Association of Consulting Actuaries Limited
Regis House, First Floor, 45 King William Street, London EC4R 9AN
Tel: +44 (0)20 3102 6761 EMail: acahelp@aca.org.uk Web: www.aca.org.uk

22 March 2017

AE 2017 Review Team
Private Pensions Directorate
Department for Work and Pensions
First floor, Caxton House
Tothill Street
London
SW1H 9NA

Dear Sir/Madam

Review of automatic enrolment – initial questions

I am writing on behalf of the Association of Consulting Actuaries in response to the above call for views on the initial questions ahead of the 2017 AE Review.

Our comments on the specific questions you raised are set out in the Appendix to this letter.

The major part of our members' work is as advisers to UK pension funds with total assets in excess of £1 trillion. The majority of the country's largest pension schemes are advised by ACA members and they, amongst thousands of other pension schemes, sponsors and organisations take advantage of a wide and varied range of services offered by our members.

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. Please contact me at Hugh_Nolan@spenceandpartners.co.uk or on 0207 495 4619 if you require further assistance.

Yours sincerely

Hugh Nolan

Hugh Nolan
Chairman, DC Committee
Association of Consulting Actuaries Limited

Sent by e-mail to: mailto:2017automatic.enrolmentreview@dwp.gsi.gov.uk

Review of automatic enrolment – initial questions
Response by the Association of Consulting Actuaries (ACA)

Theme 1 – Coverage

1. **Do the earnings trigger (£10,000 in 2017/18) and age criteria (22 to SPA) continue to bring the right people into automatic enrolment? 1 a. Is there a case for bringing individuals not currently eligible for automatic enrolment into scope, and on what grounds?**

   As we have suggested in previous representations to Government, we believe that the earnings trigger should be reduced to around £5,000 - £6,000 pa and that this should be coupled with the removal of the lower earnings deductible. The new State pension will not provide anything like an adequate retirement income for the vast majority of people. Without private pension savings, very many people will continue to rely on other State benefits in retirement, the level of which and their persistency being very uncertain. The expectation must also be that the State Pension Age will move upwards in the years ahead, underscoring the need for public policy to encourage private savings at all income levels.

   We note that some lower paid workers in manual jobs may be less able to continue working to State Pension Age, with TUC research in 2016 finding that poor health is the most common reason for people aged between 50 and State Pension Age to leave a job. We are also mindful that the earnings trigger discriminates against part-time and notably female part-time employees. With the increasing number of part-time and zero hours contracts, many people are undertaking multiple employments but being excluded from automatic enrolment because each individual job in isolation generates earnings below the trigger.

   The ACA's 2016/17 Survey of smaller firms (i.e. those with fewer than 250 employees) highlighted that over 40% of workers employed by 840,000 micro employers (i.e .those with fewer than 5 employees) earn less than the earnings trigger and are therefore ineligible for automatic enrolment. Our survey also showed that, despite the extra costs that would fall on them from increased contributions and administration, one in three employers with up to 250 staff support lowering the earnings trigger.

   There is an argument to extend the age criteria to include younger employees, notably to instill pension savings as a favourable habit throughout someone's working life (and to maximise the savings period). However, this is offset by the additional administration burden on the employer, particularly given the shorter average length of employment for workers below age 22 and the small pots that would arise for many in this category. There is also a particular risk that younger workers are more likely to opt-out initially and may then not join a pension scheme at all later in life. We are therefore comfortable with the current age criteria (but please see also our response to question 2 under Theme 3).

2. **Do the categories of non-eligible jobholders and entitled workers continue to make sense in terms of enabling those who are not eligible to be automatically enrolled to save into a workplace pension?**

   Yes. We support the intention to provide access to a pension scheme to a wide range of workers and strongly agree that it is appropriate to provide such access to employees even where there is no requirement for auto-enrolment and minimum contributions.

3. **In the light of the continuing evolution of the labour market, is there a case for exempting any group or groups of employers from automatic enrolment duties?**

   On grounds of efficiency and cost, it is difficult to justify micro employers being included in the automatic enrolment project, especially if the earnings trigger remains at a level that excludes over 40% of their employees. As at 1 March 2017, it is estimated that there are still over 850,000 employers to pass their staging date with most of these being micro employers. Our survey showed that the vast majority of the smallest employers (83%) are aware of their staging date but only 34% have a budget plan to meet the costs.

