Getting Retirement Right - Plan, prepare, enjoy: Part 2
Follow up proposals

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The organisations above have contributed and were consulted in developing the proposals and recommendations in this report. None of the proposals should be assumed to be the individual policies of any of these organisations. They do, however, represent significant thought and debate and whilst not all organisations have had the same level of involvement, they all welcome the opportunities these proposals provide for a constructive dialogue with government, regulators and other financial services stakeholders.

About TISA

The Investing and Saving Alliance (TISA) is a unique and rapidly growing membership organisation. Our mission is to work with our industry members to improve the financial wellbeing of all UK consumers to **deliver practical solutions** and devise innovative, evidence-based strategic proposals for government, policymakers and regulators that address major consumer issues.

TISA membership is **representative of all sectors** of the financial services industry**:** We have **over 200-member firms** involved in the supply and distribution of savings, investment products and associated services, including the UK's major investment managers, retail banks, insurance companies, pension providers, online platforms, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

Complementing our development of consumer policy and commitment to open standards and governance, TISA has become the **pre-eminent membership body for the delivery of digital industry initiatives**, including:

- **Open Savings & Investments -** a fundamental component of Open Finance which will enable our industry to become fully digitally enabled
- **Digital ID** - enabling easy access to all digital services by creating a single, reusable, secure ID owned and controlled by the consumer
- **TISAtech -** the new generation digital marketplace connecting Financial Institutions with FinTechs
- **TISA Universal Reporting Network (TURN) -** an industry-designed blockchain data solution for the collection & dissemination of EMT data

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Introduction

This set of proposals are an extension to the proposals contained within our February 2020 retirement research paper **'Getting Retirement Right'**. This concluded that for a median earning household, a contribution level of 12% of whole salary may enable families, when combined with full state pensions, to achieve a moderate retirement[1] for their expected life expectancy. This factored in a range of typical life events which impact on the ability to save for retirement. 12% is a 'rule of thumb' and individual circumstances may mean that a contribution level above 12% should be considered. This set of proposals considers how we reach the level of 12% and the implementation approach.

An additional consideration and subsequent addition to the original set of proposals relates to the inclusion of a flexibility component within the AE framework to cater for lower earning households, who may not be able to afford to pay minimum contributions. Whilst the 'opt out' rate of circa 10% remains lower than originally predicted, we do not know the impact this additional monthly outgoing has on lower earning individuals and households.

Research has shown that the least financially secure still have similar participation rates to those who are better off.[2] However, many of this group will be struggling to meet these contribution levels and may be increasing personal levels of debt or be foregoing household essentials and experiencing a lower quality of life in order to remain opted in. There is no clear reason why this group of people do not opt out.

For this group of people, it may be appropriate to opt out until finances improve and they are able to recommence retirement saving. However, they should not be excluded from the benefit of an employer contribution – they need this benefit the most and the AE framework should not fail this cohort. Arguably some low earners should not be auto enrolled because of the impact on means tested state benefits at or nearing retirement where some lower earners will see no benefit by making pension savings, but that is a separate issue not covered in detail in this paper.

The proposed removal of the lower earnings limit is in effect a contribution increase and the impact of COVID-19 has resulted in thousands experiencing pay reductions or changes to lower paid jobs. This increases the problem of affordability.

TISA agrees broadly with the principle that Automatic Enrolment requires the participation of the employee to benefit from the additional employer contribution but to recognise the affordability issue for this smaller group, we propose the concept of an additional earnings threshold, where those who earn under it can opt out from a personal contribution with the continuance of the employer contribution. The level of this can be reviewed on an annual basis and is a needed addition to the AE framework.

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[1] PLSA Retirement Living Standards

[2] IFS: Automatic enrolment - too successful a nudge to boost pension saving? May 2020

PROPOSALS

1. The 12% level of contribution proposed in our research 'Getting Retirement Right' should be split equally between the employer and employee – 6% employee (gross) / 6% employer.

