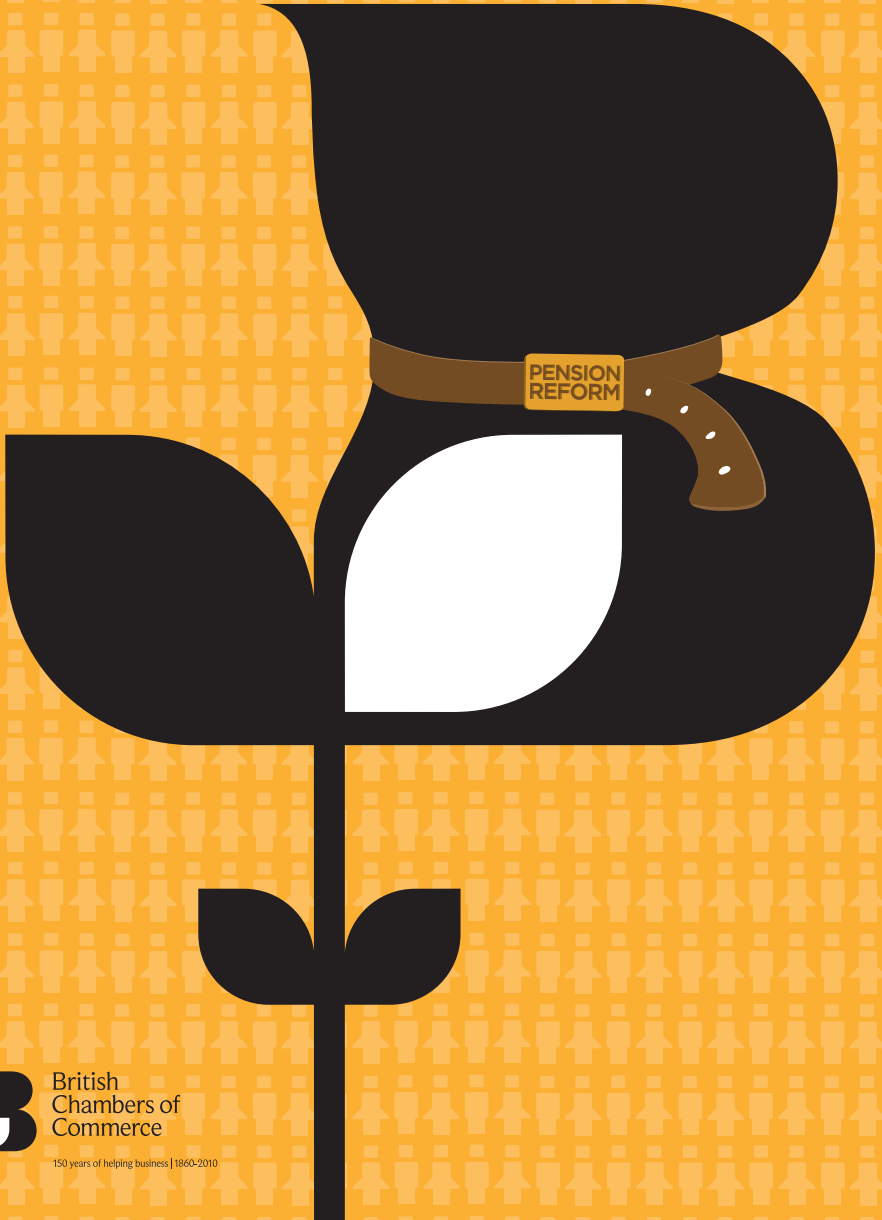


PENSION REFORM:
LIMITING THE SQUEEZE ON BUSINESS
SEPTEMBER 2010



British
Chambers of
Commerce

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ABOUT US

The British Chambers of Commerce is the national body for a powerful and influential Network of Accredited Chambers of Commerce across the UK; a Network that directly serves not only its member businesses, but the wider business community.

Representing 100,000 businesses who together employ more than 5 million employees, the British Chambers of Commerce is The Ultimate Business Network. Every Chamber sits at the very heart of its local community working with businesses to grow and develop by sharing opportunities, knowledge and know-how.

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CONTENTS

Foreword	p3
Executive Summary	p4
1. Introduction	p6
2. Potential Impacts of 2012 Reforms on UK Business	p15
3. Recommendations	p27
4. Conclusion	p29
5. Methodology	p30



No one, least not business, disputes the enormity of the challenge that demographic change poses to the UK economy. By 2026, half of all adults in the UK will be over 50. Our current fiscal position, combined with longer life expectancies, means the Government can no longer guarantee there will always be enough money to pay for long retirements. People will have to work longer, and they will have to save more.

This is why the British Chambers of Commerce has been a supporter of auto-enrolment as a means to boosting retirement income. However, the complex web of regulations that were passed at the beginning of 2010 is not what was expected when the concept was first proposed four years earlier. Businesses cannot be expected, nor can they afford, to act as an administrator to make the Pensions Act 2008 run smoothly. Both the set up and running costs of the reforms are too high, and there is a real risk that, combined with the other employment regulations due to commence in the next few years, they could damage job creation.

