



HOUSE OF LORDS

# Library Note

## **Pensions Bill [HL] (HL Bill 37 of 2010–11)**

The Pensions Bill [HL] had its first reading in the House of Lords on 12 January 2011 and is due to receive its second reading on 15 February 2011.

The Bill implements recommendations from three recent pension reviews. It speeds up the timetable for increasing the state pension age to 66. It amends the requirements for automatic enrolment into a workplace pension scheme which are due to come into effect from 2012 onwards by raising the earnings trigger and making automatic enrolment simpler for employers to administer. It also amends existing legislation covering judicial pension schemes to allow contributions to be taken from scheme members. The Bill also contains a number of technical measures and includes provisions to amend references to indexation in existing primary legislation, in line with the Government's switch from RPI to CPI as the basis for revaluing and indexing certain pension rights.

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## 1. Introduction

The Pensions Bill [HL] had its first reading in the House of Lords on 12 January 2011 and is due to receive its second reading on 15 February 2011.

The Bill implements recommendations from one Government pensions review (*A Sustainable State Pension: When the state pension age will increase to 66*) and two independent pensions reviews (*Making Automatic Enrolment Work* and the interim report of the Independent Public Service Pension Commission (IPSPC)). The Bill speeds up the timetable for increasing the state pension age to 66. It amends the requirements for automatic enrolment into a workplace pension scheme which are due to come into effect from 2012 onwards by raising the earnings threshold at which employees will be automatically enrolled, and by making some changes intended to reduce the administrative burden on employers. The Bill also amends existing legislation covering judicial pension schemes to allow contributions to be taken from scheme members towards the cost of their personal pension benefits.

This Note describes the policy background to these changes by outlining the relevant pension reforms already introduced by the Labour Government, and the conclusions of the reviews established by the Coalition Government. References are provided to additional briefing materials produced by the House of Commons Library which look at state pensions, automatic enrolment and public service pensions in the round, and which therefore set the reforms covered by this Bill in a wider context.

The Bill also contains a number of technical measures and includes provisions to amend references to indexation in existing primary legislation, in line with the Government's switch from RPI to CPI as the basis for revaluing and indexing pension rights in defined benefit occupational pension schemes. This Note does not cover the technical provisions in great detail, but further information can be found in the [Explanatory Notes](#) to the Bill.

## 2. State Pension Age

### 2.1 Summary

Part 1 of the Bill introduces provisions for amending the state pension framework. In particular, it amends the timetable for increasing the state pension age to 66. Under the Pensions Act 2007, the increase to 66 was due to take effect between 2024 and 2026. This Bill will bring forward the increase so that state pension age for both men and women will begin rising from 65 in December 2018 to reach 66 by April 2020. As a result of bringing forward the increase to 66, the timetable contained in the Pensions Act 1995 for equalising women's state pension age with men's at 65 by April 2020 will be accelerated, so that women's state pension age will reach 65 by November 2018.

### 2.2 Policy background: Reforms under the Labour Government

Reform of the state pension age resulted from a long-term review of pension provision. In December 2002, the Labour Government established a Pensions Commission (also referred to as the Turner Commission after its chair Adair Turner, now Lord Turner of Ecchinswell) to "keep under review the regime for UK private pensions and long-term savings". The Pensions Commission produced its first report, *Pensions: Challenges and*

*Choices*, in October 2004. It observed that:

Life expectancy is increasing rapidly and will continue to do so. This is good news. But combined with a forecast low birth rate this will produce a near doubling in the percentage of the population aged 65 years and over between now and 2050, with further increase thereafter. The baby boom has delayed the effect of underlying long-term trends, but will now produce 30 years of very rapid increase in the dependency ratio. We must now make adjustments to public policy and/or individual behaviour which ideally should have been started in the last 20–30 years.

Faced with the increasing proportion of the population aged over 65, society and individuals must choose between four options. Either:

- (i) pensioners will become poorer relative to the rest of society; or
- (ii) taxes/National Insurance contributions devoted to pensions must rise; or
- (iii) savings must rise; or
- (iv) average retirement ages must rise.

But the first option (poorer pensioners) appears unattractive; and there are significant barriers to solving the problem through any one of the other three options alone. Some mix of higher taxes/National Insurance contributions, higher savings and later average retirement is required.

Our response to the demographic challenge should include a rise in the average age of retirement. Healthy ageing for many people makes this possible; and an increase in employment rates among older people is now occurring. But the increase needed to make later retirement a sufficient solution alone looks very large; and significant inequalities in life expectancy and health across socioeconomic groups may limit the scope for across the board increases. Increases either in taxes/National Insurance contributions and/or in private savings will therefore also be needed to meet the demographic challenge.<sup>1</sup>

The Pensions Commission published its second report, *A New Pension Settlement for the Twenty-First Century*, in November 2005. This report concluded that the existing system of private funded pensions combined with the state system would deliver “increasingly inadequate and unequal results”<sup>2</sup>, and that:

Over the long-run, fairness between generations suggests that average pension ages should tend to rise proportionately in line with life expectancy, with each generation facing the same proportion of adult life contributing to and receiving a state pension.<sup>3</sup>

The Pensions Commission proposed that “earnings-related pensions should in the long-term be provided via funded private savings, rather than via a state PAYG [pay-as-you-

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<sup>1</sup> Pensions Commission, [\*Pensions: Challenges and Choices\*](#) (October 2004), pp ix–x.

