PPI policy seminar: How will automatic enrolment affect pension saving?

The Pensions Policy Institute (PPI) held a policy seminar on 16 July 2014 to launch its latest report *How will automatic enrolment affect pension saving.* The research was sponsored by Legal and General. The PPI's research series on the implications of the introduction of Automatic Enrolment was also sponsored by the Association of British Insurers (ABI), the Defined Contribution Investment Forum, the Department for Work and Pensions (DWP), the Institute and Faculty of Actuaries, Prudential and The People's Pension.

The report analysed how employee and employer responses might have an impact on the number of people saving in private sector workplace pension schemes and the value of assets in private sector workplace pension schemes.

Chris Curry, PPI Director, chaired the seminar.

Nigel Wilson, Group CEO of Legal and General, gave a pension providers' perspective on automatic enrolment, and made the following points:

- Challenges caused by the ageing population include the increase in the costs of the state pension from £9bn now to around £400bn by 2062 along with increases to spending on healthcare.
- Further economic growth and higher levels of immigration are two ways in which better pensions could be achieved in the UK. It would require 140,000 working age immigrants per year to offset the costs of the ageing demographic.
- Legal and General anticipate growth in the master trusts as small employers, who are not experts or enthusiasts about pensions, will rely on them.
- Ways in which either pension saving could be increased or the costs of pensions to the state could be decreased include making contributions compulsory and bringing forward the increases to the State Pension Age. Housing wealth is another area that could be considered in terms of the provision of retirement income.
- The pensions tax relief system should be replaced with an arrangement that is less regressive, such as a flat rate of tax relief.
- Legal and General support the provisions around greater flexibility for retirement savings outlined in the 2014 Budget although they do expect to see a decline in the annuities market.

Steve Webb MP, Minister of State for Pensions shared the Government's latest view on the implementation of automatic enrolment, and made the following points:

- DB pension income is currently peaking and there is a cohort who do not have DB pensions and will not have time to save sufficient amounts under automatic enrolment. The Minister stated that longer working lives and the floor provided by the single-tier pension will work to address this.
- New flexibilities outlined in the 2014 Budget provide a bigger incentive for older workers to remain in a pension after automatic enrolment – opt out rates for this cohort could fall.
- There have not been large differences between men and women's behaviour under automatic enrolment but the Minister noted that it is worth looking into any differences.
- The single-tier pension will provide a windfall for the self-employed.
- Any change to the 8% contribution rate would have to take place in the next parliament (if at all).
- Social norms are important in terms of increasing pension saving, and the Minister does not see a case for compulsion where only 10% of people are opting out of pension saving.
- Tax relief is not within the Minister's brief but personally he agrees with the notion of a flat rate of tax relief on pension saving.
- The Minister believes that the appetite for Collective Defined Contribution schemes will grow.
- The Minister pointed out that almost 4 million people have been automatically enrolled during the last 18 months.

The following points were raised during the questions and discussion section. They do not necessarily reflect the views of the PPI or the PPI seminar speakers.

- There was discussion about small and medium employers' needs under automatic enrolment and the need to target accountants in terms of information about automatic enrolment. However, it was also highlighted that, while the Department for Work and Pensions' communications strategy has segmented its audience, small and medium employers do have access to free advice and to generic products and that the challenge is to make sure that they are aware of this.
- There was a question around the arrangement that will be used for the transfer of small pension pots.
- It was pointed out that for the cohort that are not adequately covered by DB pensions or by automatic enrolment, the use of housing assets might provide a solution. There was discussion around the equity release market and the building of properties suitable for retired people as a way to make downsizing a realistic option. At the same time there was

recognition that the bequest motive remains important to people who may not wish to use their property to fund their retirement.

- There was a discussion around products for self-employed people and the fact that it is important to differentiate between the short and long-term self-employed as the former may be covered by workplace pensions. It was noted that there might be a case for compulsion of pension saving for the self-employed.
- There was a discussion around the framework for guidance that will be required under the new flexibilities announced in the 2014 Budget. A view expressed was that complexity should be avoided in the guidance.

