House of Commons

Treasury Committee

The design of a National Pension Savings Scheme: Government Response to the Committee's Fifth Report of Session 2005–06

Fifth Special Report of Session 2005–06

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The Treasury Committee

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Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997–98 onwards are available on the Internet at www.parliament.uk/parliamentary_committees/treasury_committee

Committee staff

The current staff of the Committee are Colin Lee (Clerk), Fiona McLean (Second Clerk and Clerk of the Sub-Committee), Dominic Lindley and Adam Wales (Committee Specialists), Lis McCracken (Committee Assistant), Michelle Edney (Secretary) and Tes Stranger (Senior Office Clerk)

Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk. Media inquiries should be addressed to Luke Robinson on 020 7219 5693

Fifth Special Report

The Treasury Committee published its Fifth Report of Session 2005–06, *The design of a National Pension Savings Scheme*, on 21 May 2006, as House of Commons Paper No. 1074–I. The Government response to this Report was received on 21 July 2006. Because the response was received after the Committee's last meeting before the Summer Recess, the response has already been made available on the HM Treasury website at the Chairman's request. The text of the response is now appended below.

Appendix: Government response

The Government notes the conclusions of the Treasury Committee's Report on The design of a National Pension Savings Scheme.

Introduction

The Government welcomes the Treasury Committee's report on the design of a National Pension Savings Scheme and the role of financial services regulation.

The Report commends the Pensions Commission for stressing the challenges and the opportunities presented by the economic, demographic and social changes in the coming century in its second report. The Committee fully endorses the Commission's recommendation on the need to both fully address these factors and to ensure a coherent and consensual approach in order to provide a sustainable settlement.

The Government published its wide-ranging proposals to reform the State and private pension systems in the White Paper, Security in retirement: towards a new pensions system, on 25 May 2006. The White Paper proposes a simpler, fairer State pension, with broader coverage, less means-testing and a stronger basis on which to build a more robust private pensions system. These proposals represent a radical reform to the UK's pension system and the Government is currently consulting on these proposals with a number of external stakeholders including: the pensions industry; representatives of employer, employee and trade union groups; and charities.

The period of consultation on the proposals contained in the White Paper ends on 11 September 2006. The Government will publish a document later setting out move detailed proposals on the introduction of personal accounts. The Government welcomes the Committee's recognition of the importance of this ongoing engagement to secure a sustainable and lasting settlement that commands consensus.

The report is a valuable contribution to arriving at a consensus solution and many of the Committee's recommendations have been proposed in the White Paper or are areas where the Government has set out a further programme of work to take forward the proposals to introduce personal accounts.

Conclusions and Recommendations

White Paper proposals

The Committee has made a number of specific recommendations and conclusions. Many of these are proposed in the White Paper—in particular the Government believes that the following recommendations form part of the White Paper proposals.

1. One of the starting points for consideration of proposals by the Pensions Commission and of rival proposals must be the realisation that Stakeholder pensions have not been successful in halting the decline of non-State pension provision among middle earners. Indeed, a combination of sales approaches, commission incentives, regulatory requirements and decisions about the charge cap have created a position in which Stakeholder pensions are seen as uneconomic to both providers and potential customers among the original target market of middle income earners. The lessons from this process must be learned in taking forward proposals arising from the work of the Pensions Commission. We have sought to draw out these lessons in our ensuing conclusions and recommendations. (Paragraph 21)

Stakeholder pensions have been a success for its target audience and their introduction has made a good value personal pension vehicle widely accessible for the first time. This is backed up by the sales figures which show that:

- Just over 2.7 million stakeholder pensions have been sold from their introduction on 6 April 2001 to 31 December 2005.
- Stakeholders are being bought by their target market of moderate earners; around two-thirds of those taking up the pension are workers earning less than £20,000 a year.
- 99% of stakeholder pensions receiving contributions in 2003/04 were held by people in work.
- In 2004/05, total contributions to stakeholder pensions were around £2.4 billion.

The Government proposes to build on the success of stakeholder pensions and introduce a low-cost saving scheme of personal accounts for low- to middle-income earners who have not been traditionally targeted by the pensions industry.

2. The Pensions Commission is to be congratulated for bringing about a broad consensus in favour of auto-enrolment as the basis for securing a major advance in the level of private pension saving among middle earners. A move to auto-enrolment is an essential precondition if the NPSS or any rival option is to be implemented. (Paragraph 33)

The White Paper confirms the Government's commitment to introducing auto-enrolment into either personal accounts or a workplace-based private pension for eligible employees to maximise coverage and address savings inertia.