<sup>2</sup> Pensions Commission, [\*A New Pension Settlement for the Twenty-First Century\*](#) (November 2005), p 2.

<sup>3</sup> *Ibid.*, p 4.

go] scheme”.<sup>4</sup> Nevertheless, in order to address the problems of the current system while coping with changing demography, the Commission concluded that both an increase in public expenditure on state pensions as a percentage of GDP, and a rise in the state pension age would be required.<sup>5</sup> The report emphasised that an integrated package of reforms would be necessary and recommended that the state system should deliver a more generous, more universal, less means-tested and simpler state pension; that there should be strong encouragement to individuals to save for earnings-related pensions through automatic enrolment; that there should be a modest minimum level of matching employer contributions; and that the state should have a role as an organiser of pension savings where good employer-sponsored pension provision was lacking.

The Pensions Commission published its final report, *Implementing an Integrated Package of Pension Reforms*, in April 2006. The Commission found that, since the second report, there had been widespread support for its proposition that “the State Pension Age should rise over the long-term as life expectancy rises, but as part of a package whose overall impact is fair, allowing for differences in life expectancy by socio-economic group, and which is accompanied by policies to support flexible retirement and later working”.<sup>6</sup>

The Labour Government responded by publishing its proposals for reform in a White Paper, *Security in Retirement: Towards a New Pensions System* in May 2006. Building on the work of the Pensions Commission, the White Paper proposed a new scheme of personal accounts to provide a straightforward way for employees to contribute to a “high-quality, low-cost savings vehicle” with matched contributions by employers; automatic enrolment for employees into this new scheme, or into their employer’s own occupational scheme, providing it met a minimum standard; restoration of the link between the uprating of the basic state pension and average earnings; and reform of the contributory principle, making the state pension fairer and more widely available. In addition, the state pension age would rise to 68 by 2046:

We will gradually raise the State Pension age in line with gains in average life expectancy. The State Pension age for women is already due to rise from 60 to 65 between 2010 and 2020, to equalise with men’s State Pension age. There will be a subsequent rise for both men and women which will follow the same approach, beginning with a rise from 65 to 66 over a two-year period from 2024, then again by one year over a two-year period from 2034 and from 2044.

... The increased State Pension age will share the growth in life expectancy between time spent in work and time spent in retirement, and it will secure the financial stability and sustainability of the state pension system for the long term.<sup>7</sup>

This phased increase in the state pension age was introduced in section 13 of the Pensions Act 2007.

### **2.3 Policy background: Coalition review of state pension age**

The Coalition Government announced in May 2010 that it would hold a review to set the date at which the state pension age starts to rise to 66, although this would not be

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<sup>4</sup> *Ibid.*, p 12.

<sup>5</sup> *Ibid.*

<sup>6</sup> Pensions Commission, [Implementing an Integrated Package of Pension Reforms](#) (April 2006), p 14.

<sup>7</sup> DWP, [Security in Retirement: Towards a New Pensions System](#), Cm 6841 (May 2006), p 18.

sooner than 2016 for men and 2020 for women.<sup>8</sup> The results of this review were published in November 2010 by the Department for Work and Pensions (DWP) in a report on *A Sustainable State Pension: When the state pension age will increase to 66*. The main findings were that:

The State Pension age has not kept pace with demographic changes. The Pensions Act 2007 legislated for the State Pension age to rise for both men and women to 66 by 2026, to 67 by 2036, and to 68 by 2046. But subsequent gains in average life expectancy have outpaced the projections on which this timetable was based. Official projections for those reaching 65 in 2026 have since been increased by 1.5 years for men and 1.6 years for women.

These revisions in official average life expectancy projections, just for those reaching State Pension age this year, are expected to mean extra State Pension costs of £6.5 billion over the lifetime of this cohort.

In the face of these demographic challenges, the Government has reviewed the timing of the increase in State Pension age to 66...

Women's State Pension age is currently rising from 60 to be equalised with men's at 65 by April 2020. To enable an earlier increase to 66, the equalisation timetable will be adjusted from April 2016 so that women's State Pension age will reach 65 by November 2018. This will also affect the minimum qualifying age for Pension Credit, which is based on, and rising in line with, women's State Pension age.

The Government has decided that the increase to 66 should be brought forward, so that the State Pension age will rise from 65 to 66 between December 2018 and April 2020 for both men and women. The increase will be phased in at a rate of three months' increase in State Pension age every four months.<sup>9</sup>

The Government also plans to review the existing timetable for increasing the state pension to 67 and 68, and intends to bring forward proposals on this in due course.<sup>10</sup>

Clause 1 of the Bill makes provision for this acceleration to the timetable for increasing state pension age to 66. The Government estimates that the impact of this will be savings of over £30 billion:

Bringing forward the increase in State Pension age to 66 by 6 years will result in total net savings of approximately £30.4 billion between 2016/17 and 2025/26 (when the State Pension age was due to have reached 66 under existing legislation). This total includes the predicted cost of an increase in claims for working-age benefits.

Without a change to the State Pension age timetable, the £30.4 billion savings would have been costs that the working-age population would have to pay for through higher National Insurance contributions, reduced public spending in other areas, or higher government borrowing. Those reaching State Pension age

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<sup>8</sup> [The Coalition—Our Programme for Government](#) (May 2010), p 26.

<sup>9</sup> DWP, [A Sustainable State Pension: When the state pension age will increase to 66](#), (November 2010, Cm 7956), pp 7–8.

