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PENSIONS POLICY INSTITUTE

PPI Annual Supporters' Event

Automatic Enrolment 2032 – Position and Policy Debate

Event write up:

The objective of the event, held on Monday 5 December 2022, was to bring together key PPI Supporters and take an historical look at the impact of automatic enrolment and look at ways to build on the success. Specifically, the event looked to the future of automatic enrolment, and discussed and debated where automatic enrolment policy should be in 2032 and how to get there.

The event was kindly sponsored by **BlackRock**, and Gavin Lewis, Head of UK Institutional Client Business & PPI Trustee welcomed attendees. Over 50 people attended the event, with representatives from across government and industry.

Maddi Forrester, PPI Chair of Trustees, chaired this event. Chris Curry, Director, PPI, provided a synopsis of the journey so far.

Panelists

Baroness Jeannie Drake CBE (House of Lords and PPI Governor) provided a policy perspective.

Zoe Alexander (Director of Strategy and Corporate Affairs at NEST) provided the consumer focus.

Ben Rees (Head of UK DC Investment Solutions at BlackRock) provided the investment position.

Each panelist put forward policy suggestions as to where they think automatic enrolment should be in 2032 and how they think we can get there, which were voted on by the attendees. The audience then made their own policy suggestions.

The session was held under the Chatham House Rule and the views expressed do not necessarily reflect the views of the Pensions Policy Institute or the panelists.

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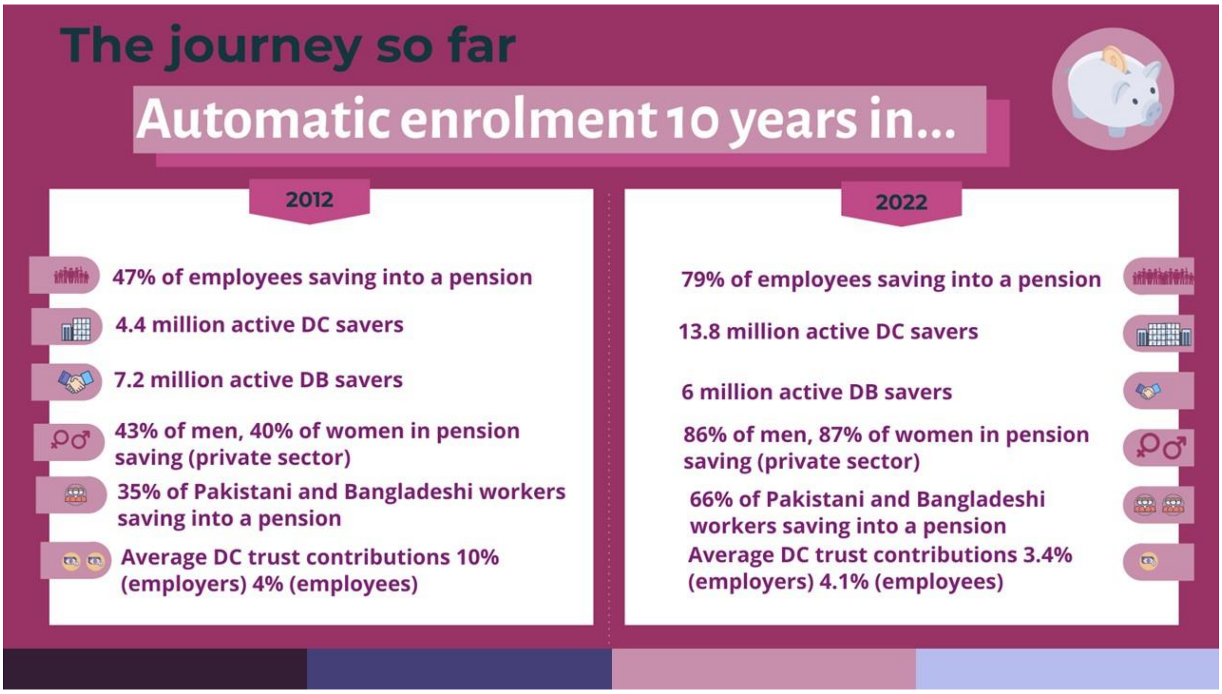
Presentation of the automatic enrolment journey so far



To kick off the event, Chris Curry, Director, PPI, presented some key statistics on the automatic enrolment journey so far to provide context to the meeting. This included:

- Participation in pensions has increased in 2012 from 47% to 79% in 2022;
- Active DC saving has increased from 4.4 million to 13.87 million;
- Active DB saving has declined from 7.2 million to 6 million;
- Increase in Pakistani and Bangladeshi workers saving into a pension has increased from 35% to 66%; and
- A decline in DC trust employer contributions from 10% to 3.4%.

