Association of British Insurers

**ABI response to the initial 2017 Automatic Enrolment Review questions**

22 March 2017

### *About the ABI*

The Association of British Insurers is the leading trade association for insurers and providers of long term savings. Our 250 members include most household names and specialist providers who contribute £12 billion in taxes and manage investments of £1.6 trillion.

### *Background*

The ABI welcomes the opportunity to comment on the initial list of questions published by the DWP to inform its review of automatic enrolment.

Automatic enrolment has been successful to date, with a 37 percentage point increase in participation in workplace pensions from 2012 to April 2015[1] addressing the problem of mass participation in long-term savings and reversing a decades long decline in the proportion of the population saving for their retirement through workplace pensions.

The low opt-out rates seen thus far likely demonstrate the effectiveness of the behavioural nudge, or the assumption of the passive saver, which is the basis of the programme. They may also reflect a latent desire to save and scope for further engagement to increase saving.

### *Executive summary*

1. The ABI remains committed to automatic enrolment as the best means of ensuring people save adequately for retirement and commend the efforts of the Department of Work and Pensions (DWP) and the Pensions Regulator (tPR) in supporting employers through the staging process.

2. However, only half of working age people are currently eligible for automatic enrolment.

3. The ABI believes that this review should be looking at how to extend the coverage of automatic enrolment to be more inclusive, to ensure employers comply with their automatic enrolment responsibilities and to learn from areas of best practice.

4. The ABI recognises the stark and worsening problem of the current pension provision for the self-employed and understands that a one-size-fits-all approach to the problem of this diverse group may not be appropriate. However, we believe it is important to act quickly to help as many of this group as possible.

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[1] Institute for Fiscal Studies (2016) What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the UK

5. The ABI therefore advocates for an automatic enrolment type opt-out system of pension saving for the self-employed as the most effective way of helping self-employed individuals save for their retirement. Further consideration should be given to how the Government, regulators and providers can work together to ensure this group of customers can find a scheme or policy that is right for them.

6. The Government and industry should harness the opportunity presented by the current public interest in pensions resulting from the introduction of the New State Pension and Freedom and Choice reforms to improve engagement with retirement saving under automatic enrolment.

7. Automatic enrolment has seen increased numbers of people passively engaging with pensions in general, but not actively engaging with pension decision-making.

8. The ABI believes that the current approach to engagement needs to change and that the automatic enrolment review should focus primarily on two engagement strands:

   - How to engage the young with long-term saving and their pension provision.

   - Retirement planning focusing on people in their late 40s-60s making sure people prepare adequately for their retirement.

9. There is a wealth of literature about behavioural economics tools, the detail of which is beyond the scope of this response, but it is important to note that this research should be leveraged when designing tools and strategies to improve pension saving.

10. There are also practical tools that can support engagement by increasing awareness of people's retirement provision. The ABI, with the sponsorship of HM Treasury, has managed a cross-industry project, to create a pension dashboard prototype. The ABI believes the dashboard could be a tool used to enhance engagement; it will empower people to pull together their disparate pensions data from different providers, schemes and the state to be able to get a full picture of their retirement.

11. This review is also a good opportunity to refocus on the original policy intention of automatic enrolment which was to address adequacy. It is generally accepted that the automatic enrolment contribution of 8% of qualifying earnings may not be sufficient for many savers. However, whilst it may not be appropriate to increase the default level of contributions in the short-term, it is important to lay the groundwork now for future increases, as any changes will take time to implement, although, it should also be borne in mind that the solution may not lie in mandatory contribution increases. The ABI believes that streamlining the automatic enrolment system could increase contribution rates without having to raise the contribution rate percentages.

12. In the ABI's view, any substantial changes to automatic enrolment should be signalled in advance, in order to give employers and members adequate time to prepare. As such, the ABI believes it would be appropriate to have reviews of the policy more frequently than every five years.

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## ***Coverage***

### *Summary*

13. Since automatic enrolment was first introduced in 2012, over 250,000 employers have successfully implemented the system and more than six million new savers are now contributing to a workplace pension[2]. However, only half of working age people are currently eligible for automatic enrolment.

