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Stoking the slow revolution: keeping up the momentum on auto-enrolment?

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- The Government's policy of auto-enrolment has brought nearly 6 million new members into pension schemes. This has been a revolution in that it has brought about a striking reversal in the previous long-term decline in long-term savings.
- Albeit a slow revolution though: when auto-enrolment finally 'stages' to all employees in 2019, it will have taken over 13 years since the Turner Commission first recommended the strategy in 2005.
- Whilst there are key challenges to overcome in the next three years, the government and industry should exploit and build upon a clear momentum behind the policy that clearly exists.
- Two key issues still need to be addressed. The first is delivering the levels of income in retirement that people on average appear to want, through initiatives such as auto-escalation.
- The second issue is protecting savers' finances whilst they are building their assets for retirement. For example, while addressing the savings gap, it does not address the immediate needs of younger savers such as income protection or life assurance.
- The inclusion of auto-escalation of pension contributions and integrated life cover into the auto-enrolment apparatus are practical steps to take to address these
- A review of auto-enrolment should be conducted now to gain consensus to building in these features once the current implementation is completed in 2019.

CII Introduction: with the roll-out and implementation of auto-enrolment over the last few years and the increase in long-term savings rates that it has brought suggest that this might be the one pensions policy that has been an undeniable success. So does this signify "job done" for pensions savings and a shift in attention entirely to the decumulation end? People minded of austerity and other political limitations might say so. But those seasoned pensions observers might think that the Government should build on this success with policies like auto-escalation and extending this strategy to protection and life assurance. In this Thinkpiece, Nick Hurman FCII, Chartered Insurer returns to the series with a look at the thinking behind this debate.

Wednesday, 30 November 2005 to Saturday 6 April 2019: a period of 4,875 days feels pretty long for a revolution. But that's how long it will be from the publishing of the Pensions Commission's second report, recommending the adoption of auto-enrolment, until 8% contributions into qualifying pensions will first be required following the 2008 Pensions Act.

A quiet success story is unfolding

Not that the pensions world has been quiet in the interim. But behind the continuing work arising from recent initiatives such as *better workplace pensions* and *pensions freedoms*, the auto-enrolment revolution has been building a quiet, yet growing, success story.

Opt out rates have been at the lower end of expectations and providers have been available and able to enrol 5.8 million new members through auto-enrolment[1], resulting in a striking reversal of the previous long-term decline trend in scheme membership.

We can expect there will still be challenges to come. 2016 will see the enrolment of a large number of the smallest businesses with 30 or fewer employees. They will have little, if any, experience of occupational pensions and these inexperienced employers could prove both troublesome and costly for providers to enrol and administer.

And in April 2018, the minimum combined employer and employee contribution rates will rise from 2–5% before reaching 8% in April 2019. The associated increase in gross contribution for employees from 1% to 3% and then 5% is the next major test of the effectiveness of auto-enrolment. The question is whether the increased levels will trigger a wave of employee opt outs.

Something strong to build on?

So whilst it may be a little early to pass overall judgement on the success of the auto-enrolment policy, there is definitely momentum—sufficient to start thinking about whether there is more that could be done to build on this.

The 2008 Act had originally timetabled a review in 2017 although this was principally to review the constraints placed around the National Employment Savings Trust (NEST) as part of the settlement with the pensions industry. In 2012, the then pension minister, Steve Webb, suggested it should look at the whole process of rollout[2]. If we are to stoke the fires of auto-enrolment, 2017 feels none too early to grab a shovel and poker.

Despite the revisions to the state pension system, most commentators would agree that contribution rates need to be nearer double the minima set in 2008. The danger is an 'unfinished revolution' where millions contribute and believe it is job done.

But why should we need to take auto-enrolment further if it has delivered the agenda set out by the 2005 Commission? I would suggest there are two key reasons: first that auto-enrolment was a good start; and the second that wider needs must be considered.