<sup>10</sup> *Ibid.*, p 30.

before 2025/26 will gain from increasing life expectancy, but would not carry a fair share of the additional costs.<sup>11</sup>

## 2.4 Reaction

Reaction to this provision in the Bill has focused on the impact on women. It has been calculated that half a million women would have to wait longer before receiving their state pension under the new timetable, and that for some women, this could equate to losing £10,000 of pension payments.<sup>12</sup> Rachel Reeves, the Shadow Minister for Work and Pensions, said:

Women born in 1954 have already had to adapt to one major revision as women's state pension age was increased from 60 to 65 between 2010 and 2020 and they now have to face another with little time to prepare. Those women who turn 65 in 2018 will now have to wait an extra year to get the basic state pension and pension credit—and will have to work for longer too.<sup>13</sup>

Ros Altmann, the Director General of Saga, said that the acceleration in the timetabling for equalising the state pension age for men and women was “clearly discriminatory”. She considered that “Women accept the need to equalise pension ages, but the timetable is unfair”.<sup>14</sup>

The DWP's gender equality impact assessment of the Bill concluded that:

This proposal will close the current gender gap in State Pension age more quickly and thereby reduce the advantage currently enjoyed by women over men as a result of a lower pension age and higher life expectancy. Women will, however, on average still receive their State Pension for longer than men. By late 2018 (when the State Pension ages will be equal under these proposals) over 90 per cent of both women and men reaching State Pension age are likely to have built up a full basic State Pension.

The picture in relation to the impact on lifetime pension income is more complex, in part due to the effect of earlier equalisation. All other things being equal, in general men would lose a slightly higher proportion of their lifetime pension income than women as a result of increasing the State Pension age, because of lower average life expectancy. However, because of higher average earnings, men may be in a better position than women to offset part of this loss through higher additional contributions to a private (Defined Contribution) pension scheme. In contrast, the proportionate loss of lifetime pension income for women affected by the maximum increase of two years would generally be greater than for their male contemporaries, other than those men whose entitlement to Pension Credit would also be delayed by two years.

Overall, we conclude that while some aspects of the change will impact women more strongly than men, the impact is not disproportionate and is a consequence of closing the gender gap in State Pension age earlier than under current plans.<sup>15</sup>

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<sup>11</sup> *Ibid.*, p 29.

<sup>12</sup> Myra Butterworth, 'Half a million women hit by 'unfair' increase in state pension age', *Daily Telegraph* (14 January 2010).

<sup>13</sup> Polly Curtis, '[Default retirement age to end, say ministers](#)', *Guardian* (13 January 2010).

<sup>14</sup> 'The pension reforms and what they mean', *Times* (15 January 2011).

<sup>15</sup> DWP, [Pensions Bill 2011—Impacts—Annex A: State Pension Age](#) (11 January 2011), p 31.

Discussions about previous proposals to increase the state pension age had raised the issue of whether doing so would have a disproportionate impact on people in lower socio-economic groups, who tend to have a lower life expectancy.<sup>16</sup> However, the DWP has calculated that:

While average life expectancy differs among people from different socio-economic backgrounds, national statistics suggest that there have been very substantial improvements in longevity at age 65 across all socio-economic groups...

This suggests that, if these trends continue, an increase in State Pension age of a year by 2020 should not lead, on average, to a reduction in the time spent in receipt of state pensions by people previously employed in manual occupations.<sup>17</sup>

## 2.5 Retirement age

The state pension age is not the same thing as the default retirement age. State pension age is defined as the earliest age at which an individual can draw their state pension, but s/he does not have to retire at this point. Once an individual reaches state pension age, s/he can stop working and start receiving state pension; continue working and receive the state pension as well; or continue working and put off claiming state pension. Those who defer their state pension claim may be able to get a higher level of state pension or a lump-sum payment when they later start to claim.<sup>18</sup> There is no national mandatory retirement age, and retirement ages are normally a matter for individual employment contracts. Under age discrimination legislation which came into force in 2006 compulsory retirement ages are unlawful unless they can be objectively justified. However, this is subject to a national default retirement age of 65 which allows mandatory retirement for those over this age (or the employer's normal retirement age) as long as employees are given the opportunity to exercise their right to request working beyond retirement age.<sup>19</sup>

When the Coalition Government announced it would review the timetable for increasing the state pension age, it also made a commitment to phase out the default retirement age (DRA).<sup>20</sup> The Government's consultation document on this issue, published in July 2010, made clear that the two reforms went hand-in-hand:

Phasing out the DRA is just one of the steps that the Government is taking to enable and encourage people to work for longer, alongside reviewing when the State Pension Age should reach 66 and ensuring there is effective support for those out of work to find work. There are a range of reasons for pursuing these policies, including demographic change; the financial benefits to both the individual and the wider economy; and the health and social benefits many people gain from working later into life.<sup>21</sup>

The Government confirmed on 13 January 2011 that it will remove the default retirement age so that people have more choice when to stop working. The default retirement age

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<sup>16</sup> See House of Commons Library, [State Pension Age](#), SN/BT/2234 (last updated 1 February 2011).

<sup>17</sup> DWP, [Pensions Bill 2011—Impacts—Annex A: State Pension Age](#) (11 January 2011), p 18.

<sup>18</sup> Directgov, '[Calculating your state pension age](#)'.

<sup>19</sup> House of Commons Library, [Retirement Age](#), SN/BT/961 (last updated 29 July 2010).

<sup>20</sup> [The Coalition—Our Programme for Government](#) (May 2010), p 26.