Businesses have told me that they need more information about these reforms so that they can start planning the future of their workforce, deciding on appropriate and affordable benefit packages, and importantly to be able to accurately tender for future contracts. Yes it is important that employees have access to a pension pot at the end of their working lives - but it is also important to ensure that the private sector can afford to create the jobs required to drive the economy in the first place.

A handwritten signature in black ink that reads "David S Frost". The signature is written in a cursive style and includes a long, sweeping underline that extends to the right.

David S Frost

Director General

The British Chambers of Commerce undertook research with its members to uncover the impact that the Pensions Act 2008 would have on business and the UK economy when it is implemented between 2012 and 2016. Although some of the previous Government's research examined business reactions, this was done pre-recession, and without regard to the cost impacts of other pieces of employment legislation. The previous Government also failed to adequately consider the effect that the pension reforms will have on the temporary labour market, and how their planned staging process would affect competition.

This report first looks at the background to the reforms, and analyses how the labour market, the economy and the employment framework have changed since the reforms were first conceived. It also looks at the recent experience in New Zealand, where, as a result of the recession, the KiwiSaver scheme was changed to make it less costly for employers.

BCC research identifies four key problem areas for business, and suggests some ways that the business impact could be reduced:

COMPETITION

In a response to a Parliamentary Question on the staging process on January 29th 2010, the then Pensions Minister, Angela Eagle MP gave the example of "a small firm staged in 12 months before another small firm that it actively competes with will face approximately £960 more in contribution costs than the firm that is staged later." Businesses, regardless of size or sector, see this competition impact as an issue for them, whether or not they plan to increase their prices or fund the resultant increase in labour costs by other means.

PENSION SCHEME ADMINISTRATION

The vast amount of administration that businesses will have to deal with will include both one-off set-up processes and recurring paperwork. The costs and difficulties with the set up will be more problematic as each business has a different staging date which can be any month (except December). The costs to set up the pension scheme, particularly for business with no in-house experience or expertise in this area, will be very high. Once the scheme is set up, the biggest administrative burden for many firms with high staff turnover will be processing new starter enrolments, opt outs and refunds.

THE EMPLOYMENT RELATIONSHIP

A recurring concern from business in our research was how the reforms would affect the relationship between an employer and their employee. Business experience suggests that, for many workers, their payslip will be the first they know of their new pension scheme – or the first they know of their mandatory contribution. The problems that auto-enrolment will cause are aggravated by the requirement to re-enrol employees every three years.

RISKS TO THE EMPLOYER GENERATED BY THE PENSION ACT 2008 OBLIGATIONS

New employment obligations will always create a new route for vexatious employees to make claims against businesses; new areas for well meaning businesses to get it wrong; and opportunities for unscrupulous businesses to gain a competitive advantage. In reforms as complex and alien to many business such as these, the risks are higher. The current penalty regime is harsh. A flat rate fine of £400 can be levied by the regulator for any form of non-compliance, including innocent procedural mistakes.

This report analyses the impact of the 2012 pension reforms, which will be implemented in a very different economic environment to the one in which they were conceived. The cumulative effect of these reforms and other new employment regulations are considered, alongside an international comparison of the reforms and an evaluation of their potential impact on future job creation.

OVERVIEW OF PENSIONS REFORMS

The Pensions Commission

In December 2002, the then Labour Government set up a Pensions Commission, chaired by Adair Turner, to 'keep under review the regime for UK private pensions and long term saving.' The Government believed that reforming private provision was necessary, alongside state reform. The Commission came to the following conclusions:

- On the business side, employers no longer believed that contributing to an employee's pension would help recruitment and retention.
- On the employee side, psychological barriers often prevent people making long term decisions about saving without some degree of encouragement or compulsion.
- The pensions industry was also ill-equipped. Without an Annual Management Charge (AMC), the industry was reluctant to offer pensions to those on low incomes in small businesses or to the self employed. At the same time, an AMC is a significant disincentive to saving.

The Commission's final report was published on 4th April 2006 and made a number of recommendations to alleviate these problems. The key recommendation was the creation of a National Pension Savings Scheme (NPSS). This would involve:

- All employees being automatically opted into NPSS or a high quality employer pension scheme, but with the right to opt-out;
- the self-employed would be able to participate on a voluntary basis;

- default level of contributions should be set at 8% of earnings above the primary threshold¹;
- the employee would pay 4%, the employer 3%, and then tax relief would make up the remaining 1%;
- employers wanting to offer a higher level of provision would be able to opt-out of the national scheme and make their own arrangements; and
- the AMC of the national scheme should be 0.3% or less.

Government Response

On 25th May 2006, the Government responded to the Pension Commission's final report with a White Paper, 'Security in Retirement: Towards a New Pensions System.' Ministers accepted the Pension Commission's recommendation to create a new auto-enrolment scheme, but made some changes to the detail:

- contributions based on a band of earnings between £5,000 and £33,000 a year; and
- contributions should be phased in by 1% each year for three years to make the plans more affordable for employers.

These proposals were consulted on and a second White Paper followed in December 2006 entitled, 'Personal Accounts: A new way to save.' Further consultation and a Government response followed before the Pensions Bill went before Parliament.