Daniela Silcock, PPI Senior Policy Researcher and Ciaran Ellis, PPI Policy Modeller, presented the main findings of the report. These included:

- Self-employment has been increasing while pension scheme membership among the self-employed has been on the decline. Possible explanations include the availability of ISAs from 1999, the recession from 2008 onwards, any changes to the nature of self-employment and characteristics of the self-employed, and changes to scheme charges, commission and marketing.
- 90% of those automatically enrolled are saving into a pension. While comprehensive data is not yet available, emerging patterns suggest that older people, women and those with financial constraints are more likely to opt out. There is also tentative evidence that those who are automatically enrolled at higher contribution levels are more likely to opt out. There is some uncertainty around how opt out rates will look for small to medium sized employers who may have less comprehensive HR functions and structures to support automatic enrolment. However, the Government is assuming that the opt-out rate overall will be 15%.
- Factors that might affect the number of savers and aggregate value of saving include employees' responses, such as opt outs and level of contributions, employers' responses, such as contributions levels and choice of schemes, charges and investment returns.
- The research modelled the level of saving for different employee responses under 4 scenarios; no automatic enrolment, central opt-out rate (15%), low opt-out rate (9%) and high opt-out rate (25%).
- Without automatic enrolment there could be around 6.5m people actively saving in private sector workplace pension schemes and £350bn assets in private sector workplace DC pension schemes by 2030.
- The number of people actively saving in private sector DC workplace pension schemes in 2030 could range between 12.5 and 14.5 million, depending on opt-out rates. The value of assets in private sector DC

workplace pension schemes in 2030 could range between £455bn and £495bn depending on opt-out rates.

- In terms of employer responses, those larger employers that extend existing provision were less likely to lower contribution levels than those offering access to a new scheme. In contrast, employers without existing provision, and particularly smaller to medium employers, are more likely to say that they intend to pay at the minimum required contribution level.
- The research modelled the level of saving under different employer responses under 3 scenarios; 'minimum contributions' – levelling down by all employers on behalf of all workers, 'existing trends' – current employer behaviour continues throughout the staging of automatic enrolment and in the future, 'maintaining current provision' – maintaining pre-automatic enrolment provision/contribution levels for workers of all employers with existing provision.
- The value of assets in private sector DC workplace pension schemes could range between £450bn and £505bn in 2030 depending on contribution levels by employers.

Fiona Morrison, President-elect at the Institute and Faculty of Actuaries gave an overview of automatic enrolment from the Institute and Faculty of Actuaries' perspective and made the following points:

- The Institute's role is to inform and engage with the public policy debate under automatic enrolment.
- The fact that some employers with existing provision are not levelling down under automatic enrolment is encouraging. However, the decline in self-employed individuals contributing to pension is an area of concern and opt-out rates for employees working for small and medium employers remain to be seen.
- The Minister should congratulate himself over the progress of automatic enrolment to date; however it remains essential that individuals understand the risk and implications of undersaving for retirement.
- A PPI report on adequacy of pension saving under automatic enrolment found that a median earner has less than a 50% chance of having an adequate retirement income. The Institute has identified factors that play a role in inadequate retirement income; these include an inability to afford the level of contributions, competing demands, inappropriate assumptions, concerns around unfavourable outcomes and individuals underestimating what they will need.
- It may be helpful for individuals to consider their target replacement ratio of retirement income to working age income rather than the level of contributions. Similarly, a focus on outcomes would help individuals to understand how they are progressing towards their target.

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- There was some discussion around the Labour Party's proposal to lower the threshold for automatic enrolment to the Lower Earnings Limit and the consensus that contribution levels need to increase. Barriers to increased contributions include the fact that employers may have to take the money from elsewhere and employees' mistrust of the financial services industry.
- It was pointed out that, in the past, DC pensions have had bad press where now there is the challenge of individuals having a false sense of security around their retirement income because they feel that their minimum contributions under automatic enrolment are sufficient.
- There was wide recognition of the importance of financial education and views were shared on different approaches to financial education. Legal and General described their education programme in schools. A suggestion was made that the provision of guidance for retirement planning should not be a one-off event close to retirement and support should be available at much younger ages. An alternative view was that pensions guidance should not be provided too early on in working life as individuals will have competing priorities such as paying off student debt and purchasing a home.
- The potential role played by technology in helping individuals to understand pensions and to keep track of their pension saving was discussed.
- The role of defaults in the new pension system and the need to engage individuals in order to make active choices, for example ahead of retirement, were discussed.