### *Review questions on coverage*

**Q1. Do the earnings trigger (£10,000 in 2017/18) and age criteria (22 to SPA) continue to bring the right people into automatic enrolment?[3]**

**Q2. Is there a case for bringing individuals not currently eligible for automatic enrolment into scope, and on what grounds?**

**Q3. Do the categories of non-eligible jobholders and entitled workers continue to make sense in terms of enabling those who are not eligible to be automatically enrolled to save into a workplace pension?**

**Q4. In the light of the continuing evolution of the labour market, is there a case for exempting any group or groups of employers from automatic enrolment duties?**

14. The ABI believes that this review should be looking at how to extend the coverage of automatic enrolment to be more inclusive, to ensure employers comply with their automatic enrolment responsibilities and to learn from areas of best practice. We do not endorse the idea of exempting any group or groups of employers from their automatic enrolment duties.

15. For example, 23% of employed people do not currently meet the automatic enrolment qualifying criteria. The main reason for not being eligible is low earnings: of those in employment who are not eligible for automatic enrolment, 57% are not eligible because they fail to meet the earnings threshold. This is 13% of the UK employed population that earn below the threshold and must either be in part-time work or be receiving less than the minimum wage[4]. This would indicate that current automatic enrolment qualifying criteria means that workplace saving is not evenly spread across or representative of the UK workforce.

16. Some sections of the population – particularly multiple job holders, gig economy workers, part time workers, carers and women – are all more likely to be missing out due to the current criteria.

17. Out of the 13 million employed women in the UK, 32% do not meet the current qualifying criteria for automatic enrolment, compared to 16% of male workers. 2.1 million women earn below the earnings threshold and others have multiple part time jobs instead of full time employment[5].

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[2] Aviva (2016) Auto Enrolment Pre-Review

[3] Details of automatic enrolment eligibility criteria can be found here:
http://www.thepensionsregulator.gov.uk/docs/resource-diff-types-of-worker.pdf

[4] Pensions Policy Institute Briefing Note 75 "Who is ineligible for automatic enrolment".

[5] http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-75---who-is-ineligible-for-automatic-enrolment

18. The ABI believes there is considerable scope for making the automatic enrolment regime simpler and more inclusive. Ideally, being employed should correspond with being automatically enrolled.

19. The ABI strongly supports moving the lower age limit from 22 to 16 as the current lower age limit is excluding the 50% of school leavers who do not go on to higher education. By lowering this qualifying age threshold, automatic enrolment would help establish a savings habit earlier, from day one of employment. The rationale for the upper age limit also seems unclear and it goes against the grain of the Government's "longer working life" policy. The ABI can therefore see no reason for its retention.

20. Similarly there would be gains in both inclusivity and simplicity if the £10,000 minimum income threshold were removed. In particular this would support the concept of pension saving from day one of employment, even for the low paid, ensuring that no one is excluded from the benefits of employer contributions. It would also mitigate exclusion issues, particularly for multiple job holders who can find themselves not eligible for automatic enrolment, despite having overall earnings in excess of the threshold.

21. However, there are issues which need to be considered including potential unintended consequences. In particular, the risk that people are automatically enrolled against their better economic interests needs to be recognised. Although the benefit of the employer contribution makes this unlikely, the case for removing the threshold would be strengthened if the problem of the low paid missing out on tax relief under net pay arrangements were addressed.

22. The case for restricting contributions to band earnings is also unclear. Again removal of the lower and upper band earnings limits would simplify the system and address issues of exclusion.

23. Amending the age limits and removing of both the £10,000 threshold and band earnings would also remove another unnecessary complication – the distinction between entitled and eligible cohorts. If the principle that employment equates to automatic enrolment from the first pound of earnings were followed through to its conclusion then the need for the distinction would fall away completely. However, even if only the age limits were amended, this would result in useful simplification that would be beneficial to business.

### *Q5. How can self-employed people be encouraged and enabled to save more for later life/ for retirement?*

24. The ABI recognises that the self-employed are a diverse group and that a one-size-fits-all approach may not be appropriate. However, due to the current stark and worsening pension provision for this group it is important to act quickly to help as many of this group as possible. Research shows that just 30% of the self-employed are saving into a pension and surprisingly that only 24% of self-employed with household incomes of over £1,000 per week pay into a pension.