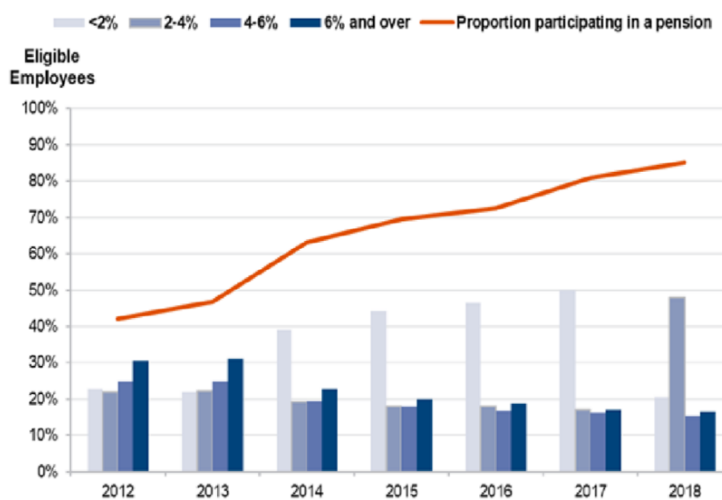
It is an equitable approach for contributions to be shared by both parties. The contribution level paid by the employer should be considered as part of the total employment package in the same way that other employee benefits are.

Whilst businesses do not believe that now is the correct time for increasing employer and employee contributions, they are committed to providing competitive workplace pensions.[3]

- 98% think there is a strong business case for providing a competitive workplace scheme
- 75% believe a competitive workplace scheme positively impacts ability to recruit and retain staff
- 95% believe they have a moral duty to contribute
- 71% believe they will need to make higher pension contributions to their employees in future to secure sufficient levels of retirement income[3]

In 2018, over 30% of private sector eligible employees with workplace pensions were receiving an employer pension contribution of at least 6% of pensionable salary. Over 30% of eligible employees were paying a personal contribution of at least 4% of pensionable salary. Furthermore, most employees in most contribution bands were receiving at least a matching contribution from their employer.[4]

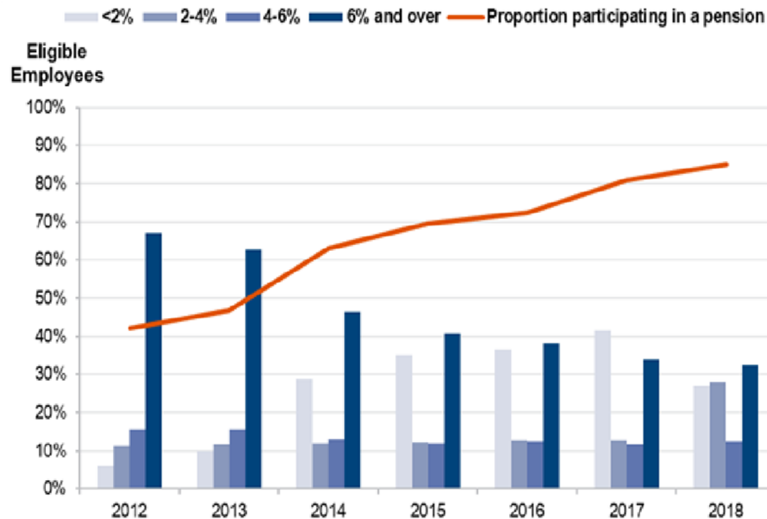
Employee contributions of private sector eligible employees participating in workplace pensions



[3] CBI/Scottish Widows Pensions Survey 2019

[4] DWP: Automatic Enrolment evaluation report 2019

Employer contributions of private sector eligible employees participating in workplace pensions



We have already proposed that the proposals to remove the lower earnings limit and reduce the minimum age to 18 are implemented by 2022, which means contributions will be based on pensionable salary rather than banded earnings. We believe that the proposed contribution increases should commence from 2023.

We recognise that the additional 3% employer contributions will need to be absorbed in different ways dependent on employer size and sector, as will the additional 0.8% personal net contribution and have factored this into the proposals which follow.

It is encouraging to see that we are not starting from scratch and that in 2018, nearly one third of eligible employees in the private sector were already receiving an employer contribution of at least 6%, and one third were paying at least 4% and most employees were in a contribution structure where their employer at least matched the employee contribution. Over two thirds of employees state a workplace pension scheme is an important factor when looking for a new job.[3]

It is also interesting to note the take-up of Auto-Enrolment strategies globally with Georgia, Ireland and Thailand all either planning or operating a phased contribution schedule, which sees an equal contribution from the employee and employer.

2. To recognise the financial impact on employers and employees, the increases should be phased in over a period of 6 years at a rate of 0.5% per year and should commence the year after the proposed mid-2020 proposals have been fully implemented – 2023 and complete in 2028

This is broadly comparable to the Australian Superannuation contribution increases for employers. This was 3% of salary in 1992 and rose to 9.5% in 2014. Future increases of 0.5% per year are due to commence in 2021 with the schedule completing at 12% in 2025. The proposed contribution escalation schedule is below:

	Employer %	Employee % (including tax relief)	Total %
Year 0 (2022)	3	5	8
Year 1 (2023)	3.5	5	8.5
Year 2 (2024)	4	5	9
Year 3 (2025)	4.5	5	9.5
Year 4 (2026)	5	5	10
Year 5 (2027)	5.5	5.5	11
Year 6 (2028)	6	6	12

As the employee increase includes tax relief, the actual increased cost to the employee in total is 0.8% or 0.4% per year. When contributions are based from the first £1, for a median earner 0.4% equates to an additional salary deduction of £8.80 per month.

