Northern Ireland Assembly

COMMITTEE FOR SOCIAL DEVELOPMENT

OFFICIAL REPORT (Hansard)

Briefing on Pensions

19 November 2009

NORTHERN IRELAND ASSEMBLY

COMMITTEE FOR SOCIAL DEVELOPMENT

Briefing on Pensions

19 November 2009

Members present for all or part of the proceedings:
Mr Simon Hamilton (Chairperson)
Mrs Mary Bradley
Mr Mickey Brady
Mr Thomas Burns
Mr Jonathan Craig
Mr Alex Easton
Mr David Hilditch
Ms Anna Lo
Mr Fra McCann

Witnesses:
Mr Tony Attubato) Pensions Advisory Service

The Chairperson (Mr Hamilton):

Tony Attubato is the technical manager for the Pensions Advisory Service (PAS). Tony, you are most welcome.

Will members and those in the Public Gallery please turn off their mobile phone as they interfere with the recording? I do so myself, to lead by example. Members' papers include a cover note from the Committee Clerk, a briefing paper from the PAS and the Committee Clerk's cover note on the Pensions (No. 2) Bill regulatory impact assessment from November 2008.

The Committee has sought this briefing because of the increased number of pension issues it considers. There will be a Hansard report of the session, as it may be relevant to the Committee's examination of future legislation. Tony, please make a brief presentation, and then I will open the session for questions.

Mr Tony Attubato (Pensions Advisory Service):

Thank you very much for inviting me to brief the Committee on pensions matters. Before I provide an overview of the current pensions scene and what will happen in the future, I will say a few words about the organisation that I work for.

Some or, perhaps, all members may not know much about the Pensions Advisory Service

(PAS). It is an independent voluntary organisation that is funded by grant-in-aid from the Department for Work and Pensions (DWP). We give information and guidance to the public via our website and through e-mail correspondence, a helpline, and traditional post. We help people who have problems with private pension arrangements; and when people have disputes with a pension company or a pension scheme, we help them understand what has been happening.

I understand that the purpose of the briefing is to provide the Committee with an overview of the pensions industry. Unfortunately, the industry is riven with jargon, and I fear that, when explaining some of it, I might slip into that jargon; please interrupt me if I do so. Pension provision in the UK is subdivided into defined benefit schemes and defined contribution schemes. I will start with defined benefit schemes, which are more commonly known as final salary schemes and are exclusively offered by employers. In such schemes, people accrue a portion of their pay, typically one sixtieth or one eightieth, for each year that they are members of the scheme. The exact basis of how one accrues benefit depends on the scheme rules or, in the case of a public sector worker, the particular legislation that applies to the specific area.

Normally, members are expected to pay a portion of their pay. However, employers bear the responsibility for balancing the cost and funding the arrangement. Therefore, employers bear all the investment risk to ensure that the promised benefits are paid when they are due. Benefits are due when a person reaches retirement age. Some scheme rules allow earlier payment, and there may be reductions in that event. For example, some scheme rules allow early payment of benefits for ill health and, quite often, there are contingent benefits in the event of death, such as four times the lump sum cover, or benefits payable for a spouse.

Such schemes are becoming increasingly rare in the private sector, and members have probably read coverage in newspapers when major big-name employers have closed down their final salary arrangements. However, the schemes are still open and available to public sector employees. In the past, there have been major headlines when members have lost significant benefits, because their final salary scheme closed. Protection for that sort of issue has increased considerably in the past few years, and the pension protection fund is now in place. Therefore, if an employer becomes insolvent and leaves behind an underfunded arrangement without enough money to pay the promised benefits, compensation can be available from the pension protection fund. That will, generally, compensate members to 90% of their built-up benefit if they are under scheme pension age and 100% if they are over that age.

I also mentioned defined contribution schemes, which are more commonly known as money purchase schemes. Company schemes are increasingly of a money purchase nature: as I said, defined benefit schemes are becoming increasingly rare. Money purchase arrangements cover private individual arrangements that a person might take out with an insurance company such as a personal pension, a stakeholder pension or a self-invested personal pension. In a company arrangement, the amount contributed by the employer and the employee is defined; that is why they are called defined contribution schemes.

