ETHICAL INVESTORS

ETHICAL FINANCIAL MANAGEMENT

2012 -

All Change

For Pensions

Introduction

Just when you thought it was safe to rely on the latest 'new pensions regime', another one comes along and everything is back to the drawing Board. In 2001 the Government introduced Stakeholder Pensions. In 2006 they introduced 'Pensions Simplification', a raft of new rules designed to simplify retirement planning which have actually made a positive difference to many people. So, after simplification, was there a need for anything else?

Well, if we are being generous, the answer is probably yes. What the Stakeholder Pension and Pensions Simplification have not been able to achieve is a significant increase in the number of people planning for their retirement. Whilst the existing system is much improved, being more flexible with more generous tax reliefs, this only really applies to those who would have set up a pension plan for themselves anyway. The Government's main aim is to increase the number of people that will set aside funds towards their retirement. What is their solution? ***Personal Accounts***.

Personal Accounts

Although the legislation has yet to be passed in full, the Government is pushing on with the plans for Personal Accounts from 2012. The name Personal Account sounds quite innocuous, but be warned; this is one of the biggest shake-ups in the history of retirement provision in the UK. So, what's so radical about the scheme? Well, Personal Accounts are fundamentally different to anything that has gone before:

Since a State Pension was first introduced at the beginning of the 20th century, the scheme has always operated on a 'pay-as-you-go' basis. This means that workers have contributed towards a State Pension throughout their working life, but no money has ever actually been saved. Money paid in by those in work has been paid out to those that have retired. When those in work retire, they are paid their State Pension by those who are remaining in work. No money is ever put aside by the Government.

This was fine whilst the working population was increasing and a relatively small proportion of the population lived for a long time in their retirement. The system works really well if there are lots of workers and the retired die early! If either of these factors changes, a State pay-as-you-go system starts to fall apart. In 2008, both of these factors are now in reverse; we have a decreasing working population and a significantly increasing retired population. We could be as little as a decade or so away from a critical turning point for State pensions; the number of people working and paying in to the State will be outnumbered by those who have retired and are claiming a pension. It doesn't take a genius to work out that something needs to change.

Whilst we do not see any sign of the Basic State Pension being threatened, the introduction of Personal Accounts is an attempt to deal with the problem. For Personal Accounts, instead of working on a pay-as-you-go basis, payments will be collected by Government and the money will actually be invested in an account in each individual's name. In the long term, therefore, the strain on the State is likely to reduce as a very high proportion of the population has a pension account in their own name.

The Government has established the Personal Accounts Delivery Authority (PADA), whose responsibility it will be to administer Personal Accounts, control the collection and allocation of payments and to appoint investment managers to invest the money (see later for ethical options).

Impact on Employees

Compulsion? – this is the bit that will interest everyone. The current plans are to introduce compulsion for all employees to be placed into a Personal Account on the day they start work, unless their employer offers a scheme that is equivalent to Personal Accounts. Even if there is a probation period associated with the job, entry into the Personal Accounts regime will begin on day one.

National Insurance payments for the Basic State Pension will continue, with Personal Accounts sitting on top of this. The suggested compulsory minimum payment by employees will be **4%** of band earnings (between £5035 and £33500). Currently, anyone is free to pay into a private pension or not, but from 2012 all employees will be forced to make a payment to a Personal Account unless a suitable employer arrangement is in place, into which they can contribute.

There are early suggestions that an ‘opt-out’ facility might be available, but this needs to be spelled out in greater detail. For example, if an employee decides to ‘opt-out’ of paying into a Personal Account, will they be forced to make a payment into an alternative pension, or will they simply be allowed to pay nothing? If the latter, will the compulsory employer contribution be lost? This would be an important financial decision – choosing not to pay oneself is one thing, but losing the employer’s payment will make a very big difference.

Before everyone runs off to their employer to ask for a pay rise to cover the drop in earnings, bear this in mind. Employers will also be forced to make a **3%** contribution of band earnings to each employee’s Personal Account. So, they’ll be feeling the cost of Personal Accounts as well.

Please note that if an employee is already a member of an employer sponsored pension arrangement, which PADA accept as being equal to the new Personal Account, then there will be no compulsion to join the Personal Account arrangement. The Personal Accounts legislation is really aimed at the 85% of employers, employing 77% of the work force, who do not have a ‘good quality’ pension plan in place.

