Leading on Investments and Savings

TISA Response to

Review of automatic enrolment:
Initial questions

March 2017

About TISA

TISA is a unique, consumer focused membership organisation. Our aim is to improve the financial wellbeing of UK consumers by aligning the interests of people, the financial services industry and the UK economy. We achieve this by delivering innovative, evidence based proposals to government, policy makers and regulators.

TISA's growing membership comprises over 160 firms involved in the supply and distribution of savings and investment products and services. These members represent all sectors of the financial services industry, including asset managers, insurance companies, fund managers, distributors, building societies, investment managers, third party administrators, FinTech, consultants and advisers, software providers, financial advisers, pension providers, banks and stockbrokers.

Current themes of TISA policy work include:

- Brexit: developing proposals for government that will enable the savings and investments sector to prosper on a global scale
- Digitalisation: a digital identity for consumers of financial services, innovation, standards and data responsibilities
- ISA's: LISA, simplification of the regime
- Retirement saving: the Auto Enrolment review, self-employed and pension tax relief
- Housing: the use of property to supplement retirement income
- Guidance: developing a framework and services to make guidance more widely available
- Education: supporting the education of young people to make them aware of the impact of finance on their life.

TISA also provides support on a range of operational and technical issues targeted at improving infrastructure and processes, standards of good practice and the interpretation and implementation of new rules and regulations. TISA has a successful track record in working cooperatively with government, regulators, HMT, DWP and HMRC to improve industry effectiveness by reducing cost and risk and to enhance customer outcomes. This work currently includes: MiFID II, CASS, the UK Fund Settlement initiative and Payments Strategy Forum. TISA Exchange (TeX) is providing a model for transfers and re-registrations.

Summary

Auto Enrolment has been a great success to date and the 2017 review is clearly an important step in allowing the industry to identify ways of building on that success.

It is widely acknowledged that contribution levels need to rise, so initially we need to ensure the increases in 2018 and 2019 are implemented as planned.

Evidence shows that a high percentage of individuals do not understand pensions or tax relief. Engagement will be crucial as we complete the staging of small employers and increase minimum contribution rates. Responsibility doesn't lie with a single group - Trustees, IGCs, Providers, Employers and Government should all play their part in ensuring employees are engaged with accessible and appropriate material. As we go through this period of transition and look to establish an Auto Enrolment solution that delivers realistic and relevant outcomes, engagement will be at its heart, with the objective of educating employers and employees, ensuring opt out rates remain low and realistic contribution levels are achieved. Fintech will play an important part in delivering these engagement solutions and the dashboard is one such initiative that could greatly assist. The forthcoming 'single financial guidance body' will have an excellent opportunity to engage with employees and offer high quality guidance throughout members' working lives and into retirement.

We believe the range of employees being auto enrolled should be broadened by phasing out the qualifying earnings lower limit and earnings trigger, so ultimately all employees are automatically enrolled and all earnings will qualify for pension contributions.

Although not specifically in scope for the review, consideration needs to be given to contribution rates post 2019. With contributions of around 12-15% being regarded as necessary to create a fund capable of providing a sustainable and realistic pension in retirement, a longer-term plan and timetable to reach that will need to be in place. Evidence shows that the concept of matching contributions resonates well with employees and increases active participation. This should be considered alongside future increases in conjunction with a tiered contribution structure, allowing members with affordability issues the flexibility to contribute between a percentage range. For example, if we move to matched contributions then an increase to a range of 12% - 15% could result in the employee being able to contribute anything between 6% and 7.5%.

With the number of self-employed approaching 5 million and only one in ten contributing to a pension, it is vital this is addressed now rather than storing up the problem for further down the line. As inertia has proven successful to date, we need to apply that approach to the self-employed and develop a mechanism to collect contributions. Whilst NI is currently a 'hot potato', a method of collection through the tax or NI system is one potential solution. Analysis will then need to be undertaken alongside Master Trust schemes to develop a process of sending the contributions through. One significant element for the self-employed is the absence of an employer contribution. Tax relief on its own will not be enough to motivate individuals, so we must look to deliver some form of incentivisation to achieve similar success levels to what we have experienced to date.

In terms of charging, we already have a 0.75% cap in place. We should be focussing on delivering an approach that allows these pots to grow into meaningful fund values at retirement. Contribution levels, investment growth and decumulation options are the three most important aspects in achieving this. It will be appropriate to place a focus on charging at a later date when the AE proposition matures and is delivering the desired outcomes.

