ASSOCIATION OF ACA CONSULTING ACTUARIES

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25 November 2014

Alison Evans
Department for Work and Pensions
Automatic Enrolment Programme
1st Floor
Caxton House
London
SW1H 9NA

Dear Alison

Automatic enrolment earnings thresholds for 2015/16

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the above consultation document that was issued on 15 October 2014.

We have chosen not to answer the questions posed in the consultation document directly, but rather step back and examine the policy as a whole.

The setting of the earnings trigger and the upper and lower limits of the qualifying earnings band are important aspects of automatic enrolment policy. If the current linkages are maintained then the 2015/16 values would be as follows:

- An earnings trigger of £10,500 (being the amount of the personal allowance for income tax purposes);
- A lower limit of the qualifying earnings band of £5,824 (our estimate of the Lower Earnings Limit for National Insurance purposes); and
- An upper limit of the qualifying earnings band of £42,285 (being the Upper Earnings Limit for National Insurance purposes).

However, we believe that it is no longer appropriate to continue with the first two of the three linkages. This is because of the following:

- Significantly above inflation rises in the income tax personal allowance are taking more and more people outside the scope of auto-enrolment. This trend could continue given that two of the main political parties wish to make further progress with the income tax personal allowance after the 2015 General Election.

- Poor earnings growth is resulting in more people not reaching the earnings trigger than would have been expected as the economy recovers.
- Current auto-enrolment policy is indirectly discriminating against women.
- The Government's Freedom and Choice agenda, giving much greater flexibility in the manner in which defined contribution retirement savings can be accessed, including full cash out, mean that it is no longer necessary to limit auto-enrolment to those who would benefit from receiving a retirement income through annuitisation.

These points have a particular resonance as the focus for staging now switches to small and micro-employers.

We suggest that in designing linkages going forwards the following principles need to be kept in mind:

- Contributions should remain payable on a meaningful band of earnings;
- The calculation of contributions should remain administratively straightforward;
- Those enrolled should see that they are to benefit from their contributions, that of their employer's and the Government's contributions (through tax relief on the employee's contributions).

To this end we suggest the following:

- Insofar as 2015/16 is concerned there is no further increase in the earnings trigger from its current £10,000 and that a slight reduction is explored. We do not believe it essential for the earnings trigger to relate to an item that is currently used for payroll purposes.
- That in the Autumn statement the Chancellor announces that all individuals with taxable earnings below £3,600, including those with no taxable earnings, should be able to receive tax relief at the basic rate on their contributions to a registered pension scheme up to this amount regardless of how tax relief is obtained – ie the disconnect that currently exists between the net pay arrangement and relief at source should end.
- The feasibility of significantly reducing the trigger is explored, in tandem with removing the lower limit of the qualifying earnings band, perhaps as part of an independent review after the May 2015 General Election that we called for in our recently published Smaller Firm's Pensions Survey. By removing the lower limit, a significantly lower trigger would not result in trivial contributions being made, but would bring significantly more low paid individuals into auto-enrolment.

In the appendix to this letter we set out relevant comments from our Survey.

Our proposals (especially the last) would result in a significant change to the current parameters. In keeping with our comments on previous consultations in relation to these amounts, we ask for predictability in the earnings trigger and qualifying earnings band in future years.

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. Please contact either me on 020 7432 6635 (david.everett@lcp.uk.com) or my colleague, Peter Williams on 01372 733763 (peter.williams@aonhewitt.com).

Yours sincerely

David Everett
Chairman
ACA Pension Schemes Committee

Sent by e-mail to: Automaticenrolment.consultation@dwp.gsi.gov.uk

APPENDIX

The ACA's *Smaller Firms' Pensions Survey* included the following comments.