<sup>21</sup> BIS and DWP, [Phasing out the default retirement age—Consultation document](#) (July 2010), p 5.

will be phased out from 6 April 2011. After 1 October 2011, employers will not be able to use the default retirement age to compulsorily retire employees.<sup>22</sup>

## 2.6 Further information

More detailed background on the state pension age is available in the House of Commons Library Standard Note, [State Pension Age](#), SN/BT/2234 (last updated 1 February 2011). Further information about other reforms to the state pension not covered in this Bill is available in the House of Commons Library Standard Note, [State Pension Reform](#), SN/BT/5787 (last updated 1 December 2010).

## 3. Automatic Enrolment

### 3.1 Summary

Part 2 of the Bill contains measures to amend the automatic enrolment provisions for workplace pension schemes. It revises some of the automatic enrolment provisions contained in the Pensions Act 2008 and implements some of the recommendations from the *Making Automatic Enrolment Work* review published in October 2010. The areas addressed include:

An earnings trigger at which an employee must be automatically enrolled into a workplace pension, and new uprating provisions for the qualifying earnings band on which contributions are made; the introduction of an optional waiting period of up to three months before the automatic enrolment duty commences; a change to the timing of automatic re-enrolment, so that regulations must secure that there is not more than one automatic re-enrolment date in any period of two years and nine months, rather than in any period of three years; and changes to the way an employer can certify that their pension scheme meets the necessary quality test. Part 2 also amends incorrect references in previous legislation to ensure a coherent set of regulations on automatic enrolment.<sup>23</sup>

### 3.2 Policy background: Reforms under the Labour Government

As noted in section 2.2, the Pensions Commission's first report in October 2004 concluded that higher private savings, as well as reform of state pension provision, would be necessary to address the demographic challenges posed by increasing life expectancy and a forecast low birth rate. In its second report, published in November 2005, the Commission addressed "whether the existing system of voluntary pensions would deliver adequate results" and in particular, "whether a system of compulsory earnings-related savings was appropriate".<sup>24</sup> It observed that:

Looking forward the state is planning to play a reduced role in pension provision for the average pensioner. Policy has been based on the assumption that private provision will grow to offset this decline.

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<sup>22</sup> BIS press release, '[End of the line for default retirement age](#)' (13 January 2011).

<sup>23</sup> DWP, [Pensions Bill \[HL\]—Explanatory Notes](#), pp 3–4.

<sup>24</sup> Pensions Commission, [A New Pension Settlement for the Twenty-First Century](#) (November 2005), p ix.

But voluntary private pension is not growing: rather it is in serious and probably irreversible decline. Employers' willingness voluntarily to provide pensions is falling and initiatives to stimulate personal pension saving have not worked.<sup>25</sup>

Accordingly, the Pensions Commission proposed:

A new policy for earnings-related provision, which recognises the inherent inadequacy of a purely voluntary approach, but which stops short of full compulsion, relying instead on the automatic enrolment of employees into either a new National Pensions Savings System or into existing company pension schemes, but with the right to opt out, and with a modest level of compulsion on employers to make matching contributions.<sup>26</sup>

In its final report, *Implementing an Integrated Package of Pension Reforms* (April 2006), the Pensions Commission noted that there had been widespread support in favour of its suggested approach on automatic enrolment as part of an integrated package of reforms.<sup>27</sup> The Commission noted that disagreement with this approach came almost entirely from those who supported a compulsory private pension system. However, the Commission continued to prefer automatic enrolment as it allowed people to opt out if their circumstances were such that pension saving was not essential or appropriate. Furthermore, a compulsory system could be regarded by many as equivalent to taxation, but automatic enrolment with an option to opt out would avoid this perception.<sup>28</sup>

In its May 2006 pensions White Paper, *Security in Retirement: Towards a new pensions system*, the Labour Government announced that, having assessed the recommendations of the Pensions Commission, it would:

Introduce low-cost personal accounts to give those without access to occupational pension schemes the opportunity to save. People will be automatically enrolled into either their employer's scheme or a new personal account, with the freedom to opt out. Employers will make minimum matching contributions.<sup>29</sup>

The White Paper set out some key features of how the scheme would work in terms of earnings and contribution thresholds, but noted that further consultation was necessary on the delivery model for the personal accounts scheme "in order to strike the right balance between value for money for the taxpayer and value for money for the saver".<sup>30</sup>

A second White Paper, entitled *Personal Accounts: A new way to save*, was published in December 2006 which set out detailed proposals for the automatic enrolment of all eligible employees into either a personal account or an employer-sponsored scheme, complemented by a new scheme of low-cost personal accounts based on the approach outlined by the Pensions Commission.<sup>31</sup>

The White Paper formed the basis for the Pensions Act 2008.<sup>32</sup> The Act provided that workers in Great Britain aged at least 22 and under state pension age and earning at

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<sup>25</sup> *Ibid.*, p 2.

<sup>26</sup> *Ibid.*, p ix.

<sup>27</sup> Pensions Commission, [Implementing an Integrated Package of Pension Reforms](#) (April 2006), p 16.

<sup>28</sup> *Ibid.*, p 17.

<sup>29</sup> DWP, [Security in Retirement: Towards a New Pensions System](#) (May 2006, Cm 6841), p 15.

<sup>30</sup> *Ibid.*, p 17.

<sup>31</sup> DWP, [Personal Accounts: A new way to save](#) (December 2006, Cm 6975), p 11.