Initial questions and response

Theme 1 – Coverage

Question 1

Do the earnings trigger (£10,000 in 2017/18) and age criteria (22 to SPA) continue to bring the right people into automatic enrolment? 1 a. Is there a case for bringing individuals not currently eligible for automatic enrolment into scope, and on what grounds?

The low earners and part-timers that were excluded by Pensions Act 2011 should now be brought in as the second wave.

This could be achieved through a phased reduction of the £10,000 threshold for auto-enrolment and the £5,824 Qualifying Earnings deduction until they are ultimately removed. This could be achieved over a ten-year period with a consistent 10% reduction year on year. By removing the £5,824 this results in a higher pension contribution as the % applies to the employee's entire salary. By removing the £10,000 trigger you increase the number of employees who will be automatically enrolled. A 2016 PPI survey shows that by completely removing the Qualifying Earnings band, a median earner working full time from 22 to SPa sees a 31% increase in their pension pot.

It seems sensible to have an alignment of the upper earnings limit to the higher rate tax threshold with some protection that this cannot decrease as we have previously experienced.

Since 2009, the age of 22 has had no significance as a trigger for an increased minimum hourly wage. It would be sensible to align automatic entry age to one of the current minimum age bandings for the national minimum wage – we would suggest 16. The November 2016 House of Commons Apprenticeship Statistics show that the number of new starts for 16-18 year olds continues to rise. It seems appropriate for AE savings to start as soon as possible. Not only to allow for the greatest impact of compound interest but to instil a savings culture amongst this group. If one of their first pay packets has a pension deduction, they may not even be aware and become accustomed almost straight away for this to be a standard deduction. The receipt of their first benefit statement may be the first time they are aware they have a pension, at which point they see the result of those deductions and employer contributions.

As evidence shows people are now working longer in line with the Government framework of 'Fuller Working Lives', automatic eligibility should continue until the age of 75, which aligns to the age at which tax relief on personal contributions ceases.

The table below is an extract from the DWPs 'Update of analysis on Automatic Enrolment 2016' and shows the UK workforce broken down by age and earnings.

Age	Earning below £10,000 (thousand)	Earning £10,000+ (thousand)	Total (thousand)
18-21	725 (5%)	580 (4%)	1,305 (9%)
22-64	1,885 (13%)	11,020 (76%)	12,905 (89%)
65+	145 (1%)	145 (1%)	290 (2%)
Total	**2,755 (19%)**	**11,745 (81%)**	**14,500 (100%)**

The ultimate result of the proposed amendments to earnings and age triggers would result in a further 3,480,000 or 24% of the workforce being eligible for automatic enrolment based on current figures.

It also simplifies the enrolment process for employers and reduces complications for the worker around eligibility and opting in.

Whilst outside the scope of this consultation, it should be noted that as a reduction in the thresholds will result in lower earners being automatically enrolled, consideration needs to be given to the interaction between this and means tested benefits at retirement.

Question 2

Do the categories of non-eligible jobholders and entitled workers continue to make sense in terms of enabling those who are not eligible to be automatically enrolled to save into a workplace pension?

Yes, these categories continue to make sense although as proposed, we would like to see thresholds and therefore categories phased out on a gradual basis.

Question 3

In the light of the continuing evolution of the labour market, is there a case for exempting any group or groups of employers from automatic enrolment duties?

It would be unfair if the situation existed where majority of employees benefited from Automatic Enrolment and a minority of employees didn't.

Employers have a social responsibility to meet at least the minimum requirements of AE, irrespective of their size, employee demographic or sector.

Discrimination against any groups goes against the spirit and objectives of Auto Enrolment.

Question 4

How can self-employed people be encouraged and enabled to save more for later life/ for retirement?

With approximately one in ten Self-Employed people saving for retirement, there is a clear need to increase this substantially.

Importantly, the Self-Employed do not trust or understand pensions and would prefer to invest in an ISA. A January 2016 Citizens Advice Bureau survey found the following main points:

- Lack of understanding: over two thirds of self-employed people (67 per cent) do not understand the tax breaks provided by a offered by cash ISAs and private pensions with a quarter (25 per cent) wrongly thinking that an ISA offers better tax breaks than a pension.
- Lack of trust: half of self-employed people (50 per cent) say they do not trust private pensions as a safe place to invest their money.
- Lack of information: over a quarter of self-employed people (27 per cent) say they have never received any information or advice about pensions from anyone.