   However, rather than excluding micro employers from automatic enrolment, we would prefer the review to focus on how the processes and procedures can be radically simplified to ensure the likelihood of greater participation in pension coverage. Given that 57% of the smallest employers in our survey say that automatic enrolment is "very complex", there is an obvious demand for more simplicity and a real danger of accidental non-compliance.

4. **How can self-employed people be encouraged and enabled to save more for later life/ for retirement?**

   The self-employed are a diverse group and different methods should be used to encourage and enable them to save more for retirement. For example, recent Court cases have highlighted high profile examples of workers whose self-employed status is questionable and we would expect this issue to receive greater attention in the short term. We do not think that affluent self-employed professionals are the target demographic for automatic enrolment but we do believe that contractual arrangements for lower paid workers are sometimes deliberately structured as self-employment to prevent obligations such as the minimum wage and pension contributions and that this should be addressed. However, our view is that there is a way to address retirement provision for individuals working in the gig economy in advance of tackling the challenge of more traditional self-employed individuals, for whom a more radical solution might be needed.

   The gig economy has been enabled by the internet and mobile communications with a provider (assumed to be a company) that offers a service and bills online. The service is then often provided by a self-employed individual who is paid by the provider company. There is therefore a clear mechanism by which the quasi-employer could fulfil a similar role to an employer in automatic enrolment. Because the self-employed individuals that would be enrolled in a pension scheme through this approach would still be able to opt out, we believe it would be appropriate to ensure that at least part of the pension contributions were attributed to the quasi-employer (and Parliament might want to regulate the proportion of any costs that could be imposed on the workers).

Theme 2 – Engagement

1. **What examples are there of effective communications and engagement tools that have delivered sustained workplace pension saving over the long term, and increased levels of savings resulting from changing contribution rates?**

   The most effective communications that increase workplace pension savings are clear and simple messages that show an unequivocal benefit. Many defined contribution pension schemes offer a matched contribution level that enables employees to contribute at a level higher than the minimum requirement with additional employer contributions for those who pay more (up to a specified limit). Contribution analyses of these schemes show a clear spike in the numbers of members who select the rate that maximises the employer contribution, especially when that additional employer contribution is significant relative to the additional member contribution.

   As the success of automatic enrolment to date has demonstrated, engagement is limited where employees have to make active decisions or take action personally. For example, studies show that offering a limited investment choice can maximise the participation rate.

   Staff presentations, booklets and reminders (such as text alerts that highlight the potential employer contribution foregone each pay date) can all play a part in increasing engagement but experience has shown that the impact of such initiatives is usually modest. There are however some examples of stunningly successful communication exercises where the membership are very well-informed by the employer and understand the benefits of participating in the scheme (including Tesco's launch of a new scheme in 2015/16).

2. **In an individual's automatic enrolment journey, what are the most and least effective touch points when appropriate engagement can help reinforce personal ownership of pension saving? What form should that engagement take, who should deliver it and how?**

   Ideally, education from an early age could provide people with a deeper understanding of finance generally and pensions in particular. Teaching children about basic pension issues would help familiarise them with the topic and make it less daunting than it often seems for older people considering it for the first time.

   As always, a clear message at any stage can help reinforce personal ownership of pension saving. Using simple descriptions such as "your pension pot" throughout the entire saving period will drive home the message that the accumulated assets belong to the member individually. The most effective touch points will be when employees are joining a pension scheme and should understand that the employer contributions are a personal benefit to them, when they receive their first benefit statement or two showing how their contributions have built up and when they start to think about retirement and consider their options.

3. **What are the challenges and barriers to sustained or timely engagement for different cohorts and individuals, and how can they be overcome?**

   There are a myriad of challenges and barriers and the main factors can be summarised as inertia, complexity, trust and affordability. The low opt-out rate for employees who have been automatically enrolled clearly demonstrates how the first factor can be mitigated, without the need to resort to unpopular hard compulsion.

The perception of pension saving being extremely complex has some merit but is over-stated. Workers do not need to understand the full technical detail of mortality rates, annuity pricing or portfolio construction to get good outcomes from a pension scheme. Simple explanations and appropriate default options can make retirement saving even more accessible for consumers.

