

**Automatic enrolment earnings
thresholds review and revision
2015/16: a response by the
National Association of Pension
Funds**

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Executive Summary

1. NAPF recommends that, in the current economic circumstances and before automatic enrolment has been fully embedded, freezing the trigger for this year at £10,000 (Option 1) strikes the right balance between simplicity and coverage.

2. Over the next three years automatic enrolment will face its biggest challenge yet as it is extended to small and micro employers. Many of these employers will struggle with the complexity of the required payroll systems to facilitate automatic enrolment; many of them will never have had employees in pension schemes. In order to overcome these hurdles, automatic enrolment needs to be simple to administer and simple to understand. Option 1, freezing the trigger at its present rate of £10,000 and Option 3, aligning the trigger with income tax are the simplest options under consideration.

3. Automatic enrolment also needs to provide enough coverage; getting as many people who would benefit from retirement saving into automatic enrolment as possible. The NAPF recognises that this coverage should not disadvantage those who could benefit from retirement saving; in particular, it should not disproportionately disadvantage those with flexible working patterns and lower incomes and by consequence women.

4. Freezing the trigger at £10,000 both avoids the exclusion of certain groups, and retains a simple message for employers and employees to understand. However, a trade-off is being made – automatic enrolment will be less simple to administer as payroll systems will be made marginally more complex. In light of this, greater efforts should be made by industry stakeholders to support small and micro employers to comply.

5. The other two options, adjusting the threshold in line with CPI or earnings growth, are too complex to introduce suddenly and certainly too complex to introduce as automatic enrolment rolls extends to small and micro-employers.

6. The NAPF believes that in 2017, the scheduled review for automatic enrolment should be undertaken by an 'Independent Retirement Savings Commission' that has a clear remit to define measure and promote good retirement outcomes. This review needs to be informed by the rolling out of automatic enrolment to small employers and phasing in of higher contributions. With all but the smallest employers on board, this will be the right time to assess more complex arrangements for the trigger, such as Option 2 and 4.

Automatic enrolment earnings thresholds review and revision 2015 / 2016

Introduction

1. The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £900 billion of assets. We also have 400 members from businesses supporting the pensions sector. We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.
2. The NAPF has been, and continue to be, a strong supporter of automatic enrolment, which we believe is a fundamental part of the solution to the pension savings crisis in the UK. Its successful implementation so far has reversed years of decline in pension participation and it is essential that this momentum is maintained - people working for small employers need the same easy access to pension saving those working for large employers. In our latest manifesto, 'Pension possibilities'¹, the NAPF has called for future governments to commit to rolling out automatic enrolment and not deviate from its current timetable.

Simplicity is key to the success of automatic enrolment

3. The NAPF believes that simplicity is the key to the success of automatic enrolment as it goes through the critical stages of extending to smaller employers, over the next three years. It needs to be simple to administer and simple to understand. If it is too complex to administer, non-compliance may be encouraged. If it is too complex for employees to understand then opt out rates may be driven upwards. This call for simplicity needs to be reflected in the threshold for automatic enrolment. Our own research, 'Automatic enrolment, one year on'² shows that many of our members have dedicated a lot of time and resource to making their messaging around automatic enrolment clear, simple and engaging for scheme members.

Automatic enrolment should be simple for employees to understand

4. Financial planning is confusing for individuals at the best of times. Quality communications explain to employees why their earnings qualify them to be automatically enrolled into pension saving and how much is being deducted from their salary. We know from DWP analysis indicates that *"lower than anticipated opt-out rates were sometimes associated with effective communications"*³. If this explanation is tenuous or confusing for individuals, this may discourage engagement with automatic enrolment and encourage opt out. It follows that the simpler

¹ <http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~media/Policy/Documents/0401-NAPF-Manifesto-Pension-Possibilities.pdf>

² <http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0345-Automatic-enrolment-one-year-on.aspx>

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254182/research-report-851.pdf

automatic enrolment is to communicate and the more that message rings true for those individuals, the more successful (when success is defined in terms of low opt out rates) it will be.