Impact on Employers

As mentioned above, those employers who do not currently offer what PADA consider to be a ‘good quality’ pension arrangement will be compelled to contribute to a Personal Account for every member of staff at the rate of **3%** of band earnings. Effectively, this is an overnight increase in the cost of employment. Pension contributions do attract tax relief, but from a cash flow and budgeting perspective this is a significant increase. Also, band earnings will include normal salary, overtime, commissions and bonuses, and as such the payment can vary regularly for some employees, adding to the administration.

If the employer already offers a pension arrangement that is deemed to be ‘good quality’, then there are three main options to choose from when Personal Accounts are introduced: -

a) Keep the existing scheme exactly as it is. This is probably the easiest option, especially where the current contribution levels are in excess of the 3% for Personal Accounts.

There will be an impact, however, if the existing scheme membership is voluntary. The Personal Accounts rules will either force the employer to enrol non-joiners into Personal Accounts, or to join the main arrangement. So, there will still be cost implications when Personal Accounts arrive in 2012.

b) If the current level of employer contribution is in excess of 3%, the employer could reduce the payment down to the 3% level. This could obviously be seen as a negative option as far as existing members are concerned, but it might be a way for the employer to provide the funds needed when compulsory enrolment comes in.

c) Close the current scheme completely and simply enrol everyone in the Personal Accounts arrangement.

Employers are going to need independent advice once the new rules come in to play, and for those employers wishing to add an ethical option, Ethical Investors is well placed to offer help and advice.

Self Employed?

See our Guide to Stakeholder Pensions – Personal Accounts are only directed at employees

Ethical Personal Accounts

As things stand at the moment, it looks as though this is going to be fudged. Ethical Investors' Director, Lee Coates, is a Board member of the UK Social Investment Forum which is actively engaged with the Government and representatives of PADA to introduce a 'socially responsible option'.

The Government has pledged to recommend to PADA (it has decided not to order PADA) that it offer an SRI option amongst the fund links available to Personal Account holders. Even if this goes ahead, there will probably only be a single SRI option, the 'one ethic fits all' approach. The current terminology leads us to believe that the SRI option will be anything but ethical. It is likely to have no avoidance criteria, and will probably be quite soft on the positive side as well.

For those that wish to avoid arms, alcohol, tobacco, human rights issues, environmental damage, animal testing, factory farming etc, it looks unlikely that all these will be covered in Personal Accounts.

What does this mean for those who wish to invest ethically? Well, in simple terms, hard luck. Individuals cannot choose not to open a Personal Account, unless they 'opt-out', but the implications of the latter are as yet far from clear. Nor will they have the choice to invest their money ethically. So much for personal freedom! Please be assured that we are actively campaigning through every possible channel to ensure that the rights of ethical investors are upheld. We believe it is entirely unacceptable for the Government to force people to act against their personal values, or faith, and that something must be done to allow everyone to apply their principles within Personal Accounts.

The big problem, as far as we see it, is that the Government is in an almost impossible position if it applies ethical values to a single investment link within Personal Accounts. In introducing Personal Accounts, appointing PADA to oversee them and making membership 'compulsory', then in effect the scheme will be endorsed by the Government. It would then be up to the Government to set the ethical policy, and In doing so, it is likely to alienate almost everyone - damned if they do, damned if they don't.

Let's look at an example. Assume the Government decides that it ought to have criteria on Personal Accounts that meet the needs and expectations of Quakers. Those who follow Quaker principles will be very happy. Those who are not Quakers may also be happy about a policy that does not invest in the arms trade. The Arms industry, however, may be a little more than upset about being labelled as 'unethical' by the British Government. We are sure the corporate lobbying machine will get to work very quickly to protect the defence industry. On the other hand, if the Government give in to the machinations of 'big business', it is basically saying that the ethical values set by Quakers are not really legitimate.

The same argument works for vegans/vegetarians and the meat/dairy industry, Catholics and abortion/human embryo issues and almost any other ethical or moral criteria applied. The Government will alienate business by promoting particular ethical values and will alienate individuals if they do not offer criteria that each individual can accept.

We will continue our efforts to convince Government of the importance of adopting broad ethical values, and to ensure that everyone who is forced into a Personal Account has the ability to invest in line with their principles. We will be keeping clients up to date with our progress over the next few years.

ETHICAL INVESTORS
ETHICAL FINANCIAL MANAGEMENT

The ethical pension specialists

Head Office: Montpellier House, 47 Rodney Road, Cheltenham, GL50 1HX
Tel: 01242 539848 Fax: 01242 539851 info@ethicalinvestors.co.uk
www.ethicalinvestors.co.uk www.ethicalstakeholder.com www.ethicalmortgage.co.uk