He also outlined a number of emerging challenges including:

- Gender differences in pensions wealth and eligibility for automatic enrolment;
- Remaining ethnicity participation gaps between white and other ethnic groups;
- Decline in private pension savings among self-employed;
- Poor levels of pension adequacy with average contributions now at 8%, with many requiring 16% to replicate their living standards; and
- Increase in small, deferred members pots predicted to reach 27 million by 2035.

Panel discussion/Q&A:

The following key policy suggestions were put forward and discussed.

Extending coverage

It was proposed that automatic enrolment needs to be extended by 2032 to reduce the 10.1 million who are currently excluded, specifically:

- The self-employed; this group is more likely to include both women and the lower paid.
  - It could be implemented via the tax system, since tax is now digitised through RTI.
  - There should be a default scheme which should be regulated to ensure that no bogus self-employed are included.
  - All agreed there needs to be both political, and public will to extend coverage to the self-employed. Currently there is a lack of political will, but it was felt to be urgent to sort out.
  - A clear definition of what is meant by "self-employed" is necessary as they are not a homogenous group and there are some who are included who should be classified as employees.
  - Innovation and creativity are required in product design to solve the self-employed pension problem.
- Lowering of the qualifying age to 18.
- Carers credit: Carers could qualify for a carer's credit which should be made by the State and paid into a suitable automatic enrolment scheme.
- Relief at Source; some groups, particularly some ethnic minorities and some with protected characteristics, are particularly affected by this and the Treasury needs to find a solution.

Adequacy

It was felt that if savers did everything they were asked to and were only just above the level needed to claim benefits when in retirement, then automatic enrolment would be undermined, albeit in the long-term.

There was consensus that the amount of money that people have in retirement needs to be increased. However, given the UK's current economic circumstances it was felt the key question is how to phase it. Other aspects raised included:

- How can adequacy be clearly defined; is this a 2/3rd replacement rate, or is this too much for higher earners? Revisiting the Pension Commission recommendations would be a starting point. This will also entail having a clear sense of what public policy compulsion will deliver on in terms of adequacy and what then is voluntary.
- Consensus is needed on staging and the steps to getting there, with the aim of increasing contributions.
- Increasing contributions should be included in all party manifestos.

- There should be an equalisation of employer and employee contributions, with employer contributions rising by 2032 so that total contributions would be 10%. It was felt that total contributions could be raised further to 12% if the economic situation allowed.
- When raising contributions, the impact on small and micro businesses would need to be considered in terms of the speed and manner of raising these, including whether this could be done via auto escalation, involuntary incentives on employers etc.
- Collaboration will need to take place with a range of organisations including the CBI, TUC and FSB and consensus agreed on how and when to increase employer contributions.
- Recognising how important the State Pension is, as for many pensioners it makes up the largest component, means there is a need to protect the level.

Other areas of the discussion and debate focused on alternative solutions including:

- New employees could receive a higher contribution rate first and then migrate to all existing staff after that. This would enable employers to cost it better. However, others felt this would be too problematic to deliver and felt inequitable.
- Follow the Australian model and make contributions compulsory. However, it was suggested that the UK is culturally different to Australia, this would be seen to be unacceptable. In the UK people want to see it as "their money" and if they were compelled to contribute it would be seen as Government money.

Sharing of risk

- In the future, a saver could pay into a pension which automatically generated an income at retirement. It was suggested that the solution for this could be a Collective Defined Contribution (CDC) type arrangement which is likely to provide savers with better returns on money, with greater risk sharing in decumulation.
- Legislation will be required to extend remit to allow for CDC.
- Sharing of risk via a CDC model could make contribution compulsion more palatable but there would need to be clear communication that this is still savers' money.