25. Citizens Advice and the Resolution Foundation have both identified a number of possible reasons for this including:

- contributing to a pension may not be viable for many self-employed individuals – the median self-employed person earns 40% less than the median employed person;

- a lack of awareness or understanding of the benefits of pensions, including tax relief - currently 69% of the self-employed do not understand the tax breaks provided by a pension;
- a lack of awareness of how to set up a pension
- a lack of accessible information about pensions, including the availability of affordable advice[6] [7].

26. There are also a number of practical barriers specific to self-employed individuals. For example, the onus is on the individual to proactively set up and contribute to their pension rather than this being set up and managed by an employer. In addition, without the employer contribution, self-employed individuals are not incentivised to save into a pension in the same way as those in employment.

27. This problem is compounded by evidence that the self-employed are not substantially investing in cash savings as an alternative to a pension - cash savings for the employed and self-employed are broadly similar[8]. Whilst any policy mechanism that encourages people to save is welcome, this could suggest that availability of pensions and other savings products is not the problem and new savings products may not necessarily be the answer to the problem of under-saving of the self-employed.

28. It should not be forgotten that the self-employed can already save into a pension, and many do. For example, the SIPP market has grown so that 700,000 SIPPs are sold every year, typically through a financial adviser and 80% of new savings are going through investment platforms.

29. It has been suggested that the Lifetime ISA (LISA) may have a role to play in addressing the long-term saving problem for the self-employed. However, the LISA does not provide an equivalent to the employer's contribution and is not available for anyone over 40. As 42% of the self-employed are over 55, the ABI believe that the LISA could currently only be considered a partial and sub-optimal solution at best[9].

30. The ABI advocate for an automatic enrolment type opt-out system of pension saving for the self-employed as the most effective way of helping self-employed individuals save for their retirement. This behavioural 'nudge' could best be delivered via the self-assessment system. However, it is important to recognise that if such a system were to be established that timing could be a potential problem as the self-assessed often save enough money to pay tax, but may not feel they have additional funds to contribute towards a pension. The forthcoming move away from an annual self-assessment process could help to alleviate this problem.

31. There are further issues which need to be addressed in designing a self-assessment system for the self-employed and these stem from the absence of the employer role in making automatic enrolment a success.

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[6] Resolution Foundation (2014) Just the job – or a working compromise? The changing nature of self-employment in the UK

[7] Citizens Advice (2016) Shy of retiring: addressing under-saving amongst self-employed people

[8] Citizens Advice (2016) Shy of retiring: addressing under-saving amongst self-employed people

[9] Resolution Foundation (2014) Just the job – or a working compromise? The changing nature of self-employment in the UK

32. Whilst the self-assessment system could provide the necessary behavioural nudge, the self-employed are still missing out on the following benefits provided by the involvement of an employer:

- implicit reassurance as to the merits of the pension provision;
- an employer contribution to supplement the employee contribution; and choosing a pension provider for the employee.

33. Whilst it should be possible for Government, providers and other stakeholders to provide necessary reassurance as to the 'safety' of pension saving, the other two elements are more difficult.

34. To try and replicate the employer contribution, the Citizens Advice Bureau has suggested a model where the Government provides an additional 'top up' of 1% of gross income[10]. Royal London on the other hand has suggested an additional class IV NIC charge of 3% which is available to recycle into a pension on an incentivised opt-in basis[11]. Inevitably, neither model can sidestep the obvious issue – that replicating the employer contribution requires extra money from somewhere. On balance the ABI supports the Royal London approach as it provides an amount equivalent to the employer contribution. However, as the recent events of the 2017 Budget show, any changes to class IV NIC would have implications for such a policy.

35. The second issue is the supply side – finding a provider. This could be solved in a number of ways, including having a central register of pension providers for the self-employed to choose from. These providers would need to have agreed quality standards. However, care needs to be taken to ensure that introducing choice at this stage in the process does not create a barrier as currently the success of automatic enrolment comes from utilising inertia. Consequently, a default option in finding a provider for the self-employed would need to be explored further.

36. Any roll-out of an automatic enrolment option for the self-employed should be heavily signposted through self-assessment communication and awareness campaigns with accessible guidance and advice services available to help overcome current knowledge barriers. The move to digital tax returns and increased frequency of returns will also help in this process.