1. Auto-enrolment a good start, but more was always intended

The Commission itself recognised that the auto-enrolment settlement was a good start but fell short of a solution to its brief to deliver adequate incomes. They said:

the proposed auto-enrolment system is designed to encourage people up to a certain level of income … to achieve at least a base load of income replacement in retirement … but it is not designed to ensure … the replacement rates they will on average want.[3]

[1] The Pensions Regulator Press release "Thousands of small employers complete their workforce pension duties," 28 Jan 2016 www.thepensionsregulator.gov.uk/press/pn16-06.aspx

[2] "Webb: Autoenrolment review will go ahead in 2017," by Steve Tolley, *Moneymarketing*, 2 Feb 2012 www.moneymarketing.co.uk/webb-auto-enrolment-review-will-go-ahead-in-2017/

[3] Pensions Committee, *A new Pensions Settlement for the Twenty-First Century – The Second Report*, 2005 http://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf

Despite the revisions to the state pension system, most commentators would agree that contribution rates need to be nearer double the minima set in the 2008 Act to achieve replacement rates that most want and expect. The danger of is an 'unfinished revolution' where millions contribute and believe it is job done.

2. Should wider needs such as protection also be explored?

The rollout has demonstrated that this mechanism can be harnessed to help people overcome their natural inertia when asked to contribute to their pension pot. But the savers now being enrolled have ever increasing needs for protection as they carry higher levels of debt both into the workplace and as they seek to enter the housing market. So whilst building assets for the future, they also need to ensure their liabilities can be paid off if they become unable to earn or die. Should these financial needs not also be addressed and so ensure that savers also get immediate benefits as they build their pots?

The Challenge of Adequacy – time to step on the auto-escalator?

A former colleague of mine, an experienced and respected pensions trustee and trainer, recently blogged following a visit to the Pensions Wise telephone service at the Pensions Advisory Service. In praising the skill and knowledge of the guiders, he remarked that:

the elephant in the room […] is that for a good financial outcome to materialise at retirement, people need the requisite guidance and nudges throughout the accumulation phase. [4]

The idea of working with peoples' inertia, the concept that underpins auto-enrolment, has already been applied to the problem of building up the rate of contributions for retirement beyond that at initial enrolment. The concept is often referred to as auto-escalation. It has its roots in the same school of behavioural economics and the champions of auto-enrolment, Richard Thaler and Schlomo Benartzi, packaged up their thinking in their Save More Tomorrow programme or SMarT[5].

With auto-escalation, the contribution level is *automatically* increased at regular intervals, typically 0.5–1% a year, until it reaches a preset maximum. In the US, 20% of the Fortune 100 companies are reported as successfully implementing auto-escalation[6]. The behavioural economics devices used are two-fold: the first is to ask the employee to sign up for auto-escalation to be enacted in the future (it is easier to save money tomorrow than today). The second is to align the increase with a pay rise so that it just offsets the pay rise rather than actually reducing take home pay. This could be combined with auto-enrolment, so that auto-escalation could be an employee opt-out as enrolment is currently.

Whilst admitting that the current enrolment rates were inadequate, the current Pensions Minister also said auto-escalation would be one of the reforms put on the back-burner while auto-enrolment is completed.

The Department for Work & Pensions has already been exploring the feasibility of importing some form of auto-escalation to the UK and Steve Webb was on record as recommending it should be implemented by the current government[7]. But the current pensions minister, Baroness Altmann, struck a more cautious note at the NAPF (now Pensions and Lifetime Savings Association) conference in October. Whilst admitting that the current enrolment rates were inadequate, she also said auto-escalation would be one of the reforms put on the back-burner while auto-enrolment is completed[8].

It appears that the rest of government is looking the other way and, instead, focusing on another review of pensions tax relief. Having already dealt with the statutory aspects of the 2017 review—confirming that transfer and contributions limits on NEST will be lifted—there is now no natural trigger to spark a wider policy review.

