THE AUTOMATIC ENROLMENT REVIEW

We examine the DWP's AE review, which included some significant proposals for the future of pension saving in the UK.

PETE GLANCY

Pete has been with Scottish Widows for 26 years, holding a wide range of senior positions, including Head of Individual Pension Propositions and Head of New Business Development in Corporate pensions, before taking on the pensions policy agenda in his current role as Head of Industry Development.

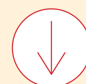
The Department for Work and Pensions (DWP) went into its 2017 review of automatic enrolment (AE) on a very strong footing. Five years in, the policy had clearly been a huge step in the right direction – even if there was much more to do.

We never expected the first phase of AE to set the UK up for prosperous retirements. It was about laying the foundations and on that basis, it was a clear success. Credit should be given to the policy makers behind the design and implementation of AE. It was well thought out and founded on sound principles – the benefits of leveraging inertia are clear to see, with opt-out rates as low as 9%.

Over nine million employees have been auto enrolled, many getting into the saving habit for the first time. The industry and Government have developed the infrastructure required to support the six hundred thousand new workplace schemes, with saving becoming a regular aspect of being employed.

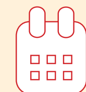
THE 2017 REVIEW

The key proposals include:



lowering the age threshold at which employees become eligible for auto enrolment from 22 to 18

changes to band earnings, so contributions are always calculated from the first pound of earnings



maintaining the earnings trigger at £10,000 although this is reviewed on a yearly basis.

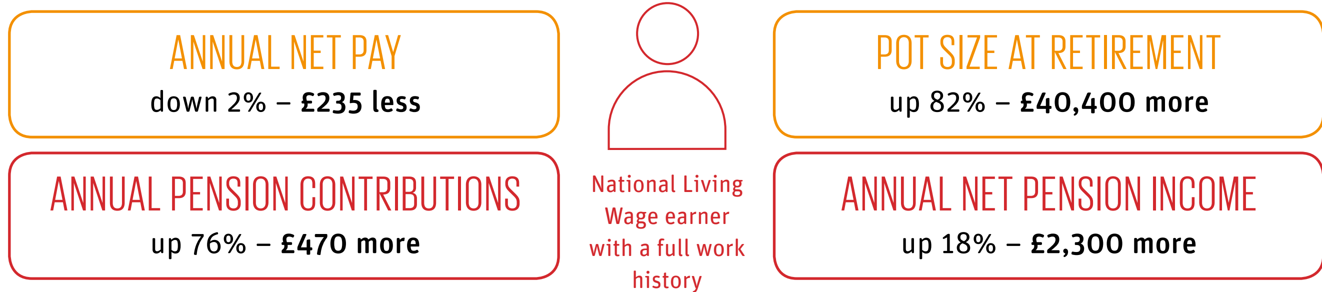
These are expected to be implemented by the mid-2020s and some have challenged the timeframe as too slow. We'd definitely like to see the changes come in sooner than later, but recognise it's important to monitor the impacts of changes yet to come, such as increasing contributions, and to engage fully with stakeholders to give this the best chance of success, while mitigating cost impacts for businesses.

There are no changes yet for the self-employed, but there is an indication of the direction of travel. While for the employed, policy makers can use a combination of incentives (in the employer contribution and tax relief) and inertia (with AE being the default), for the self-employed, there are no employer contributions and it is much trickier to make saving the default option. So, for this group, the strategy appears to be more focused on behavioural nudges and convenience. The DWP, along with HMRC and the Treasury, will test ways of making it easier and more convenient for the self-employed to put money away at the right point in their business cycles.

BETTER OUTCOMES FOR LOW EARNERS

Lowering the AE age threshold and getting rid of the lower earnings limit are very welcome proposals. We've been pressing for these changes for a number of years. The combined effect will have a significant impact on lower earners in particular, as reflected by the DWP's case study, which shows a National Living Wage earner could have a pension pot at retirement that will be 82% (£40,400) greater. This comes at a cost of 2% of annual net pay for the worker, so the Government will be hoping it is able to introduce the changes during a period of wage growth, so people are less tempted to opt-out if they don't need to.

The changes also mean that even the lowest earners can benefit now from an employer contribution if they opt-in.



Source: Automatic Enrolment Review 2017 analytic report

PART-TIME AND MULTIPLE JOB HOLDERS COULD STILL MISS OUT

We will be disappointed if the earnings trigger remains at £10,000 over the long term. We're cited in the review advocating scrapping or significantly reducing the earnings trigger. While we recognise maintaining the trigger at the same level will slowly see more people included as wages rise, there are still many part-time workers and multiple job holders missing out.

The DWP says of the earnings trigger:

"Set it too low and the predominant impact will be upon people, for whom it makes little sense to save for their retirement, potentially resulting in individuals making a conscious decision to opt-out."

While the State Pension will offer a reasonable income replacement rate for low earners (though not necessarily for multiple job holders not captured by AE), we believe there is still a role for private pensions to play for some – particularly in light of the increasing State Pension Age (SPA).

We recognise it may present an affordability challenge for the very lowest earners to pay in 5% of earnings themselves, in order to get the additional 3% employer contribution. Therefore, in addition to removing the earnings trigger, we would like to see the Government investigate ways to remove or reduce the dependency on certain employees paying in, in order to get the employer contribution.

Of course, this shouldn't apply to everyone – top-ups from your employer and the taxman are the two biggest incentives for people to pay into a pension themselves. And it should still be the case that everyone is auto-enrolled, including the employee contribution initially. But perhaps the very lowest earners could be allowed to keep the employer contributions if they have to opt-out.

In much the same spirit, we would like to see all schemes use Relief at Source (rather than net pay) for tax treatment, so everyone gets a Government top-up on their pensions.

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CONTRIBUTION LEVELS AND ENGAGEMENT

It makes sense that the Government intends to wait until AE has been rolled out to all employers and for the phased contribution levels to reach the planned 8% before determining whether they should be increased further.

But it will be a crucial question in the coming years. AE has moved people into saving something, but not necessarily into saving adequately.

Saving 8% of income a year will not provide a sufficient income replacement for most people. The longer-term aim of pensions policy should be to increase this, and we expect the right level is around 12%. The big questions are around how this should be made up – getting the right levels of employee contributions, employer contributions and tax relief – and the balance between the key intervention tools – engagement, defaults and compulsion.

In the meantime, the pensions industry needs to focus on engagement. No standard level of contribution will work for everyone and wherever the minimum ends up, there will be a lot of people who would benefit from saving more.

The review refers to a number of key engagement challenges for the industry – things we and others are already working on, including the language we use, simpler annual benefit statements and better digital services. At Scottish Widows, we're placing a huge focus on digital in particular – making it easy to view and manage pensions, on whatever device customers want to use. But the cross-industry innovation is key too. The Pensions Dashboard is a crucial element, and it is important that this initiative is delivered with support from the whole industry, as any gaps will fundamentally undermine the project's success.

Every care has been taken to ensure that this information is correct and in accordance with our understanding of the law and HM Revenue & Customs practice, which may change.
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