[10] Insert citation and link
[11] Insert citation and link

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***Engagement***

***Summary***

37. Relying on inertia will not be enough to ensure people save adequately and make informed choices at retirement.

38. The Government and industry should harness the opportunity presented by the current public interest in pensions resulting from the introduction of the New State Pension and Freedom and Choice reforms to improve engagement with retirement saving under automatic enrolment.

39. Automatic enrolment has seen increased numbers of people passively engaging with pensions in general, but not actively engaging with pension decision-making.

40. For instance, research carried out by a number of IGCs into what workplace pension members consider value for money shows that 52% of savers don't engage with their pensions and 40% are not confident when making decisions about their pensions[12]. DWP should engage with this research as part of this review.

41. When talking about engagement, we should try to be clear about:

- the extent to which it is appropriate or realistic to rely on engagement as a tool to improve pension savings habits; and
- the desired outcome of engagement.

42. There are a variety of views on the value of engagement as a tool to improve pension saving. If the term engagement is understood to mean, "interested in/prepared to make proactive choices about", trying to increase engagement will not always be the right approach and may not be cost effective. However, in its wider sense of 'involving people in pension saving' then there is much greater scope for influencing what people do. After all, the default opt-out approach on which automatic enrolment is based increases engagement in the sense that it involves people with pension saving, even if it's in a passive fashion.

43. The ABI would suggest that increasing involvement in pension saving is, to a great extent, about deploying a range of tools. This can range from encouraging active interest and equipping people to make proactive choices, to an automatic default.

44. There is a wealth of literature about behavioural economics tools and the detail is beyond the scope of this response but it goes without saying that this research should be leveraged when designing tools and strategies to improve pension saving.

45. However, it is important to be constantly mindful of what we are trying to achieve and the context in which particular behavioural tools might be appropriate. For instance, a default approach should not be used if it is likely to steer some towards an option which is not in their best interests. Whereas a default approach is appropriate in getting people into pension saving because it will almost certainly be in their best interest, it would not be appropriate to apply a default approach when people withdraw their pension under pension freedoms. Indeed it is in this latter circumstance where increasing engagement in its

[12] http://www.actuarialpost.co.uk/article/scottish-widows-survey-on-its-igc----039s-----039value-for-money----039-9811.htm

narrow sense is most important – people need to be equipped to make the necessary choices at retirement.

46. In addition to behavioural tools, there are also practical tools that can be used to support engagement. The ABI, with the sponsorship of HM Treasury, has managed a cross-industry project, to create a pension dashboard prototype. The ABI believes the dashboard could be used to enhance engagement; it is a tool that will empower people to pull together their disparate pensions data from different providers, schemes and the state to be able to get a full picture of their retirement provision.

47. The pension savings journey has changed radically through the introduction of both automatic enrolment and the pension freedoms. Thought needs to be given as to how best to use the totality of this new pension journey rather than just the final months of accumulation to ensure people are equipped to make confident and appropriate decisions about how to best use their pension pot. The consultation question about 'touch points' goes to the heart of this.

48. Irrespective of the question of mandating contribution increases, adequate pension saving should be enabled and encouraged through improved engagement in its widest sense with careful consideration of the behavioral economic tools available.

***Review questions on engagement***

***Q1. What examples are there of effective communications and engagement tools that have delivered:***
***a) Sustained workplace pension saving over the long term, and***
***b) Increased levels of savings resulting from changing contribution rates?***

49. Pension Policy Institute (PPI) research into employers' awareness of automatic enrolment found that the "Workie" automatic enrolment advertising campaign was successful in engagement terms, with 79% remember seeing or hearing at least one of the campaign adverts[13]. However, further research needs to be done to understand whether acknowledging having seen this advertising campaign has contributed to behavioural change and increased savings and awareness.

50. The ABI are currently conducting two pieces of work looking at different strands of the consumer engagement theme. We have commissioned the PPI to look at appropriate levels of engagement throughout the customer journey. In light of pension freedoms there is a general acceptance that six months is too short a period to make customers aware of their retirement options. However there is little empirical evidence to suggest what an appropriate time period would be. This project will seek to answer that question by considering what engagement works, for what purpose, when, how and why and for what type of customers.

