

SPECIAL NEWSLETTER: THE TURNER REPORT

The Turner Report

Has pensions ever had so much publicity as now? The long awaited and previewed report by the Pensions Commission, headed by Lord (Adair) Turner was finally published (after much leaking) on 30th November. In case you were not aware, there are two other members of the Pensions Commission: Jeannie Drake, the Deputy General Secretary of the Communication Workers Union and Professor John Hills, Professor of Social Policy and based at the LSE.

The final report is a very substantial document, setting out, in great detail, the history, the reasons why we are where we are, and the options and issues going forward. We summarise the main aspects in this Newsletter.

National Pension Savings Scheme

It is proposed to set up a National Pension Savings Scheme (NPSS). It would work as follows:

- a) All employees would automatically be enrolled either into a "high quality employer pension scheme" (defined rather awkwardly as one where employers already pay more than 3%) or the NPSS
- b) But they would have the right to "opt out"
- c) Contributions would total a minimum of 8% of earnings above the Primary Threshold (currently £4888pa), consisting of:
 - 4% by the employee
 - 3% by the employer
 - 1% tax rebate
- d) The self-employed would be allowed to opt in.
- e) Contributions would be collected via PAYE or a new Pension Payment System
- f) Contributions would be held in individual accounts and employees would direct where they were invested within "a range of funds", with a default fund for those who do not make a choice.

- g) Additional voluntary contributions by both the employee and employer would be encouraged.
- h) Target Annual Management Charge to be no more than 0.3% pa.
- i) The NPSS to "negotiate fund management major asset classes (6-10) aiming for very low fees in return for exceptionally high volume". Index funds to be included.
- j) Other non-NPSS negotiated funds may be made available to cover the "alternative asset classes"
- k) Investment switches to be allowed either half yearly or annually.
- l) The default fund should be "lifestyle"
- m) "Annuitisation" will be required between ages 55 and 75 i.e. an annuity must be bought. But recommended that these ages (55 and 75) should increase in line with life expectancy.
- n) Employees will be encouraged to buy index-linked annuities, but not compulsory.
- o) employees themselves to shop around for an annuity, rather than have the NPSS negotiate bulk buying cheaper annuities
- p) For those who die before starting to draw benefits, the NPSS would pay out their fund under trust.
- q) The aim is for the NPSS to provide, in the long term, a pension of 15% of final pay. For Mr(s) Average, the Basic State Pension (as revised by Turner: see below) is aiming to provide 30% of their earnings. So overall their pension will be 45% of final pay.
- r) The NPSS to be up and running from 6.4.10.

Comments

In summary:

- 1) It recognises the fundamental need that we must all save more.
- 2) The automatic enrolment relies on the inertia rule, so that the vast majority of people will stay in the NPSS (if they are not in a company scheme)

<p>3) What about small businesses? Those with less than 5 employees are exempt from the Stakeholder requirements, but Turner proposes the NPSS is to apply to all.</p> <p>4) The self-employed are a growing body in the UK. If they are exempt from automatic enrolment, will they join or make adequate other provision? The self-employed, especially in the early years, usually need to invest as much as they can in their business.</p> <p>5) The administration will be immense. Who will pay for it? Taxpayers, presumably?</p> <p>6) Who will choose the funds available for investment? What if those funds under-perform? The emphasis seems to be on keeping the AMC down. But that cannot be at the expense of performance.</p> <p>7) It is not proposed that any "free" advice is given as to where to invest the funds, other than general guidance. Most employees will not take financial advice (even if it can be found cost effectively) so logically most will opt for the default fund. And of course there are not enough (I)FA's around to advise the whole working population of the UK! Do we already hear the "Mis/non-advice" scandal?</p> <p>8) There will be no specific advice on annuity purchase. Someone who has been in the NPSS for 5 years on say £25k a year will have accumulated a fund of perhaps £10k. Insurance companies will be making fairly hefty charges out of that and the employee will only get a small pension, maybe a tenner a week?</p> <p>9) There is no reference to commutation. Under the new pension regime starting on A-Day, those with less than £15k total fund can commute wholly for cash. Is this an anomaly? Whilst the desire to supplement retirement income is laudable, there are admin issues for very small pensions, especially in the early years.</p>	<p>State Pensions</p> <p>a) State Pension Age to be raised to 66 by 2030, 67 by 2040 and 68 to 2050.</p> <p>b) Index Basic State Pension (BSP) to earnings from 2010 or 2011.</p> <p>c) The two tier State pension scheme to continue</p> <p>d) Upper Earnings Limit to be frozen</p> <p>e) For those in Defined Contribution company schemes and those with Personal Pensions, the contracting out option of S2P to be removed, with those people becoming members of S2P.</p> <p>f) For those in Defined Benefit Schemes, the contracting out option to continue but only until 2030.</p> <p>Comments</p> <p>1) Any changes to the State Pension Age (SPA) are political. The logic of the Report for an increase in SPA cannot be faulted, given the improvements in mortality. Indeed, are these proposed increases enough?</p> <p>2) Similarly, any switch to reinstating the link between state pensions and earnings is political (remember that company schemes are required to provide indexation on post 1997 benefits in line with LPI – Limited Price Indexation i.e. increases are not related to earnings). It is the old argument: should state pensions provide a consistent standard of living or one rising in line with the economic prosperity of the nation?</p> <p>3) The changes to contracting our look messy. Why not bite the bullet and cease all contracting out from say 2010?</p> <p>There is now likely to be along and hopefully constructive debate. Let us hope above all else that the main political parties can reach broad agreement on any changes.</p> <p style="text-align: right;"><i>December 2005</i></p>
--	---