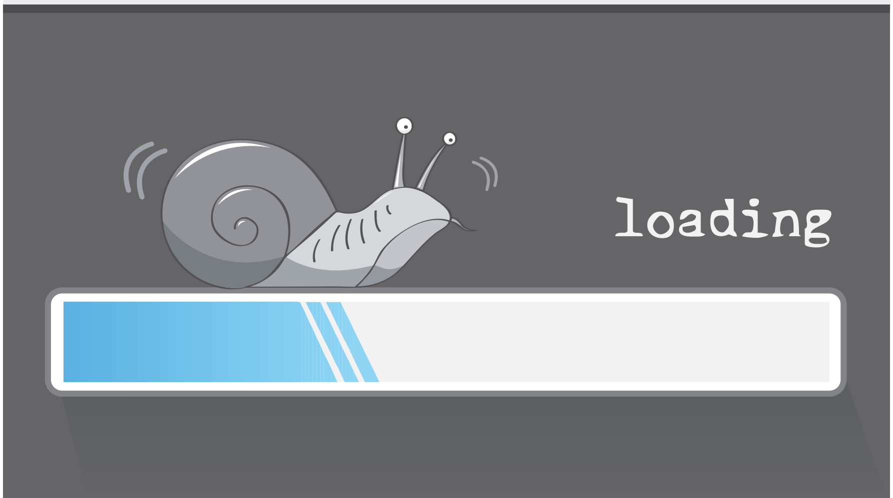

AE: Lost momentum

The industry agrees that the current minimum automatic enrolment contribution of 8 per cent is not enough, but there is less of a consensus on what the next steps should be. Natalie Tuck reports

Summary

• Three years on from the 2017 AE review, the industry is yet to see any changes, including increasing the minimum compulsory contribution.
• Whilst there is consensus that the current 8 per cent compulsory minimum is too low, there is a divide on whether increasing the minimum is needed, or whether employees should be encouraged to voluntarily increase contributions.
• Half the saver's age as a contribution percentage, or 15 per cent of annual salary, up from the previous 12 per cent, have been cited as ideal contribution amounts.
• Methods favoured when it comes to increasing contributions include a phased approach and auto-escalation.

Three years on from the publication of the review on automatic enrolment (AE) titled, *Maintain the momentum*, some might argue that momentum has been lost. The last contribution increase took place in April 2019, increasing the compulsory minimum to 8 per cent of salary and, since then, there has been little talk of any future increases.

On this lack of progress, Aries Insight managing director, Ian Neale, says: "I'm always disappointed but never surprised at the slow progress with pensions legislation. It took over 16 years to make AE a reality, from the date the Pensions Commission was announced in December 2002 to 6 April 2019 when all employers were on board and minimum contributions reached 8 per cent of qualifying earnings."

However, there are some excuses, he says, such as stiff competition for parliamentary time to consider legislation during the past three years, due to the government being busy with other things. Defending the government, former Pensions Minister, Baroness Ros Altmann, who was in office between 2015 and 2016, says it was "perhaps always rather premature to expect government to act on this".

"Especially in view of the economic uncertainties surrounding Brexit, compounded by the pandemic, the fact that AE has been kept in place at the current contribution levels is actually an achievement in itself. The government has protected this programme, even in the face of furlough," she says.

This sentiment is echoed by Pensions Policy Institute director and co-chair of the AE review, Chris Curry, who notes that the past few months and the impact of Covid-19 have changed the discussion around increased contributions.

He also says that there was always going to be a delay in introducing the recommendations of the review, to allow for evidence to be collected after the final phasing in of the minimum contribution level in April 2019.

"But now we have seen that the increase in contributions had little impact on the numbers of people either opting-out or starting to save, it would be good to see more concrete plans for the implementation of the recommendations," Curry says.

Increasing the minimum

The previous Pensions Commission, which Neale references, identified that the state pension, along with AE contributions of 8 per cent, would provide around half the level of savings needed to deliver adequate retirement incomes for most individuals.

As Neale notes, it is "widely agreed" that 8 per cent will not provide a level of income that will be perceived as adequate by most future retirees. However, the 2017 review into AE did not set out any magic number for which the government should aim for, instead stressing the importance of measuring the impact of increasing contributions first.

