PENSIONS POLICY INSTITUTE

PPI

PRESS RELEASE
FOR IMMEDIATE RELEASE
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"Auto-enrolment is likely to significantly increase the numbers of people saving in private pensions if implemented as planned" says Pensions Policy Institute

The Government has set up an independent review to examine the proposed scope of automatic enrolment into workplace pensions. The PPI has today published its response to this review.

The PPI has updated its analysis of the value of auto-enrolled pension saving at minimum contribution levels taking into account a number of recent policy announcements including: changes to the indexation of the state pension, the proposed structure of charges in NEST and the phasing and staging of contributions between 2012 and 2017.

The review is considering a range of policy options to make auto-enrolment work, including:

- changes in the earnings threshold used to determine who should be auto-enrolled
- changes to the earnings band on which contributions are based ; and
- the possibility of combining the Basic State Pension and State Second Pension into a single tier state pension.

Chris Curry, PPI Research Director said:

"The good news is that auto-enrolment into NEST or a similar employer pension scheme would give access to a low-cost pension with an employer contribution and is likely to encourage millions of people to save in a pension for the first time - if it is introduced as planned in 2012."

"The PPI's analysis confirms that today's young people are likely to get good effective rates of return from pension saving if they contribute to their pension throughout their working lives."

"New PPI analysis suggests that the phased and staged introduction of auto-enrolment, combined with a NEST charging structure that includes a 2% contribution charge, means that some older individuals will face higher charges and receive lower employer contributions than previously anticipated. This increases the risk of them getting a low effective return on their own pension contributions."

"Our analysis suggests that none of the alternative policy options considered, such as raising the earnings limit for auto-enrolment, would unambiguously increase the value of auto-enrolled saving. And none of the options removes the problems faced by individuals who go on to rent in retirement, who are most at risk of receiving less back in pension income than they have paid in contributions."

"Despite the risk of lower effective returns on pension saving some older individuals could still benefit from being auto-enrolled, as many will have existing pensions or savings or be part of a couple which would boost the value of their auto-enrolled pension saving."

"For people who may be at risk of receiving low effective rates of return on pension saving, it will be important to ensure that they have access to good information at the time of auto-enrolment to help them to make an informed decision about whether to stay in or opt out of saving into their pension."

ENDS

A summary of conclusions from the report follows.

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The response can be downloaded at www.pensionspolicyinstitute.org.uk

Notes for editors

1. The PPI is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions (state and private) through research and analysis, discussion and publication. It does not lobby for any particular issue, but works to make the pension policy debate better informed.

2. NEST is the new name for Personal Accounts. For more information see www.nestpensions.org.uk

3. The PPI analysis uses a measure of the 'effective' or 'internal' rate of return on pension saving to measure the value of saving. This compares the amount paid in by the individual with the actual increase in retirement income that the individual would achieve, expressed as an annual interest rate. The 'effective' rate of return is

therefore the nominal interest rate that the individual receives on his or her individual contributions, after allowing for the effects of tax relief, employer contributions, investment returns, charges, income tax and means-tested benefits.

4. **It is important to note that the 'effective' or 'internal' rate of return cannot be compared with investment returns on other forms of saving.** For example, it is **not** possible to say that, if an individual has an effective rate of return of 4% from saving in an auto-enrolled pension, and another savings product such as an ISA has an investment return of 5%, then saving in the ISA is preferable to auto-enrolled saving. This is because the 4% figure for the effective rate of return of saving in auto-enrollment takes account of the impact of means-tested benefits. Means-tested benefits can also affect the value of saving in an ISA, and many other products. The impact of means-tested benefits is not taken into account in the 5% figure for the investment return from the ISA, and so the 4% and 5% figures cannot be directly compared.

The response is intended as a contribution to the policy debate on NEST and auto-enrolment. Nothing in the response should be used by individuals or their advisors as the basis for saving and investment decisions.

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PPI Submission to the DWP Review: Making auto-enrolment work

Summary

1. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.

2. This submission provides the PPI's analysis and evidence to the DWP review *Making auto-enrolment work*.

3. Given the wide area for consultation, the large number of stakeholders responding and the short length of time to provide evidence, this response focuses on adding value and evidence in specific areas rather than a comprehensive analysis of every area and possible question that the review has been asked to consider. The main area covered by this response is an updated analysis of the 'suitability', or value, of saving at auto-enrolment levels for different individuals in different circumstances.

4. This analysis only considers the value of saving for specific individuals with a specific set of characteristics and under certain assumptions. The analysis illustrates the potential impacts of policy changes, rather than predicting precise outcomes for individuals, and none of the findings should be generalised as being applicable to the population as a whole. The analysis should not be relied upon for advice or guidance for any individuals.

5. This submission concludes that:-
   - Recent policy changes, including changes to the indexation of the state pension, the phasing in and staging of auto-enrolment and the use of a combined contribution charge and annual management charge for NEST have improved the value of saving at the minimum auto-enrolled level for some modelled individuals, but reduced the value of saving for others.
   - In particular, the charging structure of NEST and phasing in and staging of auto-enrolment and the employer contribution significantly reduce the value of saving for those close to pension age.
   - The value of saving is sensitive to the rate of return on investment. More cautious investment strategies could reduce volatility, but also reduce the value of saving.

- The value of saving is also sensitive to life expectancy. There is variation in the number of years that individuals will actually spend in retirement, and those who die sooner after receiving a pension will have a lower value of saving than those who die later.
- Individuals at older ages when auto-enrolment is introduced may be more likely to see relatively low value for saving. However, older individuals may be more likely to have pre-existing savings when auto-enrolled, which can help increase the value of saving, depending on the level of pre-existing savings.
- Increasing the earnings level at which contributions become payable, or alternatively introducing a de minimis rule for contributions (where contributions are only paid by those with higher earnings but on a broader band of earnings), will have little impact on the value of saving for the majority of people. For those who are affected, the impact on the value of saving appears to be small, and could be ambiguous as to whether the value of saving is increased or reduced.
- The impact of combining the Basic State Pension and State Second Pension into a single 'Foundation Pension' on the value of saving will depend on the level of the Foundation Pension and how it is indexed. A Foundation Pension introduced at a level equivalent to pension provided by the existing state pension system for someone reaching SPA in 2055 would increase the value of saving in most, but not all, of the examples modelled.
- None of the policy options considered completely overcome the low value of saving associated with eligibility to Housing Benefit. Even with a Foundation Pension the modelled median earning man renting in retirement receives marginally less than the value of his own contributions adjusted for inflation.
- Some individuals who would be auto-enrolled (even if the minimum earnings level for contributions was increased to £10,000), would have a high level of income from the state pension relative to their income while working even if they were not auto-enrolled. These are often the individuals – for examples low earners – who would also have a relatively low value of saving from being auto-enrolled.