Surely now is the time to press forward with the policy work to deliver auto-escalation. History—and the constraint of the parliamentary timetable—teaches us that there is always a significant delay between policy being agreed and the

[4] Chris Wagstaff "Pensions Wise: perception and reality" in *Pensionsexpert .com* on 4 Jan 2016: www.pensions-expert.com/Special-Features/The-Cut/Pension-Wise-perception-and-reality

[5] https://faculty.chicagobooth.edu/Richard.Thaler/research/pdf/SMarTJPE.pdf

[6] "Is auto-escalation the pension saving panacea?" *Retirement Planner*, 9 Nov 2015 www.retirement-planner.co.uk/11009/auto-escalation

[7] "Webb: New government must prioritise pension auto-escalation," by Ollie Smith, *New Model Adviser* (*CityWire*), 11 Feb 2015, http://citywire.co.uk/new-model-adviser/news/webb-new-govt-must-prioritise-pension-auto-escalation/a797743

[8] "Altmann optimistic on auto-enrolment," by Damian Fantato, *FT Adviser*, 15 October 2015 www.ftadviser.com/2015/10/15/pensions/altmann-optimistic-on-auto-enrolment-aLX7jVnCmYwT1NRxhbNfgL/article.html

implementation of legislationIf. If we want the auto-enrolment fire to burn comfortably, we need to put fresh coal on now while it is still hot.

Developing a more rounded proposition – protecting savers whilst they save

The Turner Commission focused on adequacy of saving in retirement. One criticism of auto-enrolment is that it doesn't address the more immediate needs of younger members. With many young people now carrying significant amounts of debt and yet little or no life assurance or income protection, auto-enrolment could provide a very efficient vehicle to provide such cover when it is most needed. It feels strangely unfashionable to talk about life assurance but it remains a core benefit of nearly all established occupational schemes for good reason. As with pensions, group arrangements provide an efficient and low cost distribution system, making cover good value. The provision at the workplace with the support of the employer and via salary deduction places it where employees are most likely to consider and then take up cover – in a survey back in 2013, 81% of people believed employers had some part to play in providing protection[9]. And by including it in auto-enrolment, we can use the power of inertia to remove the need for an active decision to adopt it.

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Some smart thinking could then be applied to ensure that the cost is contained whilst cover is focused on those likely to need it most. One refinement could be to integrate cover with the pension pot so that the level of cover provided makes up the difference between the value of the pot and a target amount—for example, one or two times annual salary. So, those just starting would have a larger sum provided by insurance to 'bridge the gap' to this target amount and the cover required would then decrease as the pot grows with contributions and investment returns over time. As life insurance cover is generally cheaper for younger lives, this solution would ensure that more cover is bought when it is most needed and also when it is cheapest.

[9] "Quantifying the protection gap," by Donia O'Loughlin, *FT Adviser*, 4 June 2014 www.ftadviser.com/2014/06/04/insurance/health-and-protection/quantifying-the-protection-gap-63xuMjKOyzcr3NygeqnQmL/article.html

Using such an approach, the cost for employees would be contained and, combined with auto-enrolment, make an immediate and substantial contribution to addressing the chronic 'protection gap'.

As was the case for pensions, the extent of the cover needs to be debated to arrive at a settlement that can be supported by the key stakeholders. Namely how far and for how long it covers death, disability or unemployment. But a start with, say, simple life cover might be a small but important step in the right direction towards what Prospect magazine framed ambitiously as 'Beveridge 2.0'[10].

Continue the slow revolution

There is a risk that policy has been distracted from the goal that launched the pensions revolution: that of adequacy. Whilst ensuring that the pensions regime remains both affordable and attractive to employers and employees, we owe it to the workforce now building its assets for the future to push forward from the settlement of 2005. We should use the apparatus of auto-enrolment to close further the savings and protection gaps to ensure that those working now can look forward to more resilient finances both whilst they save and when they reach retirement.

Let us all call for again for the 2017 review of auto-enrolment, and set a new agenda to build on the outcomes from auto-enrolment with both auto-escalation and integrated life cover to growing pensions revolution.

If you have any questions or comments about this Thinkpiece, please contact us: thinkpiece@cii.co.uk **+44 (0)20 7417 4783.**

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[10] "Imagine what we could do if we got pensions right" by Nigel Wilson (sponsored feature), *Prospect Magazine*, 3 Nov 2015 www.prospectmagazine.co.uk/other/imagine-what-we-could-do-if-we-got-pensions-right