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> We believe the next Government needs to take a look again in mid-2015 (as the present Government did in 2010) to assess whether there should be some policy adjustments in particular for the ¾ million micro-employers with 4 or fewer employees.
>
> Our survey suggests that many small employers still remain blissfully unaware of the auto-enrolment timetable and – more alarming still – the budgetary planning needed to identify the extra costs that most will face. The Government and the Regulator have done a great deal to raise awareness about auto-enrolment and its virtues. They need to re-double their efforts in communicating the pension message – there must not be any complacency because of the success to date in terms of low opt-out rates in larger employers, particularly if the review of policy we commend is rejected.
>
> There are two principal reasons why we believe a policy review is needed in 2015.
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> First, the increase in the income level below which employees are excluded from auto-enrolment has been very marked during the current Parliament because of the significant increase in the personal tax allowance. This has meant a high number of employees in large and mid-sized firms have been excluded from auto-enrolment (in fact as at 31 August 2014 those ineligible for enrolment broadly equates to the numbers that have been added via auto-enrolment to pre-existing pension scheme numbers). We question therefore whether, going forward, the personal tax allowance should continue to be the level below which employees are excluded from auto-enrolment. This is compounded by the evidence that employee earnings are on average markedly lower in smaller firms (see pages 7-8 of this report). Without some policy change there is likely to be an increasing percentage of employees excluded from pensions – probably rising well above a third. Indeed, when it comes to the policy applying to micro-employers (4 or fewer employees) we could reach the point where ¾ million firms are being chased to register a scheme and meet compliance rules to deliver maybe just ¾ million employees actually eligible and willing to be auto-enrolled.
>
> Second, the generally much lower average earnings in these firms and the fact that in October 2017 combined contributions from employers and employees climb from 2% of band earnings to 5% and then 8% a year later with, in all likelihood, only modest increases in average earnings over the intervening period, suggests an incoming Government and perhaps the parties ahead of May 2015 may need to consider whether they must budget for some national insurance concessions to offset these sharp increases in costs. Again, if there is no review of policy there must be some danger of high opt-outs amongst micro-employers (and perhaps in larger employers as they begin their second wave of re-enrolment).

Whilst, in the longer-term the ACA is of the view that average pension and savings rates must increase so more people enjoy a comfortable income in part or full retirement – and hence we support such initiatives as auto-escalation and extension of contributions to all earnings up to a ceiling – in the near-term Government may need to be pragmatic and consider financial incentives to deliver the desired policy outcome.

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The present Government has proudly trumpeted its achievement in raising the personal tax allowance from £6,475pa in 2010/11 to £10,000pa in 2014/15. Already the Conservatives and Liberal Democrats have seemingly targeted £12,500pa within the next 5 years. To date, in the annual reviews of the auto-enrolment earnings trigger (the level below which employees are not auto-enrolled), the Secretary of State for Work & Pensions has kept this in line with the personal tax allowance.

Raising the trigger from £9,440pa to £10,000pa this year excluded around 170,000 individuals from auto-enrolment and the larger jump in 2013/14 from £8,105pa to £9,440pa excluded around 420,000. In both cases by far the majority affected were women.

Aside from the gender issue, these leaps in the trigger present two problems.

First, the increases might be coped with if average earnings were advancing at pre-2008 levels, but they are not. Indeed, there is evidence of very little earnings growth over the last few years, with falls in earnings in some lower skilled occupations.

Second, and of particular relevance to those working for small employers, there is evidence that average earnings levels are markedly lower in the micro employer sector. Whilst ONS does not regularly report on employee earnings by size of firm, the review of auto-enrolment in 2010 did look at and report on earnings disparities. With the low growth in earnings since these figures were published, there must be a concern that as auto-enrolment reaches down to these employers, auto-enrolment eligibility rates will fall quite markedly and logically opt-out rates might also rise too.

It seems likely that already as many as 40% of employees of micro employers may be ineligible for auto-enrolment without any increase in the trigger from £10,000pa. In stark terms, this could mean that requiring ¾ million micro employers to auto-enrol eligible employees may only add to employees covered by pensions by around just ¾ million, given a quite modest opt-out rate.

It may be that earnings growth in the period from now to 2017 will be such that it will in part address these concerns, but – as things stand – the case for a review of the auto-enrolment earnings trigger and the forward application of auto-enrolment to micro employers would seem appropriate – we suggest this merits an independent review by the Government following the May 2015 General Election, allowing time for policy adjustments.

Further information about the survey can be found at: http://www.aca.org.uk/files/ACA_publishes_first_report_of_2014_Smaller_Firms_survey-23_October_2014_-20141022100203.pdf

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

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