<sup>32</sup> DWP, [Pensions Act 2008—Explanatory Notes](#), p 1.

least £5,035<sup>33</sup> a year would be enrolled into a pension scheme by their employer.<sup>34</sup> Enrolled workers would receive a pension contribution from their employer equivalent to at least 3 per cent of their earnings; pay a contribution of at least 4 per cent of their earnings; and get UK tax relief of about 1 per cent of their earnings, on contributions they made. Workers who were automatically enrolled could opt out and stop pension saving at any time, but those who stopped saving and still met the criteria for automatic enrolment would be re-enrolled periodically. The personal accounts scheme (which is now called the National Employment Savings Trust (NEST)) would have to accept all employers who wanted to use it for their workers, but employers could choose other schemes for their workers' pension saving, provided they met certain criteria which would be set out in subsequent regulations and guidance. These reforms were to be implemented in phases from 2012, with larger employers being the first to be obliged to enrol their workers automatically in a pension scheme.<sup>35</sup>

As part of the Pre-Budget Report in December 2009, the Labour Government announced that the implementation plan had been reviewed in light of economic circumstances. Automatic enrolment would begin as planned in October 2012 for large companies with over 120,000 employees, but new companies would be given until 2016 to establish themselves before being required to auto-enrol their employees. Automatic enrolment for small businesses would be phased in over 3 years from 2012. These changes to the implementation timetable would mean that some employees would be enrolled into a pension scheme later than under the original timetable. Employer contributions would be phased in from 1 per cent in 2012, to 2 per cent in October 2012, and to the full 3 per cent in 2017. By October 2017, automatic enrolment would be fully phased in.

### **3.3 Policy background: Coalition review of automatic enrolment**

In June 2010, the Pensions Minister Steve Webb announced a review into how the Government could best support the implementation of automatic enrolment. He said that a review was warranted because:

Circumstances have changed since the Pensions Commission published its recommendations in 2005. It is right that we consider whether the approach inherited from the previous Administration strikes the right balance between cost and benefits to individuals, employers and for the taxpayer, particularly in the light of current economic and fiscal conditions.<sup>36</sup>

The independent review, *Making Automatic Enrolment Work*, was published in October 2010. It addressed the following questions:

First, is there a case for excluding a substantial additional tranche of workers from automatic enrolment, for example those earning below a particular threshold or those above a certain age?

Second, is there a case for excluding any group of employers, in particular the very smallest employers, from the additional responsibilities implied by the policy?

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<sup>33</sup> It was planned that all the figures given would increase in line with earnings before the reforms were implemented.

<sup>34</sup> DWP, [Automatic saving: Changing workplace pensions](#) (November 2009), p 14.

<sup>35</sup> *Ibid.*, p 18.

<sup>36</sup> HC *Hansard*, 24 June 2010, col 2WS.

Third, would any changes to the proposed regulations, implementation and details surrounding automatic enrolment enhance the policy?

Fourth, under what circumstances is NEST necessary for the successful implementation of automatic enrolment and are there changes to the rules surrounding NEST which would be helpful?<sup>37</sup>

On the first point, the review noted that the purpose of automatic enrolment is to increase the numbers of people saving for their pension by ensuring that inaction on their part will lead to pension saving, just as inaction at present leads to no saving. However, the risk with such a policy is that inertia will lead to some people saving when they might have been better off not saving. Having examined the pros and cons of excluding more low-paid workers from automatic enrolment, the review concluded that:

In the end, unless we move the annual earnings threshold to £15,000 or more we cannot guarantee that everybody who is automatically enrolled will be better off as a result. And moving the threshold up to anything like this level will mean not automatically enrolling many millions who would benefit. Our judgment is that the detriment of any very substantial increase in the threshold would not justify the possible benefits.

However, there is one important change that we do recommend. The currently proposed threshold is very low, well below the current income tax threshold. In addition, contributions are due from the first pound earned above that threshold. This means that many people on very low earnings will build up very small pots indeed, potentially damaging the credibility of the reforms. We propose that people should only be automatically enrolled once they reach the income tax threshold (which the Government has announced will be increased to £7,475 in 2011, equivalent to £7,336 in today's prices), but that contributions should be on earnings in excess of the National Insurance earnings threshold (£5,715 in today's prices). This will avoid automatically enrolling those not earning enough to pay income tax, will ensure that the very tiny levels of pension contribution possible under the current proposals are avoided, and will ensure that many who would benefit from automatic enrolment are not excluded by a higher threshold. Our intention is that workers who earn between these two thresholds would be able to opt in and receive an employer contribution if they choose to do so.<sup>38</sup>

The review reached a similar conclusion on whether to change the upper age threshold for automatic enrolment. While some older workers would face potentially lower returns from pension saving, many would benefit from saving. The review judged that the detriment of potentially excluding such older workers from saving outweighed any potential benefits of a lower age threshold, and therefore it did not recommend any change in age thresholds.

The review noted that two thirds of employers are "micro employers" with fewer than five employees. Very few micro employers have any experience of pension provision. Automatic enrolment will impose a range of obligations on employers with regard to pension provision, and the review noted that the inclusion of many hundreds of thousands of very small employers will present "a major logistical, regulatory and

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<sup>37</sup> Paul Johnson et al, [Making automatic enrolment work—A review for the Department for Work and Pensions](#) (October 2010, Cm 7954), p 2.