5. Setting the automatic enrolment threshold in line with income tax (Option 1) bears some markers of the desired simplicity for individuals. There is a clear message 'that earning enough for income tax also means earning enough to save for retirement'; a message that employers can translate readily into automatic enrolment communications.
6. However, this simple message is endangered if the income tax threshold fluctuates over time, as will be the case in 2015/16, and is not aligned to other measures of personal financial stability (such a wage growth).
7. Option 1, freezing the threshold at its current rate of £10,000, is also very simple to understand - it is a round number, there is no complex formula to arrive at the figure, and it is one that individuals are used to under the current income tax regime.

Automatic enrolment should be simple for employers to administer

8. DWP analysis identifies categorising and assessing workers and adapting payroll systems as two of the most challenging aspects of automatic enrolment that employers have experienced so far.⁴ Indeed, during the development stages of automatic enrolment, the NAPF raised concerns about the complexity of the current automatic enrolment system for categorising employees based on earnings. Employers that have flexible working options for their employees find it challenging to correctly identify those that qualify for automatic enrolment. Their payroll providers need to be able to administer these complexities smoothly and developing this functionality has slowed down planning and implementation in many instances.
9. We know that payroll processes and systems currently used by small employers often lack the functionality to deliver automatic enrolment. Our membership indicate that they are concerned about the quality of some of the middleware IT products that have been brought to market to help small employers. We will only understand the full implications of these complexities as smaller employers begin to enroll *en masse*.
10. With these complexities on the horizon, therefore it is even more important that the thresholds set by automatic enrolment are as simple to administer as possible over the next three years, so as to reduce employer burden and instances of non-compliance.
11. A threshold in line with income tax meets this requirement, as payroll providers already have the functionality to identify the income tax threshold. This has been one of the key benefits of keeping the threshold in line with income tax in the past. Freezing the threshold at its current level, will, be marginally less, but still relatively simple to administer when compared to the other two options, which will involve another threshold to track, rather than a standalone figure to input into the administration system.

Coverage

⁴https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254182/research-report-851.pdf

12. The automatic enrolment threshold needs to be set at a level that balances the need for simplicity and coverage – getting all of ‘the appropriate target population’, those who would benefit from workplace retirement saving, automatically enrolled.
13. We recognise that adopting Option 3, the income tax threshold, has coverage and equality implications when the threshold jumps up to £10,500 in the 2015/16; it will exclude an additional 120,000 people, of which 66% will be women. We also recognise that working patterns around the threshold are more flexible (earners often work part time, or multiple jobs). Therefore there are additional equality implications to excluding individuals based on their lifestyle choices and working patterns. Finally, we recognise that defining the ‘appropriate target population’ for automatic enrolment has been challenging over recent years, with slow wage growth, constrained inflation and higher than expected increases in income tax thresholds; meaning that there has been no stable relationship between these economic indicators, a relationship that helps us to define who the target population for automatic enrolment actually is.
14. This puts pressure on striking the right balance between simplicity and coverage. Where income tax moves sharply out of line with other economic indicators, it is right that other options are considered. As explained above, while we focus on automatic enrolment being stabled embedded amongst small and micro employers, alternative options need to be as simple as possible.
15. The NAPF believes that freezing the limit at £10,000 (Option 1) is the best option in the current economic environment. By deviating from the income tax threshold, this option is not as simple to administer, as payroll providers will need to adapt their systems to account for a new and additional threshold. We think that to counteract this, greater efforts should be made by industry and government to support small and micro employers to comply.
16. In summary, since simplicity is key to the success of automatic enrolment, and this is particularly pressing given the challenges that the industry faces over the next 3 years, Option 3 is *normally* the best solution while automatic enrolment is still being embedded. However, given the situation for 2015/16, where this will have unwelcome equality implications and lower coverage than would have otherwise been the case, the balance lies on the side of improving coverage for automatic enrollment. The alternative needs to be kept simple for employees to understand- the threshold should be frozen at £10,000, though this will have some drawbacks in terms of ease of administration for employers.

