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Date: 21 March 2017
Response to: Department for Work and Pensions consultation on *Review of Automatic Enrolment – Initial Questions*

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About Which?

Which? is the largest consumer organisation in the UK with more than 1.5 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

Summary

- The Government should explore ways of "nudging" all individuals to save appropriately more for their retirement. This includes both those who are eligible and those who are ineligible for auto-enrolment.

- It is crucial that research is undertaken with eligible employees to understand the most effective "touch points" and delivery channels, and for this engagement to be designed in ways that limit the risk of people opting out for reasons they might later regret.

- The Government should consider targeting communications at those earning below the earnings trigger, to increase opt-in rates among employees that are ineligible for auto-enrolment.

- The Government should be clear about the merits of auto-enrolment, and take measures to ensure consumers are aware of the benefits of employers' contributions and the tax relief associated with pension saving. In particular, all government-backed information and guidance should be clear about the merits of auto-enrolment over the Lifetime ISA (LISA).

- The review should explore whether costs not covered by the charge cap have increased, including any attempts to pass on costs to consumers in ways that are not covered by the cap, such as via transaction costs.
- Transaction costs should be transparent and reported in a standardised form. Once there is greater transparency, the DWP should undertake fresh analysis on the scale of transaction costs, to explore whether any additional costs could be included within a charge cap.

Background

Which? has supported the policy of auto-enrolment, and agrees that it has been successful in engaging workers to newly save, or save more, into a workplace pension. It is vital that auto-enrolment continues to be rolled out to cover all employers by 2018, ensuring that all eligible jobholders have access to a high quality scheme, and that the Government builds on its success to date.

We therefore welcome the opportunity to contribute to the DWP's 2017 review of auto-enrolment. Although it is difficult to predict how the increase in contribution levels will impact opt-out rates and it is perhaps too early to speculate on further increases that may be needed, the over-arching objective to encourage consumers to save more for their retirement is correct.

In 2014, Which? welcomed the introduction of a charge cap for auto-enrolment schemes, and suggested that the cap level should be kept under review to see if it can be lowered in the future. We called for the Government to set the charge cap for workplace schemes at 0.5% and for it to cover all new and existing workplace schemes rather than just default funds within auto enrolment schemes. We calculated that lowering the cap could mean a difference of £40,500 in someone's pension fund at retirement, and save consumers around £4.8bn over the next 10 years. Two years since the charge cap came into effect, the DWP is right to consider what effect it has had on the market, and whether it could be lowered and extended.

Coverage

The review seeks to examine whether auto-enrolment could be expanded, bringing individuals not currently eligible for auto-enrolment into scope, potentially through lowering the "earnings trigger" or including categories of jobholders such as the self-employed. Which? is aware that women, for example, are more likely to be ineligible for automatic enrolment due to having multiple part-time jobs, even when the combined income from their jobs exceeds £10,000, while the number of self-employed workers contributing to a pension has fallen dramatically during a period in which the self-employed sector has grown significantly. Furthermore, a lack of pension saving among the self-employed does not appear to have been replaced by other forms of saving.

However, while the Government may explore expanding auto-enrolment to cover currently ineligible jobholders, it should equally consider other ways to encourage long-term saving among these groups. Everyone should be encouraged to save for retirement early in their career, and to continue to save throughout their career. For those people who remain out of

the scope of auto-enrolment, the Government also needs to explore policies that encourage them to save appropriately for later life.

Engagement

The Government should explore ways of "nudge" all individuals to save more for their retirement appropriately. This includes both those who are eligible and those who are ineligible for auto-enrolment.

In the few instances where consumers engage with pensions, it is important that they are provided with clear information on their current contribution levels and what this could mean for their retirement income. This could include suggesting options for additional contributions and forecasting the impact this could have on retirement incomes. The DWP should help make this information available at the key trigger points where eligible employees are engaged, such as when they are first auto-enrolled and when they are provided with statements regarding their pension investments. However, it is crucial that research is undertaken with consumers to understand the most effective "touch points" and delivery channels, and for this engagement to be designed in ways that limit the risk of people opting out for reasons they might later regret. Awareness alone is unlikely to be enough, so the Government should consider what nudges might be needed to deliver increased and sustainable pension saving over the long term.

Similar information on potential savings rates and resulting retirement outcomes should also be provided to employees that are not currently eligible for auto-enrolment. For example, this information could be provided to the self-employed via the process for self-assessment tax returns.

Early evidence suggests that auto-enrolment can increase pensions saving among employees that are ineligible, due to either employees requesting to opt-in or their employer choosing to enrol employees that are not eligible. Pension participation among employees that are ineligible for auto-enrolment has increased from 19% in 2013/14 to 24% in 2014/15, reversing a declining trend. Opt-in rates have been reasonably high for ineligible employees (although not for the self-employed), in particular for those earning below the earnings trigger of £10,000.

To increase engagement with this group, it should be made much clearer to employees who do not earn above the earnings trigger that they have the right to opt in and request to join a pension scheme with their employer, and that those earning more than the lower earnings threshold with a single employer have a right to employer contributions.