<sup>38</sup> *Ibid.*, p 4.

enforcement challenge”<sup>39</sup> However, the review concluded that micro employers should not be excluded from automatic enrolment, for the following reasons:

- To do so would exclude 1.2 million employees from automatic enrolment.
- There would be substantial practical problems in enforcing boundaries. Identifying those employers with five employees at any one time is almost certainly beyond the capacity of current systems. In addition, incentives to hide or distort the number of employees could be considerable.
- A significant disincentive to business growth would be created. The pension costs alone of moving from four employees to five could come to more than £1,500. In addition, some competitive distortions might be created between employers either side of the size cut off.<sup>40</sup>

However the review did propose some regulatory changes to simplify automatic enrolment for employers. The first change was to allow employers to have a waiting period of up to three months before automatically enrolling a new employee into a pension scheme, rather than having to do it on the first day of employment (although workers who wished to opt in during the waiting period would be able to do so). The review argued that the advantages of a waiting period would be:

- It would avoid automatically enrolling large numbers of workers who leave very quickly after starting employment, including many seasonal workers. Hence, the costs of administering many very small pots would be avoided.
- It would allow employers flexibility to align enrolment dates with their own payroll and other systems.
- It would allow workers more opportunity to decide whether they want to opt out, allowing them to respond quickly and possibly reducing the number of refunds and the number of employees with just one month’s contributions.
- It would go some small way to closing the gap in treatment between contract based pension schemes and trust based schemes, with the latter offering refunds of contributions if the employee leaves within two years.<sup>41</sup>

The review noted that: “There was virtually unanimous support for a change of this kind amongst the employers and employer representatives we spoke to”.<sup>42</sup>

The second change proposed was a simplification of the scheme by which employers can certify that their own pension scheme meets the minimum requirements. Automatic enrolment requires minimum contributions based on a very particular definition of pay (total pay between a floor and a ceiling), whereas most existing pension schemes involve contributions defined as a percentage of all basic pay (not just pay above some floor). The review suggested a simplification of the criteria used to determine whether an employer’s pension scheme meets the requirements. Otherwise, employers might change their scheme rules to ensure that they fitted in with the way that the minimum requirements are currently defined. The review’s authors were concerned that if this

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<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*, p 6.

<sup>42</sup> *Ibid.*

happened, “there is a real risk that the revised rules may be somewhat less generous overall” than the employers’ existing pension schemes.<sup>43</sup>

The review also proposed two more minor changes to automatic enrolment: firstly, the largest employers, who are scheduled to start automatic enrolment in October and November 2012, should be allowed to automatically enrol employees ahead of this planned start date if they wish, from as early as July 2012. Secondly, employers should be given flexibility over the date they re-enrol employees who have previously opted out by allowing a six month window for this activity to take place.

The review also concluded that NEST was necessary to support the successful implementation of automatic enrolment. Although the review was cautious of recommending such a major Government intervention in the pensions market, it was felt that, in the short-term at least, there was no alternative because providers are currently unable to profitably service many employers, particularly small employers, but all employers needed to have access to a pension scheme in which they would be able to enrol their employees.<sup>44</sup>

For the Government, Steve Webb welcomed the review’s recommendations as “a sensible and balanced package of proposals” which would “ensure the introduction of automatic enrolment is stable and proportionate”.<sup>45</sup> He said that the Government would proceed with reforms on the basis of the review.

### **3.4 Bill provisions on automatic enrolment**

Clause 5 of the Bill amends sections 3 and 5 of the Pensions Act 2008 so that a jobholder will not be eligible for automatic enrolment under section 3 (or, with some exceptions, re-enrolment under section 5) unless, in addition to complying with the conditions set out in the Pensions Act 2008 (principally that the jobholder is aged at least 22 and is under pensionable age), the jobholder earns in excess of £7,475 per annum (the “earnings trigger”).<sup>46</sup> This implements the recommendation from the *Making Automatic Enrolment Work* review that the earnings trigger for automatic enrolment should be raised.

Clauses 8 and 9 amend the Pensions Act 2008 to introduce a new mechanism to review and revise the new automatic enrolment earnings trigger and the “qualifying earnings band” (the earnings on which contributions are payable in the case of a “qualifying scheme” which is a money purchase or personal pension scheme). The Secretary of State must consider in each year whether the amounts for the automatic enrolment earnings trigger, or the upper or lower limits of the qualifying earnings band, should be increased or decreased, taking into account national insurance earnings limits and thresholds, income tax personal allowances, the level of basic state pension for single adults, the general level of prices and earnings and any other relevant factors.<sup>47</sup>

Clause 6 introduces the optional waiting period as recommended in the *Making Automatic Enrolment Work* review. This allows employers to defer the automatic enrolment date of a worker for up to three months by providing them with a notice stating the employer’s intention to use a waiting period, together with details of the worker’s new

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<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*, p 7.

<sup>45</sup> HC *Hansard*, 27 October 2010, col 12WS.

<sup>46</sup> DWP, [Pensions Bill \[HL\]—Explanatory Notes](#), p 11.