2017 Automatic enrolment review

17. The other two options proposed (moving the threshold in line with CPI or wage inflation and, or adjusting according to the Pension Commission’s target replacement rates) have merit, and ought to be included in a wider set of considerations in the 2017 automatic enrolment review, once automatic enrollment has been successfully embedded amongst all but the smallest employers.
18. By this point we will have a clearer understanding of the success of automatic enrolment so far. Critically, by this stage we will begin to have an understanding of the impact that phasing in of higher contributions has on the opt-out rates of low earners. There is a real possibility that when

contribution rates rise, low earners around the threshold range under consideration will begin to opt out in greater numbers than we are currently experiencing with lower contribution rates. Indeed, DWP analysis⁵ shows that employers that chose to begin automatic enrolment with contribution rates above the statutory minimum for the first phase, have experienced higher opt out rates at lower income levels. The phasing in of higher contribution rates may mitigate this effect, but the overall effect may be to encourage higher opt out rates at lower incomes.

19. Keeping stability in the system until the point where automatic enrolment has been fully embedded and making the system as simple as possible to administer and communicate is integral to informing an accurate review of automatic enrolment in 2017. This should include a nuanced review of what ought to be, and how to maintain, the appropriate target population over time.

An Independent Retirement Savings Commission

20. In our 2014 manifesto for future governments, 'Pension possibilities', we have made the case for the creation of an Independent Retirement Savings Commission that has a clear remit to define, measure and promote good retirement outcomes; we believe that this is the best way to ensure that pension policy remains focused on the long term.
21. This consultation brings to light some of the complexities in defining an automatic enrolment earnings threshold, complexities that could be deepened by sudden changes in political opinion. We believe therefore that it should be the responsibility of the Independent Retirement Savings Commission to set and review the automatic enrolment threshold, as a part of a full review of automatic enrolment in 2017.

Response to specific consultation questions

Q1: Are there any other factors that should be taken into account in the review of the automatic enrolment earnings automatic enrolment trigger for 2015/16? If so please explain why they are relevant to the review.

Opt out rates around the range of thresholds considered ought to be included in this and future reviews. The fact that opt-out rates are currently untested against phasing up of contributions also ought to be considered.

Q2: Is it your experience that alignment with an existing payroll threshold reduces complexity? If so, please explain the impact upon you (or your clients) of

- a) Freezing the trigger or
- b) Increasing in line with indexation.

The current system makes automatic enrolment simpler to communicate and to administer.

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254182/research-report-851.pdf

Freezing the trigger would still be relatively simple to communicate but would make it harder to administer, especially for small employers who will find developing strong payroll platforms to facilitate automatic enrolment challenging in the first instance, without the added complexity of integrating a new threshold.

Increasing the threshold in line with indexation would be both complex to communicate (risking higher opt out rates) and to administer but, in terms of being strong candidates for achieving the policy intent behind automatic enrolment, ought to be considered once it has been embedded stably amongst small employers.

Q3: Which of the four options do you favour and why?

The NAPF think simplicity is key to the success of automatic enrolment, and this is particularly pressing given the challenges that the industry faces over the next 3 years we think that Option 3 is normally the best solution while automatic enrolment is still being embedded. However, given the situation for 2015/16, where this will have unwelcome equality implications and less coverage, the balance lies on the side of improving coverage for automatic enrollment. The alternative needs to be kept simple for employees to understand, so we think that it should be frozen at £10,000, though this will have some drawbacks in terms of ease of administration for employers.

We think that an Independent Retirement Savings Commission ought to be responsible for conducting a more comprehensive review of the appropriate threshold, once automatic enrolment has been fully embedded in 2017.

Q4: What pensions tax relief arrangement do you (or your clients) use and why?

N/A

Q5: Are there any other options we should be considering?

N/A

Q6: Would any of the four options have a disproportionate or unreasonable impact upon any particular sectors of the population? Please explain why and how.

N/A

Qualifying earnings band lower limit

Q7: Are there any other factors that should be taken into account in the review of the qualifying earnings band lower limit for 2015/16? If so please explain why.

N/A

Q8: Has alignment with the National Insurance lower earnings limit caused any problems? If so please explain.

N/A

Qualifying earnings band upper limit

Q9: Are there any other factors that should be taken into account in the review of the qualifying earnings band upper limit for 2015/16? If so please explain why.

N/A

Q10: Has alignment with the National Insurance upper earnings limit caused any problems? If so please explain.

N/A

Further information

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