Pensions Act 2008

The Pensions Bill gained Royal Assent in November 2008, almost a year after its introduction into Parliament. One of the most important changes made during the passage of the legislation was to allow businesses to use existing contribution calculations as long as, over a year, they would equal or better 3% on the specified band of earnings. This amendment essentially introduced a greater degree of flexibility than the original proposals allowed, for example, allowing businesses to make contributions on all earnings, rather than just a band, as long as the overall effect was a 3% contribution with respect to the band.

¹ The primary threshold is the level of income at which income tax and national insurance become payable.

The real detail of the changes, and their impact on employees, is set out in regulations laid before Parliament at the beginning of 2010. These regulations set out, amongst other things, how an employer registers a scheme with The Pensions Regulator (TPR), the timetable for the reforms, and the penalty regime.

Independent Review

On June 24th 2010, the new Conservative-Liberal Democrat Coalition Government announced a review of the reforms to be conducted by David Yeandle (EEF), Adrian Boulding (Legal & General) and Paul Johnson (IFS).

This review has a wide scope looking at everything from small business exemptions, to the role of National Employment Savings Trust (NEST), to the appropriateness of pension savings to different groups of people. However, it is unlikely that the review will change the fundamental principles of the reforms – auto-enrolment and a compulsory employer contribution.

International Comparisons

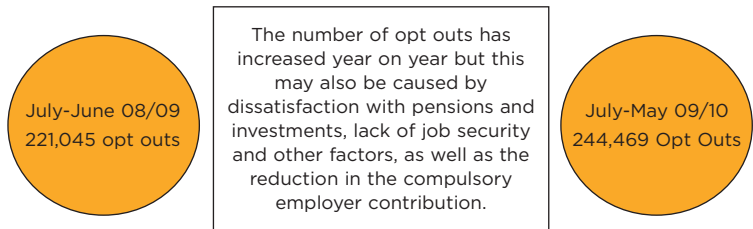
The UK reforms are modelled on the New Zealand KiwiSaver system, which also provides for a system of auto-enrolment and compulsory contributions from both employee and employer. However, there are some important differences between the two policies as they stand.

	UK	New Zealand
Age Bracket	22-65	18-64
Temporary workers?	Included	only contracts over 28 days
Time to opt out	30 days	8 weeks
Employer contribution	3% minimum	2% minimum
Withdrawal of benefits?	No	yes- for first time home buyers

The reasons for some of these differences are due to idiosyncrasies within the labour law framework in each country. For example, UK auto-enrolment was set to begin at 22 because it is at this age that an individual is entitled to the adult rate of the National Minimum Wage (NMW)².

Although the original aim of the New Zealand model was for employer contributions to rise by 1% each year until they hit 4%, an amendment came into force in April 2009 meaning that the rise from 1% to 2% would be the last one³. The Government decided to reduce the employer contribution to help employers during the economic downturn. This reduction in expectations of benefits does not seem to have dramatically affected take up of the scheme. New Zealand has a relatively small labour market, with 1.7m employed in either full-time or part-time occupations⁴. In May 2010, after opt-outs and closures of accounts, there were still 1.7m members of KiwiSaver (including over 600,000 who had not opted in through an employer⁵).

Changes in Opt out Levels in Zealand



² However, since the Pensions Act 2008 was passed, the Government decided to change the law so that 21 year olds were now entitled to the adult NMW.

³ <http://www.consumer.saver.org.nz/kiwisaver/>

⁴ <http://search.stats.govt.nz/search?af=&w=employment&date=&button2.x=14&button2.y=10>

⁵ <http://www.kiwisaver.govt.nz/statistics/ks-stats-10-04-30.html>

⁶ http://www.beehive.govt.nz/sites/all/files/KiwiSaver_info_sheet_0.pdf

The other changes that were made at the same time as the reduction in compulsory employer contribution were abolishing employer tax credit and the \$40 employee subsidy on charges. These amendments aimed to, “make it (KiwiSaver) enduring and affordable for members, employers and taxpayers⁶.”

It is clear from the KiwiSaver experience that auto-enrolment as a policy does increase pension saving. However, the reforms were not immune from the economic crisis, nor from changes in Government. The UK review would do well to take lessons from the fundamental changes that were made to KiwiSaver, whilst still ensuring that the original policy intent was implemented.

2010-2014 –Pension Reform in context

It is very unlikely that one piece of legislation or one regulation would, on its own, have a significant disincentivising effect on employment. However, there is a real concern that the cumulative effect of pension reforms and the large number of additional changes in employment regulation could dampen demand for labour in the UK.

Case Study

A property management firm in Manchester, with 45 employees and no internal HR support, has 7 members of staff who each earn under £15,000 per year. Although most of the cost of pension provision will be funded through lower basic wages, the business thinks that, in the long term, reducing staffing levels will help them to decrease the cost of these reforms, and the cost of complying with employment regulation as a whole.

The employment landscape has certainly changed a lot since the Pensions Commission made its recommendations in 2006.

2006	2007	2008
NMW increases to £5.35	NMW increases to £5.52	NMW increases to £5.73
Introduction of Default Retirement Age	Minimum Holiday Entitlement increases	
Maternity and Paternity Leave amendments	Extension of maternity leave, flexible working rights for carers and introduction of KIT days ⁷	

⁷ KIT days are Keep in Touch days which gives a woman on maternity leave the right to spend 10 days, either in the workplace or training, without losing their leave.