<sup>47</sup> *Ibid.*, p 15.

enrolment date. The worker may opt into pension saving at any point during the waiting period.<sup>48</sup>

Clause 7 makes changes to the timing of automatic re-enrolment, so that regulations must secure that there is not more than one automatic re-enrolment in any period of two years and nine months, rather than in any period of three years.<sup>49</sup>

Clause 10 follows up the recommendation from the *Making Automatic Enrolment Work* review that the certification scheme should be simplified. It amends section 28 of the Pensions Act 2008 and introduces alternative self-certification arrangements for employers. The effect of Clause 10 is that employers can certify that their pension scheme satisfies the relevant quality requirements without having to meet the quality requirements originally set out in the Pensions Act 2008, as long as their scheme meets the alternative requirements which will be prescribed in regulations. The amended section 28 will provide that the alternative requirements that the Secretary of State prescribes must meet certain conditions. Namely, the Secretary of State must be satisfied that, in respect of most schemes, the total contributions paid by the employer, and the employer and the jobholder together, will not be less than if the scheme had met the relevant quality requirement. This must be the case both for a majority of the jobholders in the scheme, and all of the jobholders taken together.<sup>50</sup>

Other clauses in Part 2 amend “incorrect references in previous legislation to ensure a coherent set of regulations on automatic enrolment”.<sup>51</sup>

### 3.5 Reaction

The Federation of Small Businesses (FSB) said it was “extremely disappointed” that micro employers were not excluded from automatic enrolment.<sup>52</sup> Although it acknowledged that the Government had put in place some measures to make the process easier for small firms, it was still concerned about the costs involved. The FSB claimed that an average small firm with four employees would pay £2,550 per year in administration and pension costs but “the true administrative costs are unknown... and could be extortionate”.<sup>53</sup>

In contrast, the Confederation of British Industry (CBI) described the Pensions Bill as “good news for businesses”. Neil Carberry, the CBI’s Head of Employment and Pensions, welcomed the measures which reduced the administrative burden of automatic enrolment for businesses. He said that the simplified certification scheme “makes it more likely they will maintain their existing pensions, which are usually more generous than the new standard”.<sup>54</sup> Some commentators have expressed concerns that under automatic enrolment, employers would reduce current higher levels of pension provision to the minimum 3 per cent employer contribution.<sup>55</sup> For example, a survey by the Association of Consulting Actuaries (ACA) of firms with fewer than 250 employees found that 29 per cent of these smaller firms were “likely” or “highly likely” to consider

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<sup>48</sup> *Ibid.*, pp 12–13.

<sup>49</sup> *Ibid.*, p 15.

<sup>50</sup> *Ibid.*, p 16.

<sup>51</sup> *Ibid.*, p 4.

<sup>52</sup> FSB press release, ‘[Automatic enrolment into pensions should not include micro firms](#)’ (27 October 2010).

<sup>53</sup> FSB press release, ‘[Pensions ticking bomb will cost small firms £2,550](#)’ (10 November 2010).

<sup>54</sup> CBI press release, ‘[CBI reacts to the Pensions Bill](#)’ (13 January 2011).

<sup>55</sup> Nicholas Timmins, ‘[Treasury gains £38bn as pensions reform goes further and faster](#)’, *Financial Times* (14 January 2011).

levelling down to mitigate the cost of auto-enrolling additional employees.<sup>56</sup> There have also been concerns that many employees will opt out of enrolment in a pension scheme. The same survey found that smaller firms expect an employee opt-out rate of, on average, 35 per cent.<sup>57</sup> Experts have also noted that the introduction of automatic enrolment will affect some business sectors more than others:

The Department for Work and Pensions estimates auto-enrolment will cost employers an additional £3.5bn a year, but the impact will be most severe in sectors like retail where typically only 20–25 per cent of employees are in the scheme and where low trading margins offer little scope to absorb the hit on cash flow.

... The nuclear options for companies are to pass the cost on to the customer, which would affect sales; to make redundancies, possibly already planned; and to pay costs out of profits.

... Other options include offsetting employer contributions against pay increases and cutting pension and non-pension benefits.<sup>58</sup>

The TUC described automatic enrolment as “a historic advance for union campaigning—a minimum pension to go alongside the minimum wage”. However, the General Secretary Brendan Barber expressed concerns about the reforms introduced by the *Making Automatic Enrolment Work* review:

We are concerned at the increase in the threshold for auto-enrolment and the three-month waiting period. The main losers from this increase will be part-time women workers, the least-likely group in the workforce to have a pension. The linking of the auto-enrolment threshold to the income tax threshold will make this worse if the coalition continues to raise the basic tax allowance.<sup>59</sup>

### 3.6 Further information

More detail on the background to automatic enrolment and some of the issues raised by the design of the policy can be found in the House of Commons Library Standard Notes, [Pensions: Automatic enrolment and employer contributions](#), SN/BT/4847 (last updated 4 February 2011) and [National Employment Savings Trust \(NEST\)](#), SN/BT/4826 (last updated 8 November 2010).

## 4. Judicial Pensions

Judges who are members of the Judicial Pension Schemes (JPS) do not currently pay contributions towards their own pension benefits. The only contribution they are currently required to make is either 2.4 per cent or 1.8 per cent of gross salary, depending on the scheme to which they belong (the higher rate now applies to very few judges), towards the provision of a contingent pension for a surviving spouse, civil

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<sup>56</sup> ACA, [Survey of Smaller Firms' Pensions](#) (4 January 2011), p 4.

<sup>57</sup> *Ibid.*

<sup>58</sup> Debbie Harrison, ‘Tough call ahead on auto-enrolment’, *Financial Times* (24 January 2011).