51. Building from our *Making Retirement Choices Clearer Guide* we have also commenced a project to re-frame pension savings. The project seeks to remove jargon from the language around pension savings and develop a consistent way of communicating about pension saving so that customers: understand the benefits of saving into a pension; can simply

[13] http://www.pensionspolicyinstitute.org.uk/press/press-releases/20161101-ppi-pr-consumer-engagement---new-research

compare saving into a pension with other saving vehicles; and, are, ideally incentivised to save more.

52. The ABI would be happy to share the findings of this consumer engagement work with the DWP, once completed.

53. Currently the standard approach to consumer engagement with pensions is flat-lining with an annual statement until six months before retirement age when engagement peaks. The ABI believes that this approach needs to change and that the automatic enrolment review should focus primarily on two engagement strands:

- How to engage the young with long-term saving and their pension provision, primarily about how much they are saving and whether they should be saving more.

- Retirement planning focusing on people in their late 40s-60s to ensure people are making adequate preparation for retirement.

***Q2. In an individual's automatic enrolment journey, what are the most and least effective touch points when appropriate engagement can help reinforce personal ownership of pension saving? What form should that engagement take, who should deliver it and how?***

54. There are a variety of possible touch points in an individual's pension savings journey. We refer later to the importance of leveraging the opportunity provided when someone changes job to ensure contributions increase or at least, do not drop. Another obvious touch point is the occasion of any pay rise. Again as noted later, this can be leveraged through'Save More Later' style schemes to provide a relatively painless opportunity to increase contributions without seeing a drop in take home pay.

55. As mentioned above, we have commissioned PPI research on appropriate engagement levels throughout the life of a pension and will be able to feed the results into this review later in the year.

***Q3. What are the challenges and barriers to sustained or timely engagement for different cohorts and individuals, and how can they be overcome?***

56. Aside from the obvious barrier to saving of having insufficient resources (to which we return in our response to question 4), research suggests that there is a range of psychological frictions which get in the way of logical economic decision making. For instance, people may be put off by having too much choice or be influenced by present bias in which they restrict savings because they are unable to identify with the needs of their future self. There are a range of behavioural tools described in literature[14] which are shown to go some way towards mitigating these frictions. The concept of making an, 'active choice,' to which we refer later in the section on contribution rates, is an example of such a tool. More generally, it is vital that the lessons of behaviourial science are fully considered in both identifying the real world barriers and selecting the appropriate tools to overcome them.

[14] Madrian (2014) citing Carroll et al. (2009)

### *Q4. What are individual attitudes to workplace pension saving and what influences those attitudes?*

57. Although the obvious question is whether people have enough money to save, there is evidence that this problem can be overplayed.

58. Despite the success of automatic enrolment, in terms of numbers of new savers, a study conducted by Prudential of workers who started contributing to pensions through automatic enrolment showed that more than half (51%) said they could afford to save more than their current contribution rate[15].

59. The study showed that nearly three in ten (29%) admitted they could afford to save an extra £100 or more each month and only 26% of workers believe they are currently saving enough for a comfortable retirement.

60. However, Prudential's research found that nearly half (49%) of these new pension savers feel they could not afford to increase contributions from their current level even though the law will require them to do so in the future.

61. The research also found evidence of automatic enrolment encouraging people to plan more generally for their future – nearly one in six (17%) of those questioned say they have been to see a financial adviser as a result of signing up to a workplace pension scheme.

## ***Contributions***

### *Summary*

62. This review of automatic enrolment is a good opportunity to refocus on its original policy intention of addressing adequacy. When it introduced automatic enrolment, the Government stated that it "...wanted to encourage people to increase the amount they are saving in pension schemes so that they get the retirement income they would like[16]."

63. However, this begs the question of what constitutes an adequate retirement income, a question which was covered in the PPI's briefing note 77[17]. This is a complex subject and much depends on individual circumstance or preference. Consequently it could potentially be a mistake to focus too much on establishing a single 'desirable' contribution rate.