CHAPTER ONE: INTRODUCTION

2009	2010	2011
NMW increases to £5.80	NMW increases to £5.93	Right to Request Time off to Train (SMEs) ⁸
Tips Excluded from NMW	Consolidation of equality legislation into one Act - with new regulations in some areas	Equal rights for agency workers (Agency Workers Directive)
Extensions of right to request flexible working	Introduction of Fit Notes	Additional Paternity Leave & Pay
Minimum Holiday Entitlement increases	Right to Request Time off to Train ⁹	
	Introduction of NMW for apprentices	

Between 2006 and 2010, the National Minimum Wage went up by 10.8%. If, between 2006-2010, the NMW had risen in line with RPI inflation then it would be £5.78, 15p less than the actual amount¹⁰. Annual statutory holiday entitlement has increased to 28 days and a plethora of new rights on issues from flexible working to agency working to discrimination rights have been introduced. Much of the cost and impact flowing from these changes has been borne by business.

The Coalition has committed to reviewing previous employment regulation, but also to introduce a limited amount of new laws in this area¹¹. In particular, attempts to remove the Default Retirement Age (DRA), extend the right to request flexible working, change parental leave provision and action on equal pay are likely to entail further cost to business.

⁸ This is subject to a consultation launched on 11th August 2010.

⁹ The continuation of this law is subject to a consultation launched on 11th August 2010.

¹⁰ ONS

¹¹ Coalition Agreement

Changes which may have a direct impact on the cost of the 2012 reforms include the planned increase of the State Pension Age (SPA)¹² and plans to phase out the DRA¹³. The combined impact of these changes, and the changing demographics in the UK, should mean that more people are working for longer. This will increase pension liabilities for firms, and the removal of the DRA will make planning assumptions for costs very difficult.

Employment

When wide-ranging reform of private pension provision in the UK was first suggested in 2006, the economic outlook was very different to today. In 2006, unemployment was 5.4%; today it is 8%¹⁴ and the BCC's Economic Forecast predicts unemployment will continue rising in 2011 to 8.4%. The Office for Budget Responsibility forecasts that the public sector will lose 460,000¹⁵ jobs between now and 2015 – and it is the private sector that will have to create jobs if these people are to be re-employed.

Given the uncertain economic backdrop, it is crucial that no new regulation disincentivises job creation in the UK. The social and economic impacts of unemployment are well documented, but there are two key indicators which are particularly significant. Firstly, youth unemployment, which in 2009 was 17.2%, compared to 12.2% in 2006. If the private sector does not begin to create a significant volume of jobs for young people across the country then there is a real danger that a 'lost generation' may result. Secondly, an upcoming issue is those who are long term unemployed. In Q1 2006, 21.2% of unemployed people had been unemployed for over 12 months, compared to 30.2% in Q1 of 2010.

This profound change in our labour market since 2006 indicates a clear need to reconsider any regulation and/or taxes which may act as a barrier to job creation. However, specifically in terms of pension reform, it is also important to examine the impact that these structural changes in the UK labour market may have had on individual employees' attitudes. Although this is outside the scope of this report, resulting changes in attitudes towards saving, work, job security and pensions must be taken into account when designing private pension provision.

¹² The Government is consulting on speeding up the increase in the State Pensions Age, which would result in people working longer and accruing more pension contributions from their employer.

¹³ The DRA will be phased out in 2011 which should lead to individuals working longer and accruing more pension contributions from their employer.

¹⁴ ONS

¹⁵ http://budgetresponsibility.independent.gov.uk/d/employment_forecast_300610.pdf

Pensions – a damaged brand?

In 2008 when the financial crisis hit the global markets, pension funds suffered dramatic losses. The largest losses incurred in the OECD were found in Ireland, where 37.5% was wiped off the value of private pensions¹⁶. Private pension saving is clearly a crucial component of current retirees' pension income. Although the OECD average is that 20% of income comes from private sources, for 5 states (UK, USA, Canada, Australia and the Netherlands) the average is over 40%¹⁷. For younger workers just beginning to make contributions, the impact of the crisis on their pension savings will be smaller but certainly this indicates the importance of reducing the impact of any future financial crashes on retirement incomes.

Evidence suggests the recession has had a big impact on pension savings in the UK, and perception of pension products. Scottish Widows' recent survey found that 41% of individuals are saving less for their retirement due to the economic downturn¹⁸. This may be because they have less disposable income or job security, but also is likely to be related to a loss of faith in pensions.

As well as the recent problems in the pension industry, many feel that pension schemes themselves, by using jargon and complex terms, put people off. Mark Hommel at PricewaterhouseCoopers LLP commented that "people are not engaged in pension savings because of complex regulation and a pensions industry communication style mired in unnecessary jargon, which contributes to an overall lack of trust¹⁹."

Many people find pension savings an emotive issue and it is important to them that they can trust their adviser and scheme with their money, investment choices and ultimately in providing them with a suitable lifestyle during retirement. A recent survey for Which? found that 85% of people thought it was important or very important to trust their scheme²⁰.

