



The recently published White Paper on pension reform will have a significant impact on how and when companies provide pensions to their workers, explains Pamela Atherton.

■ **The Pensions White Paper, which endorsed many of the proposals put forward by Lord Turner's Pension Commission, supports the idea of 3% compulsory employer contributions that would be invested in a new nationwide pension scheme to be called the National Pension Accounts Scheme.**

Compulsory contributions would be payable by employers not already contributing to a company pension scheme for their workforce and for any worker who fails to opt out of the NPAS.

This mechanism of 'auto enrolment' is supported by the Government as the only way to reach the estimated 12m workers who currently have no formal pension arrangements.

The proposal is that employees will be automatically opted into the NPAS and pay 4% of salary, employers 3% and 1% tax relief by the Government to give a total contribution of 8%.

But there will be transitional relief with 1% compulsory employer contributions in year one, 2% in year two and 3% in year three, based on employees' band earnings of between approximately £5,000–£33,000.

Compulsory employer contributions will also be limited to 3% and enshrined in primary legislation, so that they cannot be increased by future Governments merely by introducing new regulations.

The National Association of Pension Funds expects a 30–40% opt out rate by workers who for various reasons, such as debt, decide not to stay in the scheme.

Employers' contribution bills will vary considerably according to the opt out rate of their workforce and the level of wages of those who remain opted in, but the Pensions White Paper suggested an overall cost to UK companies of £2.6bn a year.

Lord Turner calculated that the scheme would add about 0.6% to total labour costs, assuming 80% of better paid workers, and 65% of lower earners, stay in the NPAS. But for small employers, the figure rises to nearly 1% because they are less likely to be contributing to their workers' pensions already.

However, employers will be allowed to offset the new compulsory contributions against pay rises, as happened when a similar scheme was established in Australia.

Despite this, employers' organisations, such as the CBI and the British Chambers of Commerce, have argued strongly against compulsion, saying it will damage the competitiveness of UK companies compared with foreign counterparts without similar costs.

As for investment arrangements, the White Paper suggests a mix of Lord Turner's proposals and those put forward by the Association of British Insurers, whereby employees would choose their investment funds from a small number of competing providers.

Other reforms include scrapping the 'contracting out rebates' that three million workers pay into defined contribution schemes (but not for defined benefit schemes).

Scrapping these DC rebates will help pay for a higher basic state pension that will start to be linked to earnings from 2012, providing this is deemed by the Chancellor to be affordable at the time.

implications

Although the White Paper has received a cautious welcome from many trade and professional bodies, worries remain over the effect that the NPAS will have on other pension arrangements. For instance, what is to stop an employer

offering a good final salary scheme into which he could be paying up to 30% of payroll, from ditching it in favour of the NPAS to which he would have to contribute only 3%?

Employers wanting to do this would face a number of hurdles before making such a drastic change. They would be required to consult with the workforce first, although scheme sponsors are not obliged to comply with their employees' wishes, and employees might have grounds for complaint if they were contractually entitled to a certain level of pension contribution.

Malcolm McLean, Chief Executive of the Pensions Advisory Service, says: "It depends on what the employer has committed himself to providing in the contract of employment. If the employer has committed himself to paying a certain level of contribution in perpetuity, an employee would have grounds to complain."

"But in my experience, employers rarely commit themselves in this way. I don't think we will see a levelling down of employer contributions to 3%, as many people have suggested. Most employers pay in far more than 3% and will continue to do so because they see the company pension scheme as a useful tool for the recruitment and retention of staff."

Assuming that the NPAS does go ahead, company pension costs will escalate by £8bn within eight years, according to the actuarial



reforms set to revolutionise UK pension provision

firm, Aon Consulting. It adds that the NPAS will represent a further burden on businesses that are struggling already under the funding requirements of the Pensions Regulator.

Aon estimates that a further £2.3bn in pension costs will be passed on to employers under the NPAS, although this will be phased in over a three year period beginning in 2012.

Added to the £5.8bn in funding requirements from the Pensions Regulator for defined benefits schemes, this is equivalent to almost 2% on the UK's wage bill, according to Aon.

Aon Chief Actuary, Donald Duval, says: "These additional costs are likely to translate into lower profits for shareholders, higher prices for customers or lower salaries for employees".

The FSB has told Pensions Minister, James Purnell, that the Government must 'soften the blow' of compulsion. FSB national pensions spokesman, Mike Cherry, said: "Asking small businesses to contribute 3% into staff pensions would be a great burden for them to bear".

The FSB has also urged the Government to have the 'courage' to tackle public sector pensions to ensure greater consistency while the Confederation of British Industry Director-General, Sir Digby Jones, said: "Compulsion will cost employers £2.3bn and they will need help in managing this burden".

later retirement

Other proposals in the Pensions White Paper will have a more long term impact on businesses and their pension arrangements.

The proposal that the basic state pension age should rise to 66 by 2026, 67 by 2036 and 68 by 2046 in order to help pay for the indexation of the basic state pension in line with earnings.

Secretary of State for Pensions, John Hutton, and the Chancellor Gordon Brown have both stated that index-linking will come into force in 2012, providing that Government finances at the time make this 'affordable'.

A higher state scheme retirement age together with new anti-age discrimination laws, due to come into force in October this year, may mean that many companies will want to review their scheme retirement ages.

The Age Discrimination Act will set a default scheme retirement age of 65, after which employees can ask to remain in employment, although employers will be able to refuse such requests without facing action for unfair dismissal.

The Government is to review the default retirement age in 2011, with a view to abolishing it. With retirement before age 55 due to be banned from 2010, many companies are looking at the economics of retaining and hiring older workers.

A recent survey by the Chartered Institute of Personnel and Development of 8000 private, public and voluntary sector organisations showed that 70% of employers are actively seeking to recruit people aged between 55 and pension age, and another 31% are seeking to recruit people already entitled to the state pension. ■

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