Tax relief

Although it was recognised that there have been a series of incremental adjustments to pensions tax relief, tension persists. General reform of tax relief to help those on lower earnings was generally considered a good move, however, there isn't consensus on how this can be achieved.

- There should be a single rate of tax relief, above the current 20% for basic rate taxpayers.
- There was discussion around the behavioural impact of the 25% tax free lump sum with recognition that savers tend to focus on their present needs not their future needs. There were alternatives suggested:
  - The 25% tax free lump sum is abolished.
  - The tax-free lump sum should be capped.
- The Lifetime Allowance be scrapped as it currently disincentives senior management from saving.

Sustainable post retirement defaults

- The success of automatic enrolment should be followed through to decumulation with a default being made available that can be opted out of. This option should be made flexible and designed with a low touch option, i.e., a default which will pay savers an income but will also allow varying payments earlier in retirement in order to bridge the gap between retirement and taking State Pension.
- Some schemes are looking at this topic, but it is becoming more urgent as there are those who are already retiring and need it now.
- A default decumulation option would also help with investments as it would reduce the liability risk to schemes but also help with clarity on investment outcome requirements.
- Core legislation will be required to deliver this option including allowing all schemes to provide drawdown options.

Investment

Up until now there has been a lack of scale in most schemes, with most DC schemes being small in terms of assets under management, as well as most having younger members, who are far from retirement. The focus has been on getting those members to save more. This, alongside interest rates and inflation rates being low and growth being stable, has meant that the environment has been relatively easy to invest in. To date it has delivered what it needed to and helped to keep their costs low.

Over the next 10 years circumstances are expected to change with DC assets expected to double from over £500 billion to over a trillion in the next 10 years, with most schemes now having scale. More people are going to be closer to retirement and will be reliant on DC. Schemes will need to adapt as growth is now less stable with high inflation and interest rates.

It was suggested that:

- Private markets are used as standard. In the initial stages there will be a need to maximise returns and grow pots and investment in private markets should become the norm as is the case in Australia.
- Investment will need to be more granular and more dynamic portfolios closer to retirement; there will need to be a rethinking on bonds and greater use of other asset classes such as listed infrastructure or commodities. This will require more frequent reviews and changes.
- Defaults in retirement; In the retirement phase a default should be standard and allow for both a lifetime income, as well as flexible drawdown, as is becoming the case in the US. This could mean that institutions will have greater buying power which will make annuities cheaper, allow for flexibility at retirement and if standard will avoid transition costs for members who stay in the default.

These solutions will require:

1. Schemes/funds to build out investment capabilities as investment will become more costly and more complicated. This could entail hiring private market expertise internally or outsourcing.
2. Standards to measure success and encourage competition and innovation, particularly for members closer to retirement.

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Efficiencies

The small pot issue was felt to be urgent, with an expectation that this will become a greater problem if the age of eligibility for automatic enrolment is reduced to 18. However, it was felt that suitable legislation and regulation are necessary to ensure money is transferred into quality schemes.

There are seen to be a number of options managing the issue, but there has been no industry consensus on which solution will work, with some believing the industry is too conflicted to be able to deliver this without a government mandate.

Indeed, some felt that a consolidator approach should have been in place from the outset, but the industry had prevented this from happening.

State pension

There was a question as to whether state pension should be means tested. It was felt that the interaction between benefits and pension savings should be looked at.

Health/social care and pension

There was a discussion on whether health and social care should be considered alongside pensions. There was concern as to how far the State intrudes and also how much more is expected to be covered by automatic enrolment.

"Sidecar savings" appear to encourage flexibility and persistency in savings, by providing immediate access to funds.

Engagement

Pensions Dashboard will help with engagement, particularly with regards to additional contributions but any policy solutions should not rely on engagement for savers to get a good outcome.

Summary

The panellists' policy recommendations for the next 10 years up to 2032 voted on by the audience were:

1. Extend coverage of automatic enrolment;
2. Increase contributions;
3. Regulation to include CDC;
4. Sustainable post retirement defaults;
5. Scrapping of the 25% tax free cash;
6. Increased investment expertise; and
7. Standard measures of success.

The top three policies were:

1. Extending coverage;
2. Increasing contributions; and
3. Sustainable post retirement defaults.