64. Automatic enrolment has delivered a huge increase in participation in workplace pension saving and under existing legislation contribution rates will increase in April 2018 and April 2019. However, automatic enrolment, whilst undoubtedly successful, does the potential for levelling down of individuals' contribution rates. This 'anchoring' behaviour, where savers in automatic enrolment who would otherwise have chosen a higher rate of contribution instead choose a lower default rate has been observed in academic studies

[15] https://www.pru.co.uk/employers/oracle/automatic-success/
[16] https://www.gov.uk/government/publications/2010-to-2015-government-policy-automatic-enrolment-in-workplace-pensions/2010-to-2015-government-policy-automatic-enrolment-in-workplace-pensions
[17] http://www.actuarialpost.co.uk/downloads/cat_1/201510%20PPI%20Briefing%20Note%2077%20-%20adequacy%20under%20the%20new%20pension%20flexibilities%20(1).pdf

undertaken on 401k schemes within the United States[18]. This may arise from a tendency for savers to view the minimum contribution rate as the 'right' amount that has been endorsed by the government as a suitable target.

65. The ABI acknowledge that although levelling down is a potential problem, research conducted by the Institute of Fiscal Studies (IFS) and sponsored by the ABI does not show evidence of it currently. Although it's not possible to rule out the occurrence of levelling down of either employee or employer contributions, if it is occurring, it is currently more than outweighed by those being brought into pensions with contributions well above the minimum rates[19].

66. It is generally accepted that the current minimum contribution of 8% of qualifying earnings may not be sufficient for many savers, with PPI research identifying the need for a minimum contribution of 11-14% of band earnings.

67. However, the solution to raising contribution rates may not be mandatory increases. It is important to recognise that streamlining the system by removing or amending the age bands, earning thresholds, and band earnings would increase contribution rates without having to raise the contribution rate percentages. Particularly by lowering the qualifying age threshold government would increase the time value of money for savers and engrain an important savings habit early on.

68. It could also be helpful to leverage research on behavioural economics where it has been found that requiring users to make one of a limited numbers of choices encourages pro-active decision making, including contributing more to their pension.

69. Touch points could be also be utilised by an approach which still counters procrastination but requires an 'Active Choice'. US academic Brigitte Madrian refers to research comparing the outcomes in an employer sponsored savings plan before and after employees were compelled to make an active choice about whether to participate. The research shows that when not required to make a choice (opt-in) only 41% of newly hired employees enrolled. In contrast when required to make an active choice about participation, which includes the option of not participating, 69% enrolled. Although not as powerful as the default approach, active choice was shown to provide a more diverse spectrum of contribution rates[20]. Such an approach could be applied to choosing a suitable contribution rate.

70. In the ABI's view, any substantial changes should be signalled in advance, in order to give employers and members adequate time to prepare. However, such changes should not be so far out as to deprive Generation X and millennials, who are unlikely to reap the benefits of legacy DB schemes, of enjoying a comfortable retirement. As such, the ABI believes it would be appropriate to have reviews of the policy more frequently than every five years.

[18] http://www.nber.org/papers/w7682.pdf
[19] https://www.ifs.org.uk/publications/8742
[20] Madrian (2014) at page 670 citing Carroll et al. (2009)

***Review questions on contributions***

***Q1. What are the key drivers, opportunities and barriers for individuals and employers that may affect their behaviours in relation to sustaining existing, or managing increasing, contribution rates?***

71. Current barriers for individuals that may affect their behaviour include affordability for employees and possible cost constraints for employers.

72. Following on from our discussion on touch points, we believe one particular touch point that could be exploited as an opportunity for sustaining existing contribution rates is the change of a job. Contribution rates could be tracked using the p45 form so that when an individual starts a new job, the new employer would automatically enrol them at their previous contribution rate, (unless it is lower than the new scheme employee contribution rate). This approach could help prevent the problem of savers levelling down. There could also be a technological solution whereby the new provider, with the customers consent, asks the old provider about their contribution level.

73. It is also worth noting that evidence from the United States shows that higher contribution rates do not increase opt-out rates. The evidence shows that 58% of those automatically enrolled maintain their default contribution rates, 33% of people increase their contribution rates and only 9% decrease them. These rates are broadly the same across all contribution levels[21].

74. As mentioned previously, the Sackers IGCs research should be considered as part of this review. This research shows, that although people realise pension saving is important they prioritise current consumption over future saving.

