Summary

- Industry figures have questioned the thinking behind the LISA and are now exploring the issue of whether it will harm the auto-enrolment landscape. There is a danger that younger people will consider saving into a LISA as the norm instead and opt out of a workplace pension.
- Questions have already been raised around the issue of inducements. There are strict rules in place by the regulator to ensure companies do not induce job holders to opt out of auto-enrolment. Concerns have been raised about whether this is what the government is doing with the new LISA.
- Savings mechanisms like auto-escalation have been put forward to keep the AE savings regime ticking over.
- An auto-enrolment regime with limited facility to opt out, which has a mandatory minimum contribution level and higher levels that employees could decide not to commit to is also an idea put forward by the industry.

Snatching defeat from the jaws of victory

Adam Cadle asks if auto-enrolment is under threat as a result of the Lifetime ISA announcement, and explores whether auto-escalation can further boost AE

In the run up to March's Budget, headlines around a planned pensions ISA and tax relief amendments dominated the media. Instead, the country was greeted by Chancellor George Osborne's announcement around the introduction of a Lifetime ISA (LISA).

Lifetime ISA

From April 2017, anyone under 40 will be able to open a LISA, meaning for every £4,000 saved the government will add £1,000 every year until the age of 50. Those who open a LISA will be able to access their money at any time for a small charge. "My pension reforms have always been about giving people more freedom and choice, so faced with the truth that young people aren't saving enough I am providing a different answer to the same problem," Osborne stated in his Budget literature.

Industry figures have questioned the thinking behind the LISA and are now exploring the issue of whether it will harm the auto-enrolment (AE) landscape. Former Pensions Minister and current Royal London director of policy and external communications Steve Webb believes the LISA introduction is "a real risk".

"AE is all about social norms and getting the right defaults. As things stand, literally millions of twenty-somethings and thirty-somethings have been enrolled into workplace pensions since 2012, and for many this may be the first time they have had a pension," he says.

"The danger with the LISA is that younger people will see this as the norm instead and opt out of a workplace pension. If young people decide they have limited spare cash for savings and want to focus on a deposit on a house and if they see their friends doing the same thing, we could see large scale opt-outs from workplace pensions. In terms of fixing our retirement saving problem this would be like snatching defeat from the jaws of victory."

Pensionsync CMO Chris Deeson describes the LISA as an "insidious threat" as "people can only afford to save a certain amount and the temptation of flexibility of use over employer contributions is bound to be seductive for lots of younger people."

The Association of Consulting Actuaries recently revealed that large and mid-sized employers, who have auto-enrolled their eligible employees, have only witnessed opt-out rates between 8 and 9 per cent. For smaller employers the rates have been recorded at 16 to 20 percent of eligible employees. With this in mind, it is a concern that opt-out rates may rise due to the influence of the LISA.

"Contributions will eventually reach a minimum level of 8 per cent, of which 3 per cent is paid by the employer, meaning that an employee on median earnings could lose over £800 per annum in employer contributions. Employers will need to make this clear to their younger employees in order to discourage opt-outs," Charles Russell Speechlys partner Jane Wolstenholme warns.

Aviva retirement and savings manager Alistair McQueen believes however that the world of long-term saving is big enough for both solutions and emphasises the role of the industry in presenting these savings methods in a way that engages savers, and doesn't confuse them.

"The LISA complements the other savings products that are already on the table," McQueen states. "It does not compete. For the vast majority of under-40s AE and the workplace pension will remain their preferred retirement savings vehicles."

An interesting question stemming from this is around the idea of inducements. While employees may choose to opt-out of their employer's pension, there are strict rules put in place by the regulator to ensure that companies do not induce job-holders to opt out. One could argue this is exactly what the government is now doing with the new LISA.

One idea mooted as a way round the LISA confusion is to include it within AE. "It is certainly possible," Wolstenholme says.

"An employer could offer contributions to the LISA as an alternative to AE without being in breach of the rules against incentives to opt out. But that does not mean it is the most sensible option. The aim of AE is to increase savings for retirement and reduce reliance on the state, whereas the LISA is not solely intended for this purpose."

Subject to an early withdrawal charge of 5 per cent, savings in a LISA can be withdrawn at any time and are less protected on insolvency. AE products are however subject to tight charge caps. McQueen argues that introducing the LISA within AE would "break the seamless process" behind the AE model with six million savers.

"Savers would have to be asked whether they want to save into a pension or a LISA, or whether they want to opt out. The introduction of a question is likely to increase the rate of opt outs – if in doubt miss it out. AE is a pension success story and there has been no shortage of pension tweaking in an attempt to fix other problems. These tweaks have often resulted in more confusion. In this case, if it ain't broke, don't fix it."

Punter Southall Aspire managing director Alan Morahan agrees that it would require people to make a decision "which is absolutely contrary to the principle of auto-enrolment".

Auto-escalation

With the AE savings system potentially under threat with a new savings vehicle on the horizon and contributions rates still very much at a low level, it has now become increasingly important to consider savings mechanisms like auto-escalation to keep the system ticking over.

In the report *Pensions 2022 – a vision of the future,* Cass Business School professor of pension economics David Blake said the government "chickened out" at auto-escalation. Furthermore, speaking at the NAPF annual conference last year, Pensions Minister Ros Altmann said it is vital a complete AE system is in place before thinking about this.

Addressing Blake's claim, Webb believes it to be an "odd" one.

"We don't even reach the 8 per cent mandatory minimum until 2019 and I haven't seen anyone produce a worked-out plan for auto-escalation so far. However in my view it is vital that this should be the focus of the 2017 review of automatic enrolment.

"My experience in government is that the 'lead times' to get things done are very considerable. You have to consult, draft legislation, get a slot in a Queen's speech, get the Bill through Parliament, produce detailed regulations and consult again, as well as giving employers and providers time to change their systems. Even if the government decided today to implement mandatory auto-escalation, it would take years to implement, so there is no time to waste," he says.

According to Webb, auto-escalation is the next 'key step'. "Enrolling people at 8 per cent and making sure they put in a bit more each time they get a pay rise helps to get people saving to a decent level," he explains.

TISA policy and strategy director Adrian Boulding emphasises the fact that the industry must find a way to combine auto-escalation and phasing.

"We are heading for a 13 month period between April 2018 and April 2019 that will see employee contributions quintuple from 1 per cent to 5 per cent. Rather than risk shaking people out of pension saving with such a rapid rise, we should schedule a longer, more gradual climb, and at the same time embed in legislation that the climb will eventually be higher, reaching 12 per cent as the end target, but getting there in baby steps of just half a percent a year for each of employee and employer."

Osborne's latest shake-up has certainly added another dimension to the world of saving and will no doubt have distinct ramifications on the pensions industry, be it positive, negative or both. For Wolstenholme, we may yet see further changes to AE.

"We may wish to look at an AE with limited facility to opt out, which has a mandatory minimum contribution level and higher levels that employees could decide not to commit to."

Written by Adam Cadle