Our research with employers showed that whilst businesses with contributory pension schemes were more confident in their ability to deal with the 2012 reforms than those that did not have a contributory scheme, many felt uneasy when dealing with their

¹⁶ <http://www.oecd.org/dataoecd/10/26/43060101.pdf>

¹⁷ Ibid.

¹⁸ http://www.scottishwidows.co.uk/documents/generic/2010_06_pensions_report_launch.pdf

¹⁹ <http://www.ukmediacentre.pwc.com/News-Releases/Changes-in-retirement-age-PwC-comment-ed4.aspx>

²⁰ <http://www.allbusiness.com/government/4109926-1.html>

CHAPTER ONE: INTRODUCTION

scheme and often resorted to external advice or management. This is likely to continue to be the case post-2012. The Government Impact Assessment accompanying the Pensions Act 2008 itself projects that 84% of businesses will seek external advice. One of the aims of the review must be to decrease this number. In fact, a lesson should be taken from this legislation that good regulation should not force the vast majority of businesses to pay for guidance to comply.

Our research uncovered four areas where businesses are most concerned, and where the impact of the reforms will be felt the most. Businesses also commented on how they are planning to fund the increase in labour costs that will flow from the implementation of the Pensions Act 2008. These are the impacts on competition with a sector/area, administering the pension scheme, the damage to the employment relationship and increased risks to the employer. Businesses felt that these issues have the potential to really affect the way they recruit staff and run their businesses, to the detriment of their own business growth and also the UK economy.

COMPETITION IMPACTS

Early on in the planning of the reforms it became clear that not all businesses could be forced to register a pension scheme with TPR and begin making contributions on the same day, as the systems at TPR and NEST would not be able to cope. The staging process that was agreed means that businesses are staged by PAYE number, one tranche per month, for three years. Larger businesses are staged first but there is insufficient granularity in the PAYE system to distinguish between smaller businesses, so that vast majority of UK businesses will be staged at random. This means that one business may be staged in over two years before a direct competitor.

Although placing some businesses at a disadvantage was an unintended consequence of this legislation, it was certainly an anticipated one. In a response to a Parliamentary Question on January 29th 2010, the then Pensions Minister, Angela Eagle MP gave the example of “a small firm staged in 12 months before another small firm that it actively competes with will face approximately £960 more in contribution costs than the firm that is staged later.” The Impact Assessment also acknowledges that the staging approach means that if businesses respond to the increase in costs by increasing their prices, “then they will experience a price differential from their competitors if those are staged in later²¹.”

Businesses, regardless of size or sector, see this competition impact as an issue for them, whether or not they plan to increase

²¹ Workplace Pensions Reform Impact Assessment <http://www.dwp.gov.uk/docs/wpr-ia.pdf> Pg32

their prices. This could be because those that are planning to pay for the reforms through reducing benefits and/or re-aligning wages are concerned that they will lose out when recruiting new employees.

Case Study

A small accountancy firm with 60 employees already offers a 5% pension scheme to their employees but take up is low, especially amongst the 10% of the workforce who earn under £15,000 per year. With no internal HR or pensions expertise, they anticipate the set up and running costs of a pension scheme will be high, particularly in the first few years. The firm will increase prices in order to pay for the direct and indirect costs and believe that their business will be severely impacted if other local accountancy firms do not also have to start complying with the Pension Act at a similar time.

The VAT increase to 20% on 4th January 2011 means that many firms will already be raising prices just before 2012. Businesses are already concerned about whether this price rise may hit consumption, particularly if unemployment continues to rise. A further price rise to pay for pension provision is too much of a risk, particularly if competitors will not have to do this.

For businesses where 100% of their costs are spent on labour (such as employment agencies), the competition risks will be magnified. Each P45 that an agency generates will sever the relationship and mean that the worker must be auto-enrolled again. Three smaller agencies we asked generated an average of 250 per week, equating to 13,000 per year²². It is difficult to see how such a large administration task could be achieved without adding cost to the business. If another agency was not facing these issues, then this would put the first agency at a severe disadvantage.

²² The Impact of the Pensions Act 2008 BCC 2009

CHAPTER TWO: POTENTIAL IMPACTS OF 2012 REFORMS ON UK BUSINESS

As well as reducing profit margins, the competition impact may mean some businesses lose out on contracts altogether. Many tenders, particularly public sector ones, last for a period of years. It is very difficult for businesses to project the cost of compliance with pension regulations. Similarly, it is impossible to know whether or not direct competitors for the contract will be facing the burden of compulsory pension contributions and so whether or not this will be reflected in their bid. For firms where a large proportion of their costs is taken up by labour, this is a real concern.

Case Study

A social enterprise and Chamber Member in Yorkshire has had a pay freeze in place since 2008. They had a final salary scheme, which has since closed to new entrants, and take up of the non-contributory scheme created in its place has been very low. They are just about to complete a tender with the Local Authority (for the period April 2011 - March 2015) but are unable to predict with any certainty their direct and indirect labour costs for that period. The largest cost will be compliance with the Pensions Act 2008, but the uncertainty surrounding this means it is impossible to factor this in to a tender. They are also concerned that other charities or businesses may be able to significantly undercut them if they are staged in two or three years later. This, combined with the increases in costs of agency working, makes bidding for such a long term contract subject to a huge amount of uncertainty.