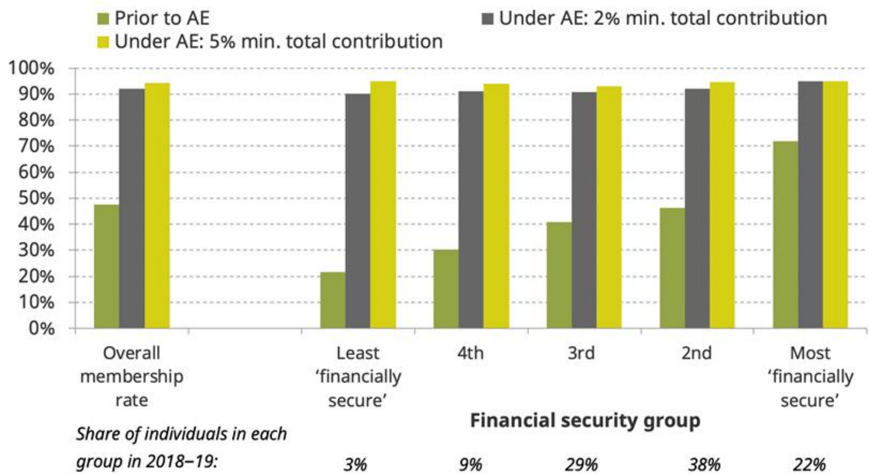
3. To introduce from 2022 an additional personal contribution 'opt out' option linked to earnings, to recognise that flexibility is needed within the AE framework to cater for lower earners.

TISA broadly agrees with the principle that Automatic Enrolment requires the participation of the employee to benefit from the additional employer contribution, but we recognise (as do other areas of industry) that there is a group of lower paid individuals who fall within AE eligibility who cannot realistically afford to make contributions. This is a group who would benefit from employer contributions the most and the AE framework should not fail this group. This group will face a contribution increase when the proposed removal of the lower learnings limit is removed and with the impact of COVID-19 resulting in thousands facing pay reductions or a change to a lower salaried job, this further restricts the affordability factor. This additional threshold is a needed addition to the AE framework.

Research suggests that lower earners may currently struggle to afford monthly contributions. This may not necessarily lead to opt outs, however members of this group may be increasing levels of debt to meet contributions or forsaking essentials and enduring a lower quality of life. For some lower earners, opting out will be the correct outcome at that time, however they should not be excluded from the benefits of an employer contribution.

Prior to automatic enrolment, pension participation was considerably lower amongst those who appear less financially secure. Only 22% of the least financially secure (by our measure) were in a pension as compared with 72% of the most financially secure. Under automatic enrolment, however, the pension participation rate of the least financially secure is above 90% and very similar to that of the most financially secure (95%). This remains true in 2018–19, after the minimum default contribution rate has increased. It should be noted that very few – just 3% – employees are in this 'least financially secure' group; but it still represents a large number of employees across the UK.[2]

Workplace pension participation of eligible employees[2]



It is not only the least financially secure who will struggle with minimum contribution affordability issues, this will extend to a larger group of lower earners. TISA proposes that the threshold is based on the DWP definition of 'low pay' which is 60% of national median earnings. ONS figures show that median household disposable income for tax year ending 2019 was £29,400 which would result in an earnings trigger of circa £17,500 (whilst a higher median income figure is available for year ending 2020, earnings have fallen since then due to the impact of Covid-19 so year ending 2019 is more reflective of current earnings). Anyone with pensionable earnings of less than £17,500 would have the option to opt out from their personal contribution and still receive the employer contribution. The default would be for the personal contribution to be deducted as normal, which is in keeping with the spirit of AE and allows an individual to identify whether they can afford the monthly saving. Where this is not possible, any subsequent opt out would not remove the responsibility from the employer to make contributions on that employee's behalf. The employee however should be re-enrolled into making personal contributions at the re-enrolment date even where earnings remain under the threshold. The threshold and an individual's eligibility for this additional option would be reviewed on an annual basis in line with other thresholds such as the earnings trigger for automatic enrolment.

