

DWP consultation on making automatic enrolment work: Response of Buck Consultants Limited

Introduction

We are pleased to have an opportunity to contribute to this review. We continue to be generally supportive of the principle of auto-enrolment, largely because of its potential – if designed and implemented appropriately – to address at least some of the shortfall in adequate savings for retirement amongst the nation’s employed workers, particularly the lower-paid who are less likely to have provision at the moment.

However, there are aspects of the actual proposals that are critical to their overall success in addressing this provision shortfall, whilst at the same time not being unduly burdensome to employers. This is particularly in view of the apparent decline in employer enthusiasm for retirement provision and the effects of the additional global economic issues that have arisen since the proposals were first crafted.

We therefore welcome the government’s decision to commission a review of the key areas of this policy, to ensure that they are still appropriate in the current environment. Our comments will concentrate on what we regard as the key issues that may need to be revisited, at least in part.

Whether the proposed scope for automatic enrolment strikes an appropriate balance between the costs and benefits to both individuals and employers, or whether the underlying policy objective of increasing private pension saving and balancing those costs and benefits would be better delivered by a different scope for automatic enrolment.

Selection of employees for auto-enrolment

Currently, the definition of Qualifying Employees provides that a “normal” member, who is subject to the compulsory auto-enrolment obligations to be imposed on employers and is entitled to the full level of contributions and tax relief, has to be within the age band that starts with his 22nd birthday and ends with State Pension Age (SPA). In addition, there is an extension to this category at either end of the age band, where the employee aged between 16 and 21, or over SPA and under age 75, may ask the employer to enrol them in the chosen qualifying scheme, and on the same terms as for the “normal” employees.

Ignoring for the moment the fact that it seems certain that SPA will be pushed back and so the top age for the “normal” qualifying will move with it, there is a question as to whether, once the default retirement age (DRA) concept is removed for all employment (as again seems likely) there should be a maximum age for determining a qualifying employee. The abolition of the DRA seems likely to lead to an increase in the number of employees who continue to work past ages that would now be regarded as “normal” for retirement, and in some cases employment will

continue beyond age 75. Given that the purpose of the auto-enrolment legislation is to encourage retirement provision for the affected group, it would be an anomaly not to allow them to continue with active pension provision while they are still in employment.

There is another issue concerning the proposed age limits for compulsory auto-enrolment. Under the present proposals, employees outside the age band may force the employer to grant them membership (although without being able to require a contribution from the employer in the case of an employee whose earnings are lower than £5,035 per annum (in 2007 terms)). Since this process is outside the control of the employer, it exposes the employer to potential and unquantifiable costs, in respect of additional case-by-case administration work, and in some cases, additional contributions. A number of employers would be prepared to accept the possibility of incurring additional costs through higher take-up, in return for greater certainty of, and control over, process and related administration costs.

Consequently, putting all this together, we believe that employers should have the power to sweep all their employees into the auto-enrolment process, if they so wish. This should not unduly affect members who would otherwise have been outside the system, since they would continue to have the choice of opting out.

Employers upon whom the auto enrolment obligations are placed

We understand the concern amongst the very small businesses which as a result of these proposals will have to offer pension provision to their employees – and bear the associated costs – for the first time. However, given that the policy objective is for this provision to be made (almost) universally available through employers, rather than by the state, it is difficult to deny access to some employees simply because they work for a small employer.

In addition, given the policy intention of helping women in particular, it would be counterproductive to grant exemption to the smallest businesses, given that a large number of these are in the retail sector and together employ a large number of women.

However, there are mitigating circumstances for businesses. First, the proposed staging provisions will ensure that small employers (with a few individual exceptions) will be the last to become subject to these requirements; consequently there will be some mitigation of their present financial position as hopefully the economy will have further improved by the time they have to start incurring these costs. Second, it is intended that they will be subjected to intensive and targeted publicity from a long time before their new obligations begin, so they should have plenty of notice to allow planning.

One of the major factors for consideration is to ensure that the rules and processes for auto enrolment, contribution payments and opting out are as simplistic as possible for employers to administer. We believe that this is a fundamental issue in achieving employer buy-in. The rules and processes should be designed to accommodate both the small employers who will not have staff to administer the pension arrangements, as well as the larger employers who could have a

significant increase in administration burden placed upon them. For example, one of the areas that should be considered in the review is the definition of “Qualifying Earnings”, as the current definition does not complement the majority of high quality workplace pension arrangements in the UK that use basic salary as pensionable earnings. The knock on issues that the current definition causes in regular monitoring activities is seen by many employers as an unnecessary burden compared to the benefits that might be achieved.

Date of commencement of an employee’s auto enrolment

There has been considerable debate over whether the administrative burden imposed on employers by requiring employees to be auto enrolled from the first day of their employment is too onerous. One of the strongest arguments against is probably that of the administrative burdens arising in the event of a new recruit’s appointment being terminated at the end of a probation period, and for those employers with high turnover in the early months.

Perhaps the most important benefit from Day One enrolment is the reduced likelihood of the employee opting-out. They will be distracted by many things when starting the new job, and it is more likely that inertia will take over, particularly as their remuneration will suffer contribution deductions from the outset and they will not have become used to receiving the higher rate of income that would arise from not saving for pension.

However, taking all factors into account, we believe that employers should have the option to defer automatic enrolment for a maximum of three months without having any “additional” contribution requirements imposed on them. This would allow a reasonable period of time for the probationary period to be completed and for the employee to assess the suitability of their new employment. In turn, the administration burden on the employer would be reduced to prevent having to enrol new hires into a pension arrangement for just one or two months.

The availability and capacity of pension providers other than NEST to serve the potential auto-enrolled population

We do not have a view on the capacity of private sector providers to serve this market, except to note that we understand that it has been the experience of many providers who embraced the Stakeholder initiative that the timeline before any profit is made (if at all) is extremely long. That being the case, it seems unlikely that there will be much enthusiasm for bearing the costs of producing another new product. However, the success of auto enrolment will depend to a large extent upon the ready availability of a vehicle to which employers can offer membership to their employees. Such vehicles will have to be clearly seen to be “fit for purpose”, since employees will effectively be forced into saving with them.

There would also be a potential issue over liability where a member's expectations (whether reasonable or not) from the selected vehicle are not met. It has already been established that unless the state's means-tested benefits system is reformed, there will be some auto-enrolled employees who will lose money by contributing to a pension. Many of those individuals will not have taken financial advice, but will blame their employers, the provider, the government, or any combination thereof for their plight. Providers are likely to require protection, which may take the form of requiring that advice has been obtained. Whatever the chosen solution, there is likely to be a cost implication for members, which will impact already meagre pension pots.

Yet bringing NEST to market will be an expensive exercise (in addition to the significant sums already expended), which will be borne by the earlier members, but meanwhile supported by a loan from the public purse. We can see the temptation in these harsh economic times for the government to seek out a viable alternative, provided all these problems can be satisfactorily addressed.

A sensible way forward may be to use a version of existing Stakeholder products as "default" funds, taking full benefit where possible of existing systems and design features, to reduce costs. Whether providers would be able to operate these products within the proposed charging structure for NEST is a key question.

We understand from reports in the financial press that conversations are already taking place with providers about alternatives to NEST; we suggest that those conversations be progressed to a conclusion as part of this review.

For further information, please contact:

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