***Q2. Is there scope for a more flexible approach to contribution rates to reflect an individual's life and employment journey?***

75. The ABI believes that the Government's top priority should be to complete the roll-out of automatic enrolment to all employers and get everyone up to 8%, whilst also acknowledging that a total contribution of 8% is unlikely to generate a sufficient level of income for many people in retirement and the level may need to rise in the long-term.

76. In the medium term it is important that contributions do increase further than 8% – however a balance needs to be achieved. Therefore when contribution rates are increased above 8%, it would be worth also giving people that have chosen to opt-out, the chance to stay opted in at the 8% level.

77. We believe it is correct to focus activity on encouraging individuals to save more than 8% and focus on more flexible ways to implement auto-escalation and to explore how to streamline the current system in such a way that contribution rates could rise without increasing contribution level percentages.

[21] [21] Fidelity investments recordkept data of 22,100 corporate US DC plans and 14.5m participants as of 12/31/16.

78. There is possibly scope for an even more flexible approach to contribution rates by linking increased contribution rates to promotions and pay rises rather than a fixed timeline. As we say above, the key to this is likely to be increased engagement.

***Q3. Do you have any evidence or views on the most appropriate/effective balance between employer and individual contribution levels? What are the options for encouraging, 'nudging' and enabling people to save more into their workplace pension?***

79. The ABI believes that the current balance between employer and individual contribution levels is about right.

80. We would also be supportive of increasing take up of 'Save More Tomorrow' arrangements where auto-escalation would boost employee contributions without risking an unaffordable increase in contribution levels. However, the FCA's recent rules around general insurance add-ons are a potentially significant barrier to employee take-up of auto-escalation, as they ban the principle of opt-out selling. This means auto-escalation schemes can only operate on an opt-in basis, which has a significant impact on employee participation rates. We urge the Government to examine this issue as part of the review and to consider amending the regulations, as we know from automatic enrolment how effective the opt-out principle can be in driving positive consumer behaviour.

***Q4. To what extent are individuals saving outside of a workplace pension for retirement and how does this impact on their interest and ability to save into a workplace pension?***

81. The ABI remains concerned that the introduction of the LISA and the continued customer demand for Cash ISAs may have a negative impact on retirement outcomes, due to savers missing out on contributions from their employer and customer confusion. The long-term savings market is complicated and customer engagement levels are low. There is a risk that adding new products simply increases the confusion around which long-term savings product to choose and causes people to take no action, thereby reversing the progress in participation made by automatic enrolment.

## ***The wider review activity***

### ***Summary***

We intend to give further consideration to the issue of the default fund charge cap during the course of the review, but our initial reactions to the costs and charges issues are outlined below.

***Q1. What are the advantages and disadvantages of lowering the level of the default fund charge cap?***

82. Whilst the charges that a pension scheme member pays are a key element of the value for money of their scheme, they are by no means the only element. Investment performance and options, service, administration, communications and flexibility/suitability can also play a critical role in determining retirement outcomes for members.

83. This is discussed in recent work undertaken on value for money in DC workplace pensions by the PPI. This research highlighted that effective governance, communication and administration play an important role in building trust in pension schemes, and ensuring that the charge and return structure, including decisions around fund volatility and management, reflect members' needs and preferences. This research also suggested that effective governance, communication and administration play a role in increasing contribution rates where appropriate, and that ultimately contribution rates can have the largest influence on the size of the member's pension pot at retirement[22].

84. Members' views on value for money were also canvassed in recent research coordinated by Sackers for a group of 11 Independent Governance Committees. This research highlighted that, of 23 value for money attributes, 'good returns' were rated as the most important value for money attribute for surveyed members, and that 'charges' were are not in the top 10 attributes for the majority of members[23].

85. We believe that the charge cap is a blunt tool, and that lowering the cap would further undermine the ability of IGCs and Trustees to make the necessary trade-offs between quality and price on behalf of their members.

86. Furthermore, there are a number of reasons why reducing the charge cap may not be beneficial to members and employers.

87. Firstly, further reductions in the charge cap are likely to have a negative impact on supply-side competition, and therefore choice for employers (and therefore, for members). This could manifest in fewer providers in the market, as well as restricted investment options and/or fewer small schemes with bespoke offerings.