The detail below provides an indication of the potential difficulties lower earning households have in meeting living costs, before factoring in additional outgoings such as pension contributions:

- 2 adult household each earning £17,500 gross p.a.
- Net monthly household take home income: £2,590
- Average monthly household expenditure: (£585[5] weekly + £150 housing costs) x 4 = £2,940
- Whilst you would expect a lower earning household to have lower outgoings than the average (some of which will be automatically calculated such as council tax and some will be a conscious decision such as leisure), it is clear to see that very little headroom would exist (if any) to meet additional outgoings such as pension contributions. This example justifies why an additional threshold is required and why £17,500 is a reasonable level

How many AE members would potentially be impacted by this proposal?

- Based on our calculations, there are approximately 6.8 million DC workplace pension scheme members who earn under £17,500.

Opting out would mean that this group of lower paid members would receive (based on full implementation of the proposals) 2% less than they do today if they remain opted in (6% vs 8%), however this is fully funded by the employer. What impact does this have on retirement outcomes?

An additional 2% contribution could create the following fund values based on a 50-year working life and contributions earned from the first £1:

SALARY	CONTRIBUTION %	FUND VALUE AT 68	2% DIFFERENCE
£10,000	6% / 8%	£59,500 / £79,300	£19,800
£12,000	6% / 8%	£71,400 / £95,200	£23,800
£14,000	6% / 8%	£83,300 / £111,000	£27,700
£16,000	6% / 8%	£95,200 / £126,900	£31,700

The impact of a low earning household remaining opted in could result in levels of debt reaching unsustainable levels and/or basic essentials being forsaken. By opting out day 1 under existing legislation, no retirement fund would be accrued, whereas the 6% contribution level above shows what would be accrued through the employer only contribution.

Arguably some low earners should not be auto enrolled because of the impact on means tested state benefits at or nearing retirement where some lower earners will see no benefit by making pension savings, but that is a separate issue not covered in detail in this paper.

[5] ONS: Family spending in the UK: April 2018 to March 2019

An additional outcome of proposal 3 is to help mitigate to some extent the problem of deferred/inactive pots which is an increasing problem which needs to be addressed. It is predicted that the number of inactive pots could increase from 8 million to 27 million in 2035.[6] Discontinuing contributions in an AE scheme currently results in a new deferred/inactive pot being created. If one of the lower earners identified discontinue their contributions under this new proposal, the pot would not become inactive due to the continuation of the employer contribution.

4. Resolve the Net Pay Anomaly through an HMRC reconciliation process using RTI data

It is welcome to see that this issue is now being addressed by Government with the issue of 'Pensions tax relief administration: call for evidence'. As highlighted above, it is the lower paid who need to benefit from AE the most and a resolution to this issue which impacts the lowest paid workers automatically enrolled is crucial.

Upon review of the options available, the solution TISA believes would produce the best outcomes for industry and consumer is Option 1, where HMRC performs an end of tax year reconciliation using RTI data and remits a bonus representing any tax relief foregone to those impacted. This is in line with the solution proposed by the Net Pay Action Group of which TISA is a member.

[6] PPI: Financial sustainability of master trust pension schemes July 2020

FULL SET OF 2020 PROPOSALS

1. Implement the 2017 AE review proposals to lower the minimum age for participation in AE to 18 within 2 years by 2022

2. Implement the 2017 AE review proposals to remove the lower earnings limit within 2 years by 2022

3. Increase Auto Enrolment (AE) contribution to 12% so that majority of households achieve the desired retirement income of £29,000 per annum, including the State Pension

4. The 12% level of contribution should be split equally between the employer and employee – 6% employee (gross) / 6% employer

5. To recognise the financial impact on employers and employees, the increases should be phased in over a period of 6 years at a rate of 0.5% per year and should commence the year after the proposed mid-2020 proposals have been fully implemented – 2023 and complete in 2028

6. To introduce from 2022 an additional personal contribution earnings threshold of £17,500, to recognise that flexibility is needed within the AE framework to cater for lower earners

7. Resolve the Net Pay Anomaly through an HMRC reconciliation process using RTI data

8. As part of the next AE review, develop solutions for increasing consumer engagement with their pension savings, plus develop solutions for providing appropriate levels of financial guidance and advice to ensure that households are making informed decisions regarding levels of savings that are consistent with their retirement income expectations

9. Ensure that any review and changes to the State Pension take in to account the overall retirement income targets that are deemed appropriate and the impacts this has on AE's ability to deliver on the income level that will be required from a private pension.