We need to harness the inertia that has made AE such a success and apply it to the self-employed. With the nudge principle now solidly proven, we could utilise the existing tax or NI framework as a mechanism for collecting additional contributions which could then be filtered into a top-quality

Master Trust, possibly through a carousel arrangement. There will be operational challenges to consider, such as how contributions are allocated to the scheme provider and on what frequency these will take place. Possibly a payment mechanism similar to the old contracting out payments could be created.

In the absence of an employer contribution, a way of incentivising saving on top of tax relief will be an important aspect to consider.

Theme 2 – Engagement

Question 1

What examples are there of effective communications and engagement tools that have delivered:

- **sustained workplace pension saving over the long term, and**
- **increased levels of savings resulting from changing contribution rates?**

Annual benefit statements continue to provide individuals with an updated fund value position on their pension, so they can see the effect of personal and employer contributions. The statement provides an excellent opportunity for member engagement and we should be considering what additional content they should contain to maintain and increase engagement. This should be educational, containing details of contribution levels, when they are due to increase and the effect this will have on their fund values and retirement position. The dashboard will be an important tool in boosting member engagement and it is paramount that this is easily accessible with all schemes participating.

We are seeing a number of self-service tools now available to members of certain schemes. This allows them to easily manage their pension and retirements online and access retirement tools enabling them to see projected shortfalls. It is important that we continue to see technological advancements enabling members to have maximum engagement in straightforward and accessible solutions.

Question 2

In an individual's automatic enrolment journey, what are the most and least effective touch points when appropriate engagement can help reinforce personal ownership of pension saving? What form should that engagement take, who should deliver it and how?

The initial employer letter is perhaps the most important touch point, as this is the first personalised information opportunity that the individual will receive about their forthcoming membership. This needs to contain all relevant information about contribution levels, scheduled increases and the potential benefits available at retirement. To be most effective, this letter should use clear and concise terminology and be available in a variety of mediums, such as paper, electronic and SMS.

Question 3

What are the challenges and barriers to sustained or timely engagement for different cohorts and individuals, and how can they be overcome?

Some employers will be more receptive to Auto Enrolment than others. This may be dependent on factors such as sector or size. Given that the workplace is a significant touch point, it is important they are fully on board with Auto Enrolment, the benefits this brings to their work force and their responsibilities. Government will have its own responsibilities in ensuring all employers are 'won over' and engaging with their work force in line with requirements.

Different groups may respond to different engagement techniques and formats. Technology may currently provide a barrier to some providers/schemes, whereby it is not possible to engage electronically and paper based communications are sent. Fintech will play an important part in the development and success of engagement. We see other sectors such as retail and banking offering multiple ways for individuals to access their services – the industry will need to improve digital capabilities to cater for this growing consumer demand.

Question 4

What are individual attitudes to workplace pension saving and what influences those attitudes?

Attitudes vary and are dependent on several factors such as age, earnings, job sector.

However recurring themes across all groups relate to the deemed complexity of pensions, tax relief and the constantly changing rules.

Below are comments taken from consumer research undertaken by The Wisdom Council in September 2015:

- Retirement is a remote construct for most working age people
- People typically understand much less about pension tax relief than they think – "Some bits I understand, others bits I know absolutely nothing about,"
- They feel detached from their pension and are failing to actively manage those savings
- However, people understand that discipline is needed to save for a pension and are prepared to have that imposed upon them by a third party
- Majority of consumers do not know how much they need in retirement or how much they should be saving.
- The current solution for pensions is considered complex

There is a belief that the Government is constantly tinkering with the pension system – "the rules keep changing so it is always difficult to be sure,"

Theme 3 – Contributions

Question 1

What are the key drivers, opportunities and barriers for individuals and employers that may affect their behaviours in relation to sustaining existing, or managing increasing, contribution rates?

The employers 'contribution is a major driver, the more the employers' contribution the more motivating for the individual to contribute. The TSIP Quantitative & Qualitative Findings September 2015 showed 90% of individuals surveyed were prepared to contribute 8% of their pay if the employer or Government put in another 7%.

A significant proportion of the public does not understand how pensions work and how much the Government is giving them. A YouGov poll in September 2015 showed that (74%) of working age people with a pension either do not understand or have never heard of the tax relief that they receive on their pension contributions. This benefit needs to be communicated in a way that individuals understand. LISA tax relief has been marketed as a 'Government bonus of 25%' which will resonate with individuals. The same basic rate tax relief for RAS pension schemes and tax payers of Net Pay schemes needs to be rebranded to have a similar effect.