3. The compulsory matching employer contribution is an integral element of the NPSS and of the rival options. If there were to be no such contributions, the FSA's evidence indicates that it is unlikely that participation in the proposed scheme or schemes could

be provided for without some regulated advice. With the increased costs consequent upon the need for such advice and diminishing contributions overall, it appears open to question whether a new scheme or schemes without such contributions would represent a step-change from Stakeholder pensions. (Paragraph 40)

The White Paper confirms the Government's commitment to introducing compulsory matching employer contributions where an employee remains opted in to personal accounts or a workplace private pension scheme.

4. The successful delivery of a new pension saving vehicle suitable for the vast majority of those eligible to contribute and thus not requiring regulated sales advice is contingent upon expectations about the extent and future course of means-testing for pensioners. These expectations are dependent not only on announcements expected in the Pensions White Paper, but also on the ability of present and future Governments to establish a policy framework based on a broad political consensus, together with accompanying forecasts on those eligible for means-testing, which deserve and attract the confidence of the public. (Paragraph 49)

The White Paper proposals on state pension reform set out the Government proposals to reduce the spread of means testing, providing a clear foundation from which individuals can save for their retirement. These proposals have commanded widespread consensus.

16. There is a great and unique opportunity to reverse the decline in private pension provision and restore confidence in long-term savings. For this opportunity to be seized there needs to be an integrated approach in which three preconditions are met. The first precondition is that the correct balance is struck between the role of the State in securing and promoting a new pension savings product and the sense of individual ownership. The second precondition is that the new product maintains the simplicity and near-universal suitability proposed by the Pensions Commission to minimise cost and the need for regulation. The third precondition is that reform of private pension saving takes place in tandem with a new direction in the State pension system. (Paragraph 81)

The Government believes that the package of reforms detailed in the White Paper meets the three pre-conditions outlined above:

- the portability of personal accounts will enable individuals to hold a single pension account through their working lives, thereby engendering a sense of individual ownership;
- the introduction of a low cost system of personal accounts; and
- State Pension reforms will create a solid foundation on which people can build up private savings.

These proposals will meet the pensions challenge in the long- term and provide a long and lasting settlement.

Ongoing work programme

The other recommendations and conclusions set out the Committee's view on how the Government should take forward its programme of work. The Government welcomes the Committee's insight in this area and will take these comments into account as its moves towards the detailed design phase of personal accounts. Looking at the individual recommendations:

5. It is of vital importance not only that the Government establishes a long-term coherent approach to policy on private and public pension provision and communicates effectively with the FSA in relation to the FSA's regulatory requirements, but also that the Government continues to provide leadership and support to ensure that a regulatory position on suitability in relation to the NPSS or a rival option, once arrived at by the FSA, proves sustainable in the long-term. (Paragraph 50)

The Government is committed to ensuring that an effective and robust regulatory regime is established for personal accounts. The nature of the regulatory regime for personal accounts, the necessary enforcement powers, and how they might be applied is an issue the Government is considering, working closely with the Pensions Regulator and the Financial Services Authority to reach a consensus on a long-term, sustainable regulatory framework.

6. We recommend that the Government give consideration at an early stage in implementation of an NPSS or any comparable measure to the design and availability of generic advice to those considering participation in the scheme as well as to scheme members. It may well be that the requirement for generic advice in this context will need to be met as part of wider endeavours to improve the quality of generic financial advice that we are considering during our current inquiry into financial inclusion. (Paragraph 51)

The Government agrees it is vital that communication with members of the new scheme is designed to help them, to make informed decisions about their saving.

- The White Paper confirms the Government's commitment in this area and sets out an extensive work programme in this area, involving:
- developing an information and communications strategy to support the introduction of personal accounts, including a high-level awareness-raising campaign, and specific information and support to employers, individuals and the voluntary sector;
- continuing our work on improving public understanding of pensions; and
- working with the FSA and others on a broader financial capability strategy.