The amount of retirement income that a person will receive from a money purchase scheme will depend significantly on: how much that person can contribute to that scheme; how well his or her savings do and the return they achieve; and the charges that are made during the running of the plan. When a person reaches retirement age and wants to receive an income, one option is to buy an annuity. Annuity rates vary depending on gender, age and, sometimes, where a person lives, because they are based on the insurer's estimate of life expectancy.

The other option is to move a fund into another type of arrangement called an unsecured pension, through which money remains invested and a person draws income off that. However, in those arrangements, a person must, generally, purchase an annuity by the time he or she reaches 75. In such schemes, there is a huge shift of responsibility from employer to employee, and individuals make the decisions on where they save, how much they save and the timing of their retirement.

For a defined contribution scheme, there is no specific protection if an employee's employer becomes insolvent. However, the assets of the scheme are completely separate to the employer, so they should not have a direct effect on the employer's insolvency. If the financial provider providing the savings options were to go bust, help could be available from the financial services compensation scheme. However, that would depend on the type of investment; but there is no protection against a general rise or fall in investments. That is a very brief rundown of private pension arrangements and what is available.

With regard to what has been happening and what will happen, one major change next year, which is the consequence of legislation some time ago to the change in state pension ages and which will get a lot of attention in the next few months, is that from April 2010, there will be a gradual equalisation of state pension ages between men and women. By 2020, the pension age for women will be 65, which will be the same as that for men. There will, eventually, be a move to increase the state pension age.

Also from April 2010, the number of qualifying years needed to qualify for a full-rate state pension will reduce, meaning that it will be a lot easier to qualify for the full-rate state pension. From 6 April 2010, anyone whose state pension age is after that date will require only 30 years' contributions. Currently, a man requires 44 years' contributions and a woman requires 39.

The big focus in the private sector will be on auto-enrolment, which is a consequence of the Pensions Act 2008. Employers will be required to auto-enrol all eligible employees into a qualifying work-based pension scheme. If employers do not have a qualifying work-based pension scheme, they will need to auto-enrol their employees into a national scheme, which, for the time being, is being called personal accounts. At the moment, there is no compulsion on an employer to offer any sort of pension arrangement. The minimum that employers with five or more employees must do is offer access to a stakeholder arrangement, but they do not have to contribute to that scheme on behalf of their employees.

There will be a radical change from 2012 onwards, when there will be a requirement to auto-enrol all employees as long as they are eligible to qualify, and there will also be compulsory contributions. Under the current proposals, all employees aged 22 and over and earning more than £5,035 in 2007 terms, will be automatically enrolled, but they will have the option to opt out. However, if they do opt out, they will be re-enrolled every three years and will have to keep making the decision about whether to opt out or in.

Under the current proposals, auto-enrolment will be phased in. Compulsory contributions will also be phased in, although that will depend on the size of the employer. The objective is that by October 2016, the minimum contribution rate will be 3% for employers, towards an 8% total. For defined benefit schemes, auto-enrolment will be required by 2015, and, to satisfy the requirements, a minimum benefit test will have to be met.

There have also been various other pieces of legislation, which I have included in my briefing note. There is a change to provisions on pensions on divorce, and I apologise as it very technical. It had been the case that if a couple were divorcing and a share of one spouse's benefit was debited and credited to their former spouse, anything that related to contracting-out rights had to be ring-fenced and called safeguarded rights. Safeguarded rights had their own legislation, which meant that they could not be touched until a person reached 60, and they could not be used to provide a cash sum. The simplification changes of 2006 made those arrangements stand out like a sore thumb, because they were completely different to all other types of pension arrangements. Legislation has been passed so that safeguarded rights are now abolished and those arrangements can be treated like any other type of pension arrangement.