Ongoing employee engagement is essential in retaining membership, increasing contribution levels and reducing opt outs. We need to continue to bring pensions into the Digital age and use technology advancements and sophisticated engagement techniques used in other sectors such as retail and banking. We are seeing an increased usage of smart apps on phones and tablets as a means of communicating and managing finances and purchases. The traditional communication method of paper will not reach an ever-increasing percentage of scheme members.

An employer with the technical and administrative capability may wish to offer Auto Escalation i.e. the level of pension contribution increases each year on a set date by X%. This is one way in which members can reach their desired contribution level over a set period of time on a gradual and consistent basis. This should be a voluntary option as some employers will struggle to meet the requirements through a manual process, however considerations for those that do offer this should include:

- Annual increase is smaller than salary increase
- Coincide it with the annual pay rise so no experience of reduced take home pay
- Signpost the increase well in advance to the employee with details of revised contribution and date

Question 2

Is there scope for a more flexible approach to contribution rates to reflect an individual's life and employment journey?

We are aware that some employers provide an option within the scheme to 'opt down' rather than 'opt out' whereby the level of contributions drop below the AE minimum. We do not currently see the need to enforce this on employers. We need to proceed with the planned contribution increases in 2018 and 2019, with the industry identifying effective ways of engaging with employees throughout this period in order to keep opt out rates at a minimum. Should we see a significant increase in opt out rates, a flexible approach may need to be considered at that time.

Question 3

Do you have any evidence or views on the most appropriate/effective balance between employer and individual contribution levels? What are the options for encouraging, 'nudging' and enabling people to save more into their workplace pension?

It is encouraging to see that the DWP Employer Pension Provision survey 2015 shows that one in three employers are already contributing above the legal minimum.

Pension schemes are often considered next to salary as the most important benefit an employer can provide. Many employers will pay more than the employee – 25% of the Sunday Times top 100 companies for instance offer an occupational pension which includes a DC option where the employer pays double what the employee does.

Workplace schemes reaching high industry standards by achieving the Pensions Quality Mark (PQM) have a 10% minimum overall contribution with at least 6% coming from the employer. Over 200 schemes currently hold the PQM and PQM+ accreditation.

A key component underpinning the success of employer pension schemes is the concept of matching contributions and we believe this should be adopted for AE. This is easily understood by employees and has been proven to affect their saving behaviour directly. Consumer research points to the attractiveness and immediacy of the employer making contributions on their behalf, and this in turn encourages saving.

A high number of studies consistently find that employer matching of individual contributions increases the rate of participation in a pension plan. Drawing on just a few examples, Papke (1995), Even and Macpherson (1996), Kusko, Poterba, and Wilcox (1994), Basset, Fleming and Rodrigues (1998), Engelhardt and Kumar (2004), and Even and Macpherson (2004) all find that employer matching increases the probability of participation in US 401(k) pension plans18. Even and Macpherson find an increase in the probability of participation of 8.8 percentage points if matching is available.

Question 4

To what extent are individuals saving outside of a workplace pension for retirement and how does this impact on their interest and ability to save into a workplace pension?

TISA – Housing vs Retirement Research October 2016 shows that 50% of the 50+ group surveyed expect to use their home to fund up to 40% of their retirement income through sale or downsizing. The main financial goal of groups surveyed is to be mortgage free. This is also seen as a measure of success in life. The same research showed that although aware of a pension shortfall, this would be mitigated to some extent by continuing to work into retirement.

A 2016 Alliance Trust Savings survey shows that 36% save into an ISA for retirement saving, wishing to benefit from access flexibility. This may increase with the introduction of the LISA

Charge Cap

Question 1

What are the advantages and disadvantages of lowering the level of the default fund charge cap?

The present focus should be on establishing and embedding longer term legislation enabling individuals to build up pension pots capable of providing an appropriate and sustainable level of income in retirement. The three most important inputs in achieving this are an adequate contribution level, investment growth and decumulation options.

Until we have reached this position, it is not appropriate to look at lowering charges from the cap that already exists. The average NEST pension pot based on 2015/16 published accounts was under £300. A charge reduction from the 0.75% cap will have a negligible effect on these pots and the numerous other AE pots with a low value.

Question 2

What are the advantages and disadvantages of extending the cover of the charge cap to include some or all transaction costs?

Transaction charges do not mean much in isolation and may not correlate to a fund's performance. Providing information of this nature to an employee will only cause confusion and may lead to inappropriate action being taken such as fund switches. It is not a detail that majority of employees will be aware of or interested in. Trustees and Independent Governance Committees should be satisfied that the funds they offer meet requirements in terms of performance and costs and this data should be available to them.