88. Furthermore, lowering the charge cap would require employers who have signed up for schemes where the charge structure is higher than the new cap, but lower than the current charge cap, to renegotiate their contracts with providers. Larger employers, and more proactive, smaller employers, may have already been through the process of assessing options for fulfilling their automatic enrolment duties twice as part of the automatic enrolment rollout process: once prior to the introduction of the charge cap, and again following the introduction of the charge cap. Whilst a number of employers may choose to renegotiate their terms with providers at the point at which they are required to re-enroll their employees, we do feel that this should not be mandated by further changes to the charge cap. Should the government chose to increase contribution rates in the future, this would be a natural time to reconsider whether the current charge cap remains appropriate.

89. There is also a risk that providers respond to a decrease in the charge cap by increasing both the application of employer charges and the level of employer charges. This is also likely to disproportionately impact schemes run for employers with one or more of the following attributes: a small number of employers, a new scheme arrangement (impacting all new businesses), high staff turnover and/or a large number of employees on relatively low incomes.

***Q2. What are the advantages and disadvantages of extending the cover of the charge cap to include some or all transaction costs?***

[22] http://www.pensionspolicyinstitute.org.uk/uploaded/documents/2016/20160504%20PPI%20Value%20for%20money%20in%20DC%20workplace%20pensions.pdf
[23] https://www.sackers.com/sackers-co-ordinates-igc-value-for-money-research-study/

90. The disclosure of transaction costs is, in our view, vital to ensuring public trust in pensions. However, it is useful to maintain a distinction between costs incurred under the charge cap, which accrue to providers, and transaction costs, which accrue to third parties in the supply chain (including brokers, other investors or the Government). We believe that providers are already adequately incentivised to manage their transaction costs, insofar as incurring unnecessarily high transaction costs will undermine the investment returns to members, and therefore, the value for money offered by their products. We therefore believe that the advantages to members of extending the cover of the charge cap to include some or all transaction costs will be negligible.

91. There are, however, several disadvantages of extending the cover of the charge cap to include some or all transaction costs, which arise from creating perverse incentives for providers. These are outlined below.

92. Firstly, as transaction costs are a 'cost of doing business' for providers, they cannot be avoided altogether. Whilst there may be scope for asset managers to renegotiate some types of transaction costs (i.e. brokerage costs) or to minimise transaction costs through improved trading execution (i.e. spreads, crossing), some transaction costs will not be negotiable (i.e. stamp duty). This implies that the transaction costs incurred will be correlated with the turnover rate of the underlying assets, which in turn can be driven by either the level of incomings and outgoings, or by the investment strategy employed by a fund manager.

93. Secondly, transaction costs are difficult to forecast accurately for any given year, as they will reflect market conditions and the demographics of members. Clearly, it will be possible to make some estimates of what they may be for the year ahead, but it will be difficult for providers to be certain that they will not inadvertently breach the charge cap on a default fund unless contractual restrictions are put on fund managers' trading activity and/or a sufficiently large level of buffer is built in (which will limit further the choices that employers are able to make when selecting a default fund).

94. Should transaction costs be included under the charge cap, fund managers may be incentivised to decrease their portfolio turnover, and/or halt trading in any given year, in order to avoid breaching the cap. We do not believe this is appropriate and could lead to poorer member outcomes.

95. Such an approach may also disincentivise investment in asset classes that may have larger, more volatile or 'lumpier' transaction costs. It could also encourage asset managers to invest in derivatives, rather than physical assets, in order to ensure that their profit margins were not sacrificed. Again, we do not believe this would be beneficial to their members.

96. It is also worth noting that the magnitude and level of volatility of transaction costs incurred by providers (and trust-based schemes) is not well understood at this time, due in part to the lack of clarity about how transaction costs should be calculated. Our understanding is that the FCA intends to publish their final rules on this matter in a Policy Statement in the second quarter of 2017. Providers are committed to working with the FCA and DWP to implement the final disclosure methodology, to provide assurance to members that charges are transparent and comprehensive and to ensure that transaction costs receive the appropriate scrutiny by IGCs and trustees.