Contribution levels

Setting introductory minimum contribution levels at 0.8% for employees appears to have resulted in good outcomes, in that opt-out rates have been low, and lower than predicted. However, existing contribution rates will not deliver sufficient retirement incomes, and it is clear that the increased participation that auto-enrolment promotes does not in itself secure adequate pension saving levels.

There is a risk that opt-out rates will increase as minimum contribution levels for employees increase to 2.4% from April 2018, and then to 4% from April 2019. It is too early to predict the impact that increases in contribution levels might have, but maintaining trust in the pension

industry is important for keeping opt-out rates low. Research by Which? in 2013 found that 35% of people who had opted out of auto-enrolment, or said they would opt out, had done so because they did not trust the pension industry to look after their money, and 22% because they were concerned about the quality of the scheme. Since then there have been a series of reforms, including the introduction of the charge cap, which could help to build trust in the pensions industry. However, further measures and safeguards to build and maintain trust should be considered, and will need to be communicated clearly to consumers.

The Government should also be clear about the merits of auto-enrolment, and take measures to ensure consumers are aware of the benefits of employers' contributions and the tax relief associated with pension saving. In particular, all government-backed information and guidance should be clear about the merits of auto-enrolment over the Lifetime ISA (LISA). Consumers might overvalue the government bonus provided within the LISA and the flexibility of a LISA when compared with a pension. This was not acknowledged in the Government's impact assessment for the LISA, which assumed that no individuals will opt out of workplace pensions to save into a LISA. In our response to the FCA's recent consultation on its proposed handbook changes to reflect the introduction of the LISA, we called for robust measures to mitigate against the risk of undermining auto-enrolment. For example, we proposed that the FCA should require clear disclosure on the merits of auto-enrolment, including the tax relief associated with pension saving, in all LISA sellers' communications.

Costs and charges

The charge cap has been in place for almost two years, so it is right that its impact is reviewed and we expect this to be repeated periodically. It would appear that the charge cap has had a minimal direct effect on pension costs, as 90% of members of pension schemes that 'qualified' for use for auto-enrolment were already paying charges within the charge cap before it was introduced. All of the members of qualifying master trusts – whose membership has increased significantly since the introduction of auto-enrolment, including via the government's NEST scheme – were already paying charges within the cap.

However, the Government should take this opportunity to scrutinise the market to see if the charge cap could be set any lower, to help savers get the best value out of their hard earned money. Even a fraction of a per cent can have a significant impact on pension funds, and people need to be confident that their scheme is giving them the best value for money.

In particular the review should explore whether costs not covered by the charge cap have increased, including any attempts to pass on costs to consumers in ways that are not covered by the cap, such as via transaction costs. The review should include:

- An analysis of the types of fees, charges and transaction costs that are levied in the market and how this has changed (to assess whether new transaction costs have been developed);
- The overall costs to consumers (including fees, charges and transaction costs) and an assessment of the overall balance of fees and transaction charges (to assess whether there has been a shift in total charges towards transaction costs to avoid the cap).

Transaction costs should be transparent and reported in a standardised form, and Which? supports the DWP's and FCA's work in this area.

It is impossible for consumers to know how much they are paying for transaction costs. Many pension providers are themselves unclear how much their members are paying to asset managers for transaction costs. Research by the DWP found that for transaction costs for fund entry, two thirds of pension providers either did not have access to the data to measure the transaction costs that applied to their members or were unsure as to whether these costs applied at all. 58% of pension providers could not provide data on transaction costs for remaining invested, and of those that could, some had costs that could more than double the amount that consumers pay each year for default funds, on top of the cap of 0.75%. The first step is to make transaction costs more transparent, so individuals know what they are paying.

In addition, employees are heavily reliant on their employers to deliver value for money, yet employers may not share the employees' incentives to minimise costs. In its 2013 market study of defined contribution workplace pensions, the Office of Fair Trading found that scheme members tended to be reliant on their employer to make most of the key decisions but that many employers lack the capability and/or the incentive to ensure that members of their schemes receive value for money in the long term. Subsequent research for the DWP found that only around a third of employers were aware that their employees paid any charges at all for their workplace pensions, with significantly lower awareness among smaller firms.

While trustees and independent governance committees are expected to report on value for money, they are currently only required to request and report on transaction costs as far as they are able. To do so they rely on asset managers for most of this information, who do not have a similar duty to provide full disclosure of these costs in a standardised form. Which? has previously called for the Government to consider mechanisms to ensure there is an exact match between this requirement on trustees and the duties of fund managers.

Once there is greater transparency, the DWP should undertake fresh analysis on the scale of transaction costs, to explore whether any additional costs could be included within a charge cap for default funds for auto-enrolment. Consumers are least engaged with these default funds and millions of consumers have been signed up to a pension scheme for the first time.

This analysis should also explore ways to mitigate any potentially damaging effects that such a policy could have on the investment approaches or decisions made by pension providers and asset managers.

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