There is also an international angle. Regulations which impose costs in the UK and not in competitor countries risk making our goods and services less competitive. Of course, price is not the only factor and if the UK is supplying better quality products then this will often also be taken into account.

PENSION SCHEME ADMINISTRATION

Our research with business focus groups showed that, as would be expected, firms that already have contributory pension schemes feel most confident about handling the administration that auto-enrolment will entail. However, out of those who do already have such a scheme, some had found interacting with their pension scheme difficult and were concerned about how they would manage switching over their scheme to a qualifying one²³.

The vast amount of administration that businesses will have to deal with will include both one-off set up processes and also recurring paperwork. The costs and difficulties with the set up will be more problematic as each business has a different staging date which can be any month (except December). Normally, legislation that affects business only commences in either April or October, the two Common Commencement Dates (CCD). Businesses that are required to go through the set up process on an 'unusual month' may incur extra costs as they will seek advice from their accountant at a different time of year and may need extra administrative support to process the paperwork. Re-enrolment and re-registration also do not take place on a CCD, so this will again increase the recurring costs also.

The costs to set up the pension scheme, particularly for business with no in-house experience or expertise in this area will be very high. Our focus groups suggested that businesses will spend a lot of time and money to try and find the right scheme for their employees. Registering, changing employee contracts, handing out the information and overhauling payroll systems are all administrative burdens and costs that businesses will face.

Once the scheme is set up, the biggest administrative burden for many firms with high staff turnover will be processing new starter enrolments, opt outs and refunds. This process must be done for

²³ The Pensions Act 2008 lays down a number of criteria that a scheme has to meet for it to be a qualifying scheme for the purposes of the act.

each qualifying member of staff, even short term seasonal workers or an employee who makes it known very early on that they wish to opt out of the scheme. Businesses also must process individual's paperwork differently depending on their type of contract and whether it means they will be a job holder, accidental job holder or ineligible for auto-enrolment. It is also the employer's responsibility to check that the opt out form has been filled in correctly by the employee.

THE EMPLOYMENT RELATIONSHIP

A recurring concern from business in our research was how the reforms would affect the relationship between an employer and their employee. Although the employer has an obligation to give information about the scheme to an employee, this is no guarantee that the information will be either read or understood. Business experience suggests that, for many workers, their payslip will be the first they know of their new pension scheme - or the first they know of their mandatory contribution.

Case Study

A manufacturer with 100 employees in Wales has a very good pension scheme on offer to all its employees, with a 7.5% employer contribution. This scheme is available to all employees, yet take-up is very low, under 30%. Even with in-house expertise, they felt it would be very difficult to manage the apoplectic employees who would demand to know why money was taken out their wage and put into a pension without their express consent. The company strongly believed that for those employees not used to pension saving, the deduction from the employee's wage as shown on their pay-check would be the first time they were aware of their enrolment into a scheme.

CHAPTER TWO: POTENTIAL IMPACTS OF 2012 REFORMS ON UK BUSINESS

The problems that auto-enrolment will cause are aggravated by the requirement to re-enrol employees every three years. Businesses saw this requirement as an administrative burden, particularly as the employee has the right to opt in at any time of their choosing. The three-year date for re-enrolment is measured from the date that the business had started auto-enrolling employees, rather than the date that the employee was auto-enrolled. Therefore, an employee may only have opted out 18 months before they are enrolled again. There was a general feeling from business that if an employee has gone through the opt out process, to force them to do so again – and with the risk that pay may be deducted before they realise – would cause friction between the employee and employer.

While not every employee will be angry that a pension contribution has been deducted from their wage without express consent, employers expect many will request advice as to whether pension saving and/or the employer's scheme is suitable for them. This is a very risky area for business; an employer must not give any advice to their employees, both for fear of being accused of inducement and also as they are not registered to give financial advice.

Case Study

The HR Director at a large company that already has a pension scheme was concerned that employees would not readily accept that businesses cannot give financial services advice. She said, "Employees are always asking for personal views on pension saving, and often ask me whether I save and how I do so. In HR, it is not good for me to have to turn an employee away, especially if they are questioning deductions in their pay."

There is a clear need for comprehensive guidance on this issue for employers, and a need to ensure that there is a free service employees can use to get the personal advice they require. Particularly for smaller businesses, where the owner-manager may have a very familiar relationship with their staff, it is crucial that the message filters down that employers cannot advise their employees in this area. This also has the potential to cause problems in the employer/employee relationship, but this can be mitigated if another advice source for employees is created.

RISKS TO THE EMPLOYER GENERATED BY THE PENSION ACT 2008 OBLIGATIONS

New employment obligations will always create a new route for vexatious employees to make claims against businesses; new areas for well meaning businesses to get it wrong; and opportunities for unscrupulous businesses to gain a competitive advantage. In reforms as complex and alien to many business as these, the risks are higher.

In a 2007 survey, the Department for Work and Pensions (DWP) found that 11% of micro businesses and 7% of small businesses planned to deal with the pension reforms by “encouraging their employees to opt out²⁴.” Such a policy would be unlawful under the reforms, and constitute inducement. Although these businesses were in the minority, if these figures came to fruition, 80,919 micros and 27,695 small businesses would be noncompliant, just under 9% of all employers in the UK.