The issue of trust is a particular challenge. We naturally believe that the pension industry provides a valuable service to society as a whole, facilitating effective saving for a happy retirement. However, there will always be occasional failures and scandals, especially given the media's understandable interest in extreme cases and the temptation to write sensational headlines. The industry can tackle this challenge by ensuring that products are transparent so that consumers understand the risks they face, with good value charges that are clearly disclosed and not viewed as excessive. There is also an opportunity to improve the reputation of pensions by highlighting the success stories, such as the huge number of pensioners enjoying retirement thanks to the income they receive from their savings during their working life.

The issue affordability is covered in our responses to other questions.

4. **What are individual attitudes to workplace pension saving and what influences those attitudes?**

   Individual attitudes to pension saving vary dramatically and are usually shaped by individual experience, including the personal history of family, friends and colleagues as well as public information such as news reports. Some people are driven to save for retirement after seeing a parent or grandparent struggle financially after retirement and others are driven to save by seeing their relatives have a highly enjoyable retirement after saving themselves. Equally many people are put off retirement saving by an inability to imagine their life in 40 years as anything other than a future problem that can be worried about (much) later.

   Headlines about corporate failures where people lose part of their pension savings or where there has been fraud or a pension scam obviously affect savings attitudes adversely but this can be offset by providing balanced information, just like *Crimewatch* highlights that the crimes they show are not likely to happen to you so "please don't have nightmares".

   The most positive influence can be a trusted colleague or relative who assures people that saving for retirement is a sensible thing to do. Automatic enrolment is a powerful tool here by normalising pension saving as simply a thing that happens naturally to (almost) everyone.

Theme 3 – Contributions

1. **What are the key drivers, opportunities and barriers for individuals and employers that may affect their behaviours in relation to sustaining existing, or managing increasing, contribution rates?**

   Individuals tend to favour immediate consumption over delayed gratification and it is understandable that people worry about short term financial constraints more than a nebulous future shortfall during a distant retirement. Workers who feel financially insecure are less likely to be happy to commit to long-term savings, preferring to enhance their short term security by saving for a rainy day (if they manage to save at all). Lifestyle factors such as paying back student loans, saving for a first home and starting a family can leave pensions as a low priority at many times.

There is a particular risk in the scheduled increase in the minimum level of automatic enrolment contributions due in April 2018 and April 2019. There is some concern amongst employers and our members that opt out rates may increase significantly at those times. While the absolute level of contributions will remain modest, the comparison of the minimum contributions payable in March 2017 to April 2017 may well be something of a shock to employees. This shock can be mitigated by a more flexible approach to contribution rates, as discussed in the next question.

It would also be helpful if tax policy complemented and supported the automatic enrolment initiative. Added complexity, anomalies and negative consequences arising for even a limited number of members can disproportionately diminish the positive perception of pension saving.

2. Is there scope for a more flexible approach to contribution rates to reflect an individual's life and employment journey?

Yes!

We recommend that the review should consider a means whereby employers staging in 2017/18 are able to phase in their minimum automatic enrolment contributions over perhaps a 3-year period. New businesses should also be considered for such a phasing-in period.

We do not believe that the current level of minimum contributions will be adequate to provide satisfactory retirement benefits for most people. Modelling suggests that a typical 25 year old needs to save 15% to 18% of earnings to maintain their standard of living in retirement from age 65, with a full State pension.

We would therefore wish to see an increase in contribution rates in the long term and would ideally like to see the review set out a pathway from 2019 onwards for probably a decade ahead. We would recommend that there should be some ability for both employers and employees to reduce contributions when difficulties arise, to prevent any repeat of the inflexibilities introduced into the defined benefit regime.

One approach that might enhance savings to a more adequate level would be to incentivise employees to save more as and when their personal circumstances allow them to do so. A minimum contributions requirement could then be supplemented by optional extra contributions, incentivised by additional employer contributions to match the employee commitment (at perhaps £1 for every £2 or £3 the member contributes, up to a cap).

We also believe that it could be helpful to offer an opt-down facility for employees facing an all or nothing choice to pay a dramatically increased contribution rate in 2018 or opt-out of their pension scheme entirely. We are mindful that there would be a small additional administration burden on employers but believe that this could be more than offset by the reduced level of contributions payable. More importantly, we believe this approach could keep a substantial number of current members within the retirement saving environment with the increased contributions being implemented more gradually for those who might otherwise opt-out, particularly bearing in mind the current economic climate and uncertainty. We would recommend that an opt-down facility could even be offered solely in response to an opt-out request within say 3-6 months of an increased contribution rate coming into force, giving those who would otherwise leave completely a second chance to stay in the scheme at an affordable level.

