the Government. The yield on conventional long-term gilts remains extremely low, while the real yields on long-term indexed-linked gilts have become negative.

34. It is important that the Government keeps the case for the issuance of CPI-linked gilt issuance under review. With more pension fund liabilities linked to the Consumer Price Index we are convinced that there will be strong demand for CPI-linked issuance, provided CPI-linked gilts can be issued without undermining the wider inflation-linked gilts market.

Recommendation 5: The Government must issue more long-dated and indexed-linked gilts in 2012-13. There is an insatiable demand for these instruments given regulation and accounting have pushed pension funds down this route.

Further information

For further information please contact:

Darren Philp
Director of Policy
darren.philp@napf.co.uk
020 7601 1700

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