These statistics look even more ominous when one considers that they were collected in 2007. If nearly 100,000 businesses in 2007 were considering encouraging their employees to opt out, it is likely this figure is even higher today – given a two year recession and continued economic uncertainty. The sheer volume of businesses intending to do this, coupled with the uncertainty surrounding the definition of inducement, suggests that this policy is not practical.

A flat rate fine of £400 can be levied by the regulator for any form of non-compliance, with even stricter scaled penalties after that. Whilst high penalty for persistent and wilful non-compliance

²⁴ IA Workplace Pensions Reforms pg 107/8

CHAPTER TWO: POTENTIAL IMPACTS OF 2012 REFORMS ON UK BUSINESS

are welcomed by business as a deterrent, such a strong early punishment is not.

Businesses are not only obliged to pay the 3% contribution – other responsibilities, if not followed, also incur a £400 penalty notice:

- Failure to register/re-register with the regulator;
- failure to auto-enrol employees on time;
- prohibited recruitment conduct²⁵;
- failure to give all pre-determined material to employees;
- failure to re-enrol employees;
- failure to keep records for prescribed period of time; and
- Inducing an employee to opt out the scheme;

Such a large fine is too severe for many of the above infringements which are related to process rather than being substantive violations. Particularly in the early years of the reforms when pensions will be a new concept to many businesses, such a harsh penalty regime is unwarranted.

Although the intention is that employees or ex-employees will complain to The Pensions Regulator (TPR) if they think an employer has not fully complied with the Act, there is opportunity for them to lodge an Employment Tribunal (ET) claim related to their pension entitlements. There is a clear incentive for them to do this – the TPR flat £400 fee will not go to the employee or whistleblower and any employee owed contributions will only be put back in the position that they would have been if the employer had complied. Lodging a claim with an ET brings the possibility that the employer will settle to stop the expense of going to Tribunal, or that the ET may award additional damages to the claimant.

There are several ways that a claimant could attempt to use the ET system in this area. The two specific instances are where individuals believe that their rights not to suffer detriment (provided for at s55 of the Act) or not to be unfairly dismissed

²⁵ This is when an employer discriminates at recruitment stage against those who wish to remain in the pension scheme

(s57) on grounds related to the new employer duties have been breached. For example, if someone is treated less favourably by their employer or simply dismissed because they wanted to become a member of a qualifying workplace pension scheme they could take a claim to an ET. The second way is by making a claim for break of contract or unlawful wage deduction and linking that to the Pensions Act reforms. These routes were not costed in the Pensions Act 2008 Impact Assessment, nor was consideration given as to how a vexatious claimant may use these regulations to bring spurious cases against employers.

In reality, it would appear that such claims are quite likely. Given that Government research indicates that nearly 100,000 businesses were planning to encourage their employees to opt out of the scheme, it would appear many employees may have a claim that they were treated less favourably. Interestingly, a 'detriment' in this context could even be if the employee took a pay rise to opt out of the pension, or were given an alternative benefit. Whilst not a 'detriment' in the commonly understood use of the term, such behaviour is unlawful under the Act and could give rise to claims.

These extra risks of claims and penalties must be taken into account when costing the impact of the reforms on business. The more risks, avenues to claims and high penalties that there are, the more expensive compliance becomes, and the more likely it is that the business will have to seek expensive external advice. Less prescriptive time scales and information requirements will reduce the risks on business that they will face a hefty fine or a Tribunal claim. More certainty over concepts such as inducement and prohibited recruitment conduct would also reduce the risk to business.

EMPLOYER CONTRIBUTION- HOW TO PAY?

For the majority of smaller businesses, in depth thinking on how to fund their new obligations under the Pensions Act 2008 has not yet begun. However, many have already begun to think about ways to mitigate their exposure to this new cost.

Case Study

A small construction company has 50 employees, 70% of whom earn less than £15,000 a year, and a significant minority of the employees are on temporary contracts. These workers are not offered a contributory scheme currently, nor do they have any other benefits which could be removed to mitigate the cost of new pension rights. For this business, structural change – moving to using individuals on a self employed basis (as limited company contractors) instead of employees and reducing staff numbers is the only way to manage the expense.

Libertas Management, a business consultancy in Staffordshire and Chamber Member, has already had some conversations with the businesses they advise. The biggest shift they envisage is in company benefit schemes – where flexibility will be removed and some benefits squeezed in order to finance compulsory pension contributions.

Flexibility in the workplace has been part of the narrative and policies of all political parties for some time. Labour introduced the right to request flexible working and the Coalition Government have promised to extend this right to all workers. Part and parcel of this is not just flexibility in working times but also in remuneration packages; parents may get access to childcare vouchers instead of gym membership and others may choose private healthcare over access to shared transport. Employers in focus groups conducted by British Chambers of Commerce suggested that this flexibility may be eroded by these reforms, firstly because employers may have to shelve some benefits altogether to fund pension contributions and secondly because flexibility could be interpreted as encouragement to opt out the pension scheme.