Finally, we believe the review should consider whether it might be helpful to introduce future workers to automatic enrolment contributions gradually, as has been done for the initial exercise. For example, workers below the current age for automatic enrolment might be included on a lower contribution rate initially, rising to the standard level by age 22.

3. **Do you have any evidence or views on the most appropriate/effective balance between employer and individual contribution levels? What are the options for encouraging, 'nudging' and enabling people to save more into their workplace pension?**

As noted previously in this submission, there is evidence that pension scheme members often select a contribution rate that maximises the level of employer contribution. We firmly believe that an element of matching contributions is essential to encourage the greatest level of participation. A simple message to members that every £1 they pay is supplemented by 25p, 50p or even £1 from their employer will encourage extra saving, even if employers adjust salaries over the longer term to rebalance the effect. We believe that the employer contribution needs to be meaningful but we recognise the reluctance of some employers to pay extra towards a retirement pot owned by employees. An employer contribution somewhere in the range from 25p to £1.00 for every £1.00 paid by employees might be appropriate, with perhaps 50p being a compromise that lends itself to simple communication, but we do not have a strong view on a specific proportion. In particular, we do not see any problem with the proportion currently scheduled as the minimum contributions rise.

4. **To what extent are individuals saving outside of a workplace pension for retirement and how does this impact on their interest and ability to save into a workplace pension?**

Treasury figures in 2016 showed that 8½ million people aged over 65 had non-pension assets of some £1.75 trillion. However, 80% of those assets were held in property, leaving just £350 billion or around £40,000 per head on average. That in itself is inadequate to provide a decent retirement income but more worryingly half of these people had less than £1,500 in non-pension and non-property assets, with 80% having less than £20,000.

A number of people with property assets own buy-to-let properties that are genuinely a source of retirement income and many other homeowners believe they can release equity from their property to fund their retirement. In practice though, it is often more difficult than people imagine to leave a cherished family home, to downsize to a smaller property or to move to a different area where property prices are cheaper. Equally, few people can encash enough from an equity release arrangement to fund an adequate retirement income, even if they are prepared to spend the proceeds from such a scheme rather than leaving their house as an unencumbered inheritance.

The popularity of ISAs and the introduction of LISA give alternative savings vehicles that can be used for retirement planning. While these products have a valuable place in the overall savings environment, they are not completely suitable replacements for pension saving. The investment of such savings is typically short term and this means that consumers can miss out from the dramatic impact of greater investment returns over a longer timeframe. We recommend that the review should consider the impact of LISA in particular on automatic enrolment.

The wider review activity

1. **What are the advantages and disadvantages of lowering the level of the default fund charge cap?**

   The advantages are clearly lower deductions from member funds, which would boost their retirement pots if all other things were equal (and there would also be a benefit in member perception and potentially a small uplift in participation as a result). However, all other things are not equal and a lower charge cap could inadvertently drive lower value and generate worse outcomes by reducing investment returns or diminishing the standards of administration and/or communications. We believe that the current cap remains broadly appropriate.

2. **What are the advantages and disadvantages of extending the cover of the charge cap to include some or all transaction costs?**

   Historic studies suggest that the most active funds underperform funds that are less actively trading, partly because of the impact of transaction charges. There is therefore some merit in considering whether the charge cap should be extended to include some transaction costs. There can be practical difficulties in identifying the precise transaction costs on a consistent basis but these are unlikely to be insurmountable, even at the expense of a marginal extra cost. There is a danger though that extending the cap in this way might inhibit investment managers from making transactions that might benefit the member, sacrificing an element of return to meet an arbitrary charging level.

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. The major part of our members' work is as advisers to UK pension funds with total assets in excess of £1 trillion. The majority of the country's largest pension schemes are advised by ACA members and they, amongst thousands of other pension schemes, sponsors and organisations take advantage of a wide and varied range of services offered by our members.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

Disclaimer

This document is intended to provide general information and guidance only. It does not constitute legal or business advice and should not be relied upon as such. Responding to or acting upon information or guidance in this document does not constitute or imply any client /advisor relationship between the Association of Consulting Actuaries and/or the Association of Consulting Actuaries Limited and any party, nor does the Association accept any liability to any person or organisation relating to the use of such information or guidance.