So, what is the perfect contribution? In the past, industry figures have landed on the figure of 12 per cent, or alternatively, half one's age as a percentage of salary. New research by BlackRock suggests, however, that individuals aspire to a retirement income of around two-thirds of their salary, an amount it says would require in excess of a 15 per cent salary contribution.

The question is whether increased contributions should come from increasing the compulsory minimum, or by pushing for increased voluntary contributions. One opponent of increasing the compulsory minimum is Altmann: "I believe the pensions industry should be getting these messages across and that the government itself should steer clear of too much compulsion. The policy was always meant to be a starter that could then be built on."

Those that are not against the idea of increasing the minimum, such as Neale, are still wary of doing so in today's climate. He says that current economic pressure means any increase risks triggering a significant increase in opt-outs by lower earners.

Sharing the burden

As per the current policy, employees are required to contribute a greater share than their employer, with the first contributing 5 per cent and the latter 3 per cent, making a total of 8 per cent. In the future, there are some in the industry that believe the share of contributions should be more balanced.

Society of Pension Professionals (SPP) president, James Riley, says 84 per cent of respondents to a survey of SPP members believe minimum employer contributions should increase over time from 3 per cent to 6 per cent of earnings, giving a headline contribution rate of 11 per cent (split 6 per cent employer and 5 per cent employee).

"We believe that businesses and savers would support the government going beyond this to the 12 per cent (split 6 per cent/6 per cent) called for by the Pensions and Lifetime Savings Association (PLSA) in its *Hitting the Target* paper from July 2018. Department for Work and Pensions (DWP) research showed that opt-outs remained less than 1 per cent across the April 2018 and April 2019 contribution increases, suggesting there is room for a further increase."

Another supporter is Curry, who says that from the perspective of minimising opt-outs, "it would make much more sense for employer contributions to increase rather than employee, so the gain from staying in, and penalty for opting out, is larger". However, Altmann believes that employees should be the ones to bear the majority of the costs when it comes to contributions, as it is their pension and their retirement income.

"Most employees no longer stay with their employer for their whole working life and it is not clear that employers who have someone working for them for a few years should have extra pension costs to bear. If the employee wishes to put some of their salary into their pension, I believe that is the employee's responsibility and decision."

Method of choice

If contributions are to be increased, the method and timing of these increases is another debate to be had. Riley warns of introducing contribution increases too rapidly, as it "risks killing the goose that laid the golden egg, causing difficulties to both employers and employees wrestling with the economic fallout from the Covid-19 pandemic".

"We therefore suggest that the change is implemented over a few years, but no later than PLSA's 2030 timetable… While any increases to contributions may be some time away, decisions need to be taken to support these future increases. If we delay deciding on increases, then there is a real risk that we cannot meet our 2030 goal."

One option of managing any cost impact, he says, would be to introduce it for new employees from one date and then allow employers discretion as to when (and in what stages) to move their existing workforce up to the improved basis but subject to a final backstop date.

Given the current economic environment, BlackRock head of UK institutional defined contributions, Alex Cave, stresses that a stepped approach would be a "pragmatic solution". Curry is also a fan of phased increases, as he says the "initial phasing plan for contributions, where changes were made at the same time as other changes (such as the income tax and national insurance thresholds) worked well".

However, he is not so sure that a national roll-out of auto-escalation would be so successful as an alternative method. He notes that while auto-escalation has worked well on an employer basis, it might be "difficult and complicated to implement nationally".

Others, such as Altmann, are supporters of auto-escalation, who says: "I think auto-escalation is an excellent idea, with employers asking workers whether they wish to put some or all of any pay rise into added pension contributions. But the responsibility for adding to their minimum AE pension in my view should lie with the workers, rather than their employer."

Looking across the pond, experience in the US shows that concepts like auto-escalation and pay more tomorrow do work, Cave says, with members more comfortable to commit future contributions from pay rises they are yet to receive.

"There is also evidence that this approach sees low levels of opt out or reversion, since members have themselves made the emotional commitment to increase contributions, rather than being mandated. In practice, however, the variability across multiple employers will be a challenge. If we want to level-up retirement income across all members, then a combination of scheduled contribution increases, balancing employer and employee levels, plus a broader adoption of auto-escalation, will be required."

Written by Natalie Tuck