Legislation will come into effect next month that will allow small trivial payments worth less than £2,000 to be commuted by occupational pension schemes in lieu of very small pensions. That will probably make the administration of schemes easier, and the members affected will probably value a lump-sum payment as opposed to a very small pension.

The Pensions Regulator was set up by the Pensions Act 2004 with three specific objectives: to protect the benefits of members of work-based pension schemes; promote good administration; and reduce the risk of claims on the pension protection fund. In doing so, the regulator has wide-ranging powers, which can be broadly grouped into three categories: powers relating to the investigation of schemes; powers relating to anti-avoidance; and powers relating to putting things right.

In gathering information, the primary source of material for the regulator is the scheme returns. Those are issued annually to almost every scheme except for the smallest one. It is a legal requirement that the trustees of a scheme complete the scheme return and submit it to the regulator. The returns will contain a lot of detail about the scheme's funding and its ability to pay the promises that are due.

There are requirements for pension professionals to report breaches of legislation, if they are material, to the regulator; and the public can also report items of concern to the regulator. In promoting good practice, the regulator issues codes of practice, which give practical guidance on how pensions law should be complied with. The codes of practice are not statements of law, and there is no penalty for not complying with them: an alternative approach is acceptable so long as it meets the objective of the law. However, if the alternative approach does not do that, it is possible that the people involved could be penalised. It is also the case that a court or tribunal, including, for example, the Pensions Ombudsman, would take the codes of practice into account when making a decision on a complaint that had been brought to their attention.

Where there are issues of concern, it is fair to say that the regulator is very pragmatic. The regulator will not rush in with all guns blazing but will enter into dialogue with the parties involved — whether that be the scheme, the trustees or the employer — and encourage the party concerned to put things right. In most instances where there are issues, discussion between the regulator and the people involved is usually enough to correct the matter. Consequently, the issuing of notices or directions is actually quite rare. However, if a party has been the subject of a determination, it can appeal to the Pensions Regulator Tribunal, which is an independent body. Consultation is currently under way on amendments to the appeal procedure so that there is a transfer of the jurisdiction of the Pensions Regulator Tribunal to the Tax and Chancery Chamber of the Tribunals Service.

I have consulted contacts at the regulator, and they do not believe that transfer will mean any noticeably different approach. To put that in context, since April 2005 there have only been eight references to the tribunal. Four were withdrawn before the formal hearings took place, but one case is currently ongoing.

The Chairperson:

I will open the session for questions, but I wonder whether we should get you, Tony, to ask us questions to see how much we understand.

Mrs M Bradley:

Very little.

The Chairperson:

That might be more revealing.

Ms Lo:

It seems that there is going to be massive administration involved with respect to new enrolment, etc. There will also be a huge increase in the pension industry, with a lot more people by that time having to go into new pension schemes.

Mr Attubato:

Undoubtedly, there will be a huge amount of work. Approximately half the workforce currently does not have pension arrangements. There will be issues as regards the possibility of undue pressure being put on employees to opt out, and it will be the regulator's role to police that. Administration will no doubt increase, certainly in the short term, as a result of bringing employees in, but it is difficult to pinpoint the effect of that yet, because a lot of this is still under consultation.

The objective is to try and make pension administration as simple as possible in order to try to reduce the burden on employers. I imagine that there will be a lot of debate and proposals right up until 2012 to try to make this as easy as possible.

Mr Craig:

Thank you, Tony: I will not try to pronounce your surname. I have examined the workplace pension scheme with interest. It contains a very clearly defined percentage that both the employee and the employer must pay into the scheme. Will that be obligatory in all workplace pension schemes, even existing ones? Will they be affected? I was in a workplace pension scheme, which is why I am interested in this matter. Will workplace schemes have to comply with the set percentage contribution? Will it do away with one of the problems that there has been in workplace schemes, in which companies took pension holidays that led to high-level difficulties around the UK?