The reaction of some businesses was to think about a structural shift away from employee and employer legal obligations altogether. This so-called ‘false self-employment’ occurs where the underlying characteristics of the relationship are employment but the engagement is presented as self-employment²⁶. The previous Government attempted to clamp down on this in the construction industry by issuing an HMRC consultation paper citing one of the main problems with this type of employment as contributing, “to a culture of employers neglecting their wider responsibilities in accordance with employment law²⁷.” This sort of sham arrangement is damaging, and these individuals are clearly not meant to be self employed. However, some businesses may see this shift as a natural evolution of the labour market as a reaction to increased regulation and direct costs, such as the pension reforms. This would be a perverse and unwanted consequence – best mitigated by assisting the employer to comply.

FOUR STAGES OF REGULATION

This report has analysed the impact that the pension reforms may have on the UK labour market, and also highlights where business believes the regulations are overly burdensome or not properly considered. Lessons must be learnt during the review into the Pensions Act 2008 and the conclusions must be considered in the implementation of any future employment legislation. Across the first three of the four stages (consultation, communication, implementation and guidance) there is evidence that the 2012 pension reformer are an example of bad practice that should inform future Ministers and policy makers.

Consultation

As highlighted in this report, Government research was undertaken during a period of unprecedented growth. Without further research or future-proofing, the predicted impact of the Pensions Act 2008 did not stand up to scrutiny when the recession took hold. Furthermore, no research on the agency sector, a crucial component of the UK flexible labour market, was undertaken. One consultation was only 6 weeks in length, even though the Better Regulation Executive Code on Consultations recommends that 12 weeks is appropriate.

²⁶ http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/consult_falseselfemploymentconstruction_200709.pdf
pg5

²⁷ http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/consult_falseselfemploymentconstruction_200709.pdf
pg12

CHAPTER TWO: POTENTIAL IMPACTS OF 2012 REFORMS ON UK BUSINESS

Communication

Although the reforms are still a way off from being implemented, they have been in the planning stages for over four years. However, awareness in the business community is still “limited²⁸”. According to our own experience in the Chamber Network and the Impact Assessment, particularly amongst SMEs²⁹.

Implementation

Such a long staging process means that communicating with employers will be even more difficult. The competition impact of implementation has been explored in this report, as well as the impact of Common Commencement Dates not being used, neither for implementation nor for re-registration and re-enrolment.

²⁸ Workplace Pension Reforms Impact Assessment pg 107

²⁹ Workplace Pension Reforms Impact Assessment pg 171

RECOMMENDATIONS FOR GOVERNMENT

As part of our submission to the Government Review into auto-enrolment, BCC submitted a number of recommendations to improve the reforms and reduce their negative impact and indirect costs on business.

The key recommendation we have made is that employees should not be auto-enrolled into a pension scheme until their 13th week of employment. This would reduce the administrative burden created by employees leaving the business after only a short time, particularly temporary and seasonal workers and agency staff. It also fits in well with the Agency Workers Directive framework where, in the UK, agency workers do not have the right to equal treatment until they have completed 12 weeks at one assignment.

Other recommendations include standardising the treatment of workers on different contracts to remove perverse labour market outcomes. As mentioned previously in this report, the current regulations treat temporary, fixed term, zero hour and agency workers differently, which adds to the complexity and risks inherent in the reforms.

We would also like to see the original penalty notice of £400 significantly reduced to a level closer to the HMRC fixed penalty notice of £125. This should prevent businesses that are trying their hardest to fully comply but may have missed out a small part of the process or a bit of paperwork from being hit with an excessive penalty.

RECOMMENDATIONS FOR BUSINESS

Although the details of the reforms are under review, the central principles of auto-enrolment and a compulsory 3% employer contribution are not. Employers must begin to familiarise themselves with these key concepts, and also understand the role of The Pensions Regulator, an agency the vast majority of businesses will not have come across or dealt with before.

For businesses taking on new employees in the next couple of years, they may want to consider their whole benefit structure and whether, in anticipation of the compulsory pension costs, they may wish to remove some benefits currently on offer.

Employers in our focus groups were very concerned about their ability to choose the right pension scheme for their staff. Early research into what schemes are on offer and discussions with employees about what is most important to them in a scheme may make it easier to choose a scheme and provider, and reduce issues arising with employees at a later stage over the choice.

The world in which the 2012 reforms were conceived was very different to the world in which they will be implemented. Lower business confidence, higher unemployment, less public sector business support, and a raft of new employment legislation will all affect the way the private sector deals with, and funds, these changes.

The Government review into the reforms is certainly welcome. Anything the review and Government can do to strip out unnecessary risk and cost will make business compliance cheaper and less likely to disincentivise private sector job creation.

As things stand, the cumulative effect of an uncertain economic environment, new employment regulations and the 2012 pension reforms is likely to damage the business environment in the UK, and have a particularly negative effect on the smaller businesses and their capacity to create jobs over the coming years.

The British Chambers of Commerce used focus groups, interviews and member reaction to previous Government consultations as the basis for this report.

FOCUS GROUPS

22nd June- South Wales Chamber of Commerce

29th June- North Staffordshire Chamber of Commerce

7th July- Derbyshire and Nottinghamshire Chamber of Commerce

We also conducted interviews and gained written responses from other Chambers of Commerce members, notably Greater Manchester Chamber of Commerce and Leeds, York and North Yorkshire Chamber of Commerce.

DWP research and the Pensions Act 2008 Impact Assessment were also useful resources.



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