7. One of the keys to the success of the NPSS or an alternative that is implemented is the minimisation of the need for regulation, because regulation entails additional costs. The NPSS and the NAPF model remove the element of employee choice about a provider, and thus the possibility that such a choice may have regulatory implications. The ABI model introduces consumer choice. From the evidence we received, not least from the FSA, it seems likely that such choice will create additional regulatory requirements which may in turn affect the overall costs of any scheme based on that

model. This places an additional onus on the ABI to provide convincing evidence that provider competition will serve to drive down costs. (Paragraph 59)

As set out in the White Paper the Government is currently carrying out an assessment to identify the best delivery model for personal accounts, considering inter-alia value for money for the taxpayer and the saver and the impact of consumer choice and competition.

8. The availability of investment choices which are clearly signposted and accompanied by appropriate information about risk and reward is highly desirable and catered for under the proposed design of the NPSS. Nevertheless, much evidence suggests that most members will remain in the default fund. The design of the range of funds, especially the default fund, and the quality of asset management of the funds, would be crucial to the success of the NPSS. We expect the case for independent scrutiny, especially of the default fund, to be one of the issues to be considered during parliamentary scrutiny of the measures arising from the White Paper. (Paragraph 63)

The Government agrees that consumers must have access to good quality information about pensions and retirement planning to help them make informed decisions about saving for retirement. As set out in our responses to recommendation 6, we have set in train an extensive work programme in this area. This will include the scrutiny and governance arrangements for personal accounts.

The issue of the range of funds available and default options will depend on the delivery model adopted for personal accounts.

9. If the Government sets out the detail of governance arrangements for a single provider of pensions and funds within a single scheme, based on the proposals of the Pensions Commission, it will be important for the Government to clarify at an early stage the likely responsibilities of the FSA for prudential regulation in relation to the provider and funds within a single scheme. The Committee endorses the recommendation of the Pensions Commission that the governance should secure an institution which is clearly separate from direct government influence and which is also, in the words of the Commission "clearly public and non profit-making". (Paragraph 64)

The system of governance of personal accounts will depend to some degree on the delivery model adopted. The Government is currently working with the Pensions Regulator and the FSA on this issue.

10. There is a possibility of effective public sector purchase of relevant administrative services from the private sector, provided that the purchasers on behalf of the NPSS or any similar national scheme have the relevant skills, whether acquired in the public or private sectors. It is important that overall administrative costs are minimised and that an appropriate balance of risk between public and private sector is achieved. (Paragraph 68)

The Government agrees that administrative costs in personal accounts should be minimised and recognises the importance of ensuring risk is managed effectively. These factors will be taken into account in the assessment of the most appropriate delivery model to personal accounts.

11. In the event that the Government proposes a model for private pension provision based on the NPSS, we recommend that the Government, in its response to this Report, set out the matters that will need to be considered before a final decision is reached on collection systems. (Paragraph 69)

The issue of appropriate collection systems is a matter that will be taken into account in the assessment of the most appropriate delivery model for personal accounts. In particular we would like to ensure it is low cost, efficient and easy for the employer.

12. We welcome the early indications from the FSA that it will be alert to the possibility of mis-selling within the context of transfers in and out of the NPSS. It is essential that information provided to members and potential member of any new scheme includes clear guidance on circumstances where it might and might not be appropriate to transfer in or out of the scheme. (Paragraph 71)

As set out in our responses to recommendation 6, we have set in train an extensive work programme on the information requirements for personal accounts.

13. Experience of Stakeholder pensions indicates that market operators may exert pressure for any charge cap to be increased and may tend to serve the most profitable parts of a market, not those most in need. (Paragraph 75) &

14. It is of crucial importance to the success of the NPSS and the overall trend of private pension savings that the Annual Management Charge is as low as possible and moves in a downward direction. An independent Board of the NPSS would have every incentive to see charges low and falling, as would the trustees of a Super Trust. (Paragraph 76)

The Government is strongly committed to a low-cost management structure for personal accounts. One of the key objectives of personal accounts is to reduce the cost of pensions saving. The level of charges will be one of the key criteria in the assessment of the most appropriate delivery model for personal accounts, including how charges would fall further over time.

15. We agree with Lord Turner that the higher social priority in this area is to promote additional pension provision for those who currently lack it. Nevertheless, we consider that the market impact of a new scheme, both prior to implementation and following implementation, merits further study and we recommend that the Government give further consideration to these issues at an early stage. We also recommend that the Government consider further measures to enhance public understanding of the long-term financial value of occupational pension schemes. (Paragraph 79)

The Government agrees with the Committee that the issue of the impact on the existing pensions market will be carefully scrutinised in the assessment of the most appropriate delivery model for personal accounts.

HM Treasury
Department for Work and Pensions
21 July 2006