Mr Attubato:

The requirements mean that those are the minimum conditions. If a scheme contributes more than the minimum, that will be perfectly acceptable. However, there is a risk that some employers may dumb down their provision in order to meet the minimum requirement, rather than maintain it at the present level. That is a risk, and we will just have to wait and see whether that happens. I hope that good employers who are committed to their pension arrangements will make little change to their schemes. The objective is aimed at those workplaces in which there is no pension provision at the moment; it is not intended to dumb down existing pension provision.

Contribution holidays were an issue some time ago, but they are now very rare. Each defined benefit scheme must have a funding agreement in place designed to ensure that benefits due can be paid. A contribution holiday is only possible now if a scheme is able to certify that sufficient money exists to allow the employer to cease contributing. If the scheme actuary is not able to certify that, and there is no agreement between the employer and the trustees about the level of contribution; that would need to be reported to the regulator, who would then have to take whatever action appropriate to ensure that the members' benefits are protected.

Mr Craig:

It sounds as though, if the global economy took off again and a company were doing extremely well, there would be the opportunity for a contribution holiday.

Mr Attubato:

If the scheme actuary were able to certify that the funding was so good that no employer contribution was necessary, then that is theoretically possible.

Mr Craig:

I think that the regulator should approach the Government about that. I was in a scheme in which the company was able to take a pensions holiday when things were going extremely well; but, literally overnight, the economy went bad and the scheme went bad. That is not to say that if there had not been a holiday, things would not have been as bad as they were, but I think that it would have helped the situation. Maybe that needs to be re-examined.

Mr Attubato:

I appreciate that. It should be borne in mind also that the funding requirements have been greatly strengthened, largely because of Robert Maxwell's robbing the Mirror Group Newspapers' pension fund. Legislation took effect in 1997 as a result of that, which introduced a minimum funding requirement. Since then, the funding requirement on schemes has been strengthened even more, so that the target they must maintain is much more onerous than it was during the early part of the 1990s.

The Chairperson:

The industry is tightly regulated, for understandable reasons. You have mentioned some of the bad cases that there have been. There have also been more recent collapses of schemes and revelations of severe underfunding because of pension contribution holidays and so on.

Therefore, it is understandable that the industry is tightly regulated. However, we are always very aware of the headline-grabbing cases, such as Mirror Group Newspapers and, locally, Richardsons Fertilizers. How frequent are irregularities of that nature? It was said that Pensions

Regulator received only eight cases, four of which were dropped. That does not indicate that irregularities are popping up every day, given the number of pensioners and the number of schemes that exist. Is that a fair assessment?

Mr Attubato:

The experience of The Pensions Advisory Service is that schemes are now, generally, very compliant. The issues that come our way tend to be individual problems. Breakdowns in administration affect a small number of members — maybe just one — in a very large scheme. Unfortunately, things can go run even in the best-run schemes. Generally, our experience of schemes is that they are very compliant and that systematic abuses are now very rare.

The Chairperson:

Therefore, powers held by the Pensions Regulator, such as the issuing of improvement notices, are not used in many instances.

Mr Attubato:

No; my understanding from the homework that I did before I coming here is that only two financial direction notices have been issued to date.

The Chairperson:

Is that the figure for the whole of the UK?

Mr Attubato:

Yes, it is.

The Chairperson:

As members of the Committee, we find it very difficult to get our heads around the issue. Therefore, I am sure that individual scheme members find it equally difficult to know that something is going wrong, even if they suspect it. People do not like to embarrass themselves in case they highlight something as being wrong which is pointed out to be normal practice. Under what circumstances should scheme members contact the regulator? You would not want to encourage people to go to the Pensions Regulator with every small problem.

Mr Attubato:

The regulator has a risk-based approach, so it would probably not be interested in one-off issues that do not indicate a major malfunction in a scheme. However, there is a helpline, which people can use to air their concerns. We also runs a helpline; and if we were advised by a member of a scheme about something that we thought that the regulator would be interested in, we would report it to the regulator or encourage the member to contact the regulator. If pension professionals, as part of their running of the schemes, think there is a material breach, they have a duty to report it to the regulator. If they do not, they could be censured.

The Chairperson:

Tony, thank you very much. That was extremely useful.