<sup>59</sup> TUC press release, “[Good and bad’ in Pensions Review](#)’ (27 October 2010).

partner or dependent children.<sup>60</sup> This scheme has been described as “the most generous in the public sector”.<sup>61</sup>

The Coalition Government announced in May 2010 that it would establish an independent commission to review the long-term affordability of public sector pensions.<sup>62</sup> In June 2010, the Chancellor appointed Lord Hutton of Furness, who had been Secretary of State for Work and Pensions under the Labour Government, to chair an Independent Public Service Pensions Commission, with a remit to “conduct a fundamental structural review of public service pension provision and to make recommendations to the Chancellor and Chief Secretary on pension arrangements that are sustainable and affordable in the long term, fair both to the public service workforce and the taxpayer and consistent with the fiscal challenges ahead, while protecting accrued rights”.<sup>63</sup>

Lord Hutton published his interim report in October 2010. It concluded that:

The issues around fairness, sustainability, promoting productivity and the need for transparency and simplicity mean there is a need to consider long-term structural reform of public service pensions. However, that reform will take time. Increased longevity, the imbalance between employer and employee contributions and the fact that total contributions may be too low if the discount rate is too high suggest there is a case to make short-term changes, pending long-term reform.<sup>64</sup>

The report argued that the most effective way to make short-term savings was to increase member contributions, and that there was a clear rationale for doing so.<sup>65</sup> The report also noted that although other public service pension schemes had been reformed under the Labour Government, the JPS had “not been significantly modernised at all”.<sup>66</sup>

A spokesman for the Ministry of Justice said that:

The government has accepted the interim recommendations of Lord Hutton’s Independent Public Service Pensions Commission, including that public servants should contribute more towards their pension costs. The judiciary are no exception... We are planning to legislate to take personal contributions from members of the Judicial Pension Schemes who have not yet accrued a full pension.<sup>67</sup>

Clause 24 of the Bill therefore amends the Judicial Pensions and Retirement Act 1993, introducing provisions into the JPS to allow contributions to be taken from scheme members towards the cost of providing personal pension benefits. Contributions will only be taken during the period in which the individual judge is accruing full pension benefits. If the judge retires, resigns or is removed from office, contributions will stop being taken from that date.

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<sup>60</sup> Ministry of Justice, [Pensions Bill 2011—Impacts—Annex E1: Judicial Pensions](#) (16 December 2010), p 5.

<sup>61</sup> ‘[Judges to pay higher pension contributions](#)’, BBC News Online (13 January 2011).

<sup>62</sup> [The Coalition—Our Programme for Government](#) (May 2010), p 26.

<sup>63</sup> HM Treasury, [Independent Public Service Pensions Commission: terms of reference](#).

<sup>64</sup> Independent Public Service Pensions Commission, [Interim Report](#) (October 2010), p 14.

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid.*, p 40.

<sup>67</sup> ‘[Judges to pay higher pension contributions](#)’, BBC News Online (13 January 2011).

The Ministry of Justice spokesman explained that judges were not being singled out.<sup>68</sup> Contributions for all public sector pension scheme members could rise following the publication of Lord Hutton's final report later this year, but rule changes to bring in employee contributions for judges required an amendment to legislation first.

Further information about the reform of public sector pensions more generally can be found in the House of Commons Library Standard Notes, [Public Service Pension Reform—1997 to 2010](#), SN/BT/5298 (last updated 23 November 2010) and [Public Service Pension Reform—2010 onwards](#), SN/B/57/68 (last updated 23 November 2010).

## 5. Indexation and technical measures

In July 2010, Steve Webb, Pensions Minister, announced that in future the Government would use the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) as the basis for revaluing and indexing pension rights in defined benefit occupational pension schemes.<sup>69</sup> This change was largely implemented by the Occupational Pensions (Revaluation) Order 2010 (SI 2010/2861) which was laid before Parliament on 8 December 2010.

Clause 14 of the Pensions Bill makes amendments to previous primary legislation (the Pensions Schemes Act 1993, the Pensions Act 1995 and the Welfare Reform and Pensions Act 1999) to address references to the RPI and to ensure that schemes are not required to increase pensions in payment by the higher of RPI or CPI.<sup>70</sup> Clause 15 removes references in schedules to the Pensions Act 2004 and the Pensions Act 2008 to the RPI when calculating indexation increases for pension compensation paid by the Pensions Protection Fund.<sup>71</sup>

Further information about the indexation of occupational pensions and the switch from RPI to CPI is available in the House of Commons Library Standard Note, [Occupational Pension Increases](#), SN/BT 5656 (last updated 31 January 2011).

The Bill also contains a number of other technical measures, including:

- Increased flexibility in the date of consolidation of additional state pension; [Clause 3]
- Abolition of new awards of Payable Up-rated Contracted-out Deduction Increments (PUCODIs); [Clause 2]
- Financial Assistance Scheme: amendments to legislation concerning transfer of assets, and amount of payments; [Clause 18]
- Miscellaneous amendments to Pension Protection Fund legislation; [Clause 17]

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<sup>68</sup> *Ibid.*

<sup>69</sup> HC *Hansard*, 8 July 2010, cols 14–16WS.

<sup>70</sup> DWP, [Pensions Bill 2010–11—Summary of Impacts](#) (13 January 2011), para 18.2.

<sup>71</sup> DWP, [Pensions Bill \[HL\]—Explanatory Notes](#), p 18.

- Amendments to legislation concerning payments of surplus to employers;  
[Clause 20]
- Amendments to legislation concerning the requirement for indexation of cash balance benefits;  
[Clause 16]
- Corrective amendments to legislation concerning the calculation of debt owing to a pension scheme.<sup>72</sup>  
[Clause 22]

Further information about these technical provisions is given in the [Explanatory Notes](#) to the Bill.

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<sup>72</sup> DWP, [Pensions Bill \[HL\]—Explanatory Notes](#), p 3.

