Challenges ahead

Rob Weaver **considers the current state of play for pensions auto-enrolment and the challenges ahead.**

TEN SECOND SUMMARY

1. **More than 230,000 employers have completed the staging process and six million employees are now within auto-enrolment.**
2. **Auto-enrolment does not cover all workers and a significant number of people have no private pension provision.**
3. **A summary of the pension challenges facing employers and employees over coming years including the dependency ratio.**

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In its automatic enrolment declaration of compliance report (tinyurl.com/z7j4263) the Pensions Regulator has stated that, by the end of August 2016, more than 230,000 employers have staged and completed the initial workplace duties. This has resulted in 6.6m employees being enrolled into a workplace pension.

On average, the level of employees opting out of auto-enrolment has remained at about 9%. The Department for Work and Pensions estimates that the projected opt-out rate could be closer to 15% once all staging has taken place. Slightly concerning is the fact that, according to the Pension Policy Institute, businesses with between one and 19 employees have opt out rates of 17%. Further, automatic re-enrolment has been occurring since September 2015 and, up to August 2016, 229,000 employees have been automatically re-enrolled about three years after opting out.

It is interesting to note that although more than 22m workers have been assessed for automatic enrolment purposes, including more than ten million who were in a qualifying pension scheme already, almost six million employees were deemed to be ineligible; for example, low earners earning less than £10,000 a year. There remain, therefore, a significant number of people who are unlikely to have a pension apart from that provided by the state.

Pension staging for SMEs

From now on, the companies that are staging have 30 employees or fewer and a significant number of companies will be doing this in the next 18 months.

The Pensions Regulator's upper estimate suggests that there could be more than 650,000 employers staging who have eligible staff. Although this will be a challenge to accountants, payroll bureaux and pension providers, the advent of improved technology – such as sending data to the pension provider and an increasing number of new providers in the market – means that there is a growing confidence that the pension and payroll industry will cope. However, after both auto-enrolment and pensions freedom measures, both industries would like some stability and a period of no significant change.

Arguably, the new Chancellor would benefit all stakeholders by confirming that he has no plans to change tax relief on pension contributions in this Parliament.

Some interesting ***Key Facts*** can be gleaned from the Scottish Widows *Retirement Report 2016* and the Pension Policy Institute's *The Future Book: Unravelling workplace pensions* (2016 edition).

Some challenges ahead

Though most would argue that auto-enrolment has been a success so far, in reality we are only at the beginning of the UK's saving journey for many people. A number of issues face employers, employees, savers and the pensions and payroll industries over the coming years.

Increasing opt outs

Currently, opt outs are significantly lower than expected. However, when employee contribution increases (up to 5% minimum employee contribution based on qualifying earnings) are introduced, it is anticipated that a proportion of people will stop paying into their pension or opt out when they are assessed.

Potential deferment of pension increases

There are rumours that the automatic increase of pension contribution in April of 2018 and 2019 may be deferred until 2020 or after the general election. This may benefit employers who will not have to increase their minimum employer contributions. Further, it can save the Treasury millions of pounds by not having to pay tax relief on employee and employer contributions. However, the losers will be the individuals missing out on further pension contributions for another two years. This will affect their pension fund on retirement.

The forgotten people

These are the self-employed, part-time workers, multi-employer employees and low earners. This is because an issue with automatic enrolment is that the increasing number of people working for themselves are not enrolled. There are now more than four and a half million self-employed people, yet the Scottish Widows *Pension report 2016* indicates that 57% of them are not saving enough for an adequate retirement. This, coupled with the almost six million workers not being enrolled after being assessed, means that a significant part of the working population is not enrolled in a pension.

The old-age dependency ratio

This represents the number of people over state pension age divided by those of working age. This illustrates the number of people who have to work and pay taxes to support each pensioner through the National Insurance system.

Increases in longevity and a decrease in birth rates have led to an increase in the old-age dependency ratio. This increase affects the ability of taxpayers to fund state pensions and pensioner benefits. In 2016, the Pension Policy Institute states that there are 308 people of state pension age or over for every 1,000 people of working age. If this continues to increase, the state pension age will have to increase and there may be further changes to the state pension, particularly for younger workers.

Minimum contributions

Growing evidence suggests many newer employers are setting up workplace pension schemes on the minimum contribution basis. A 2% contribution is not meaningful. Even 8% of qualifying earnings is unlikely to produce a decent pension in retirement.

Further, the Pension and Policy Institute states that median employer contribution rates have decreased from 8% and 5.3% – defined contribution (DC) trust and group personal pension plans (GPPs) – in 2012 to 3% and 4% in 2014. DC trust schemes have seen the biggest drop due to auto-enrolment because master trusts are more likely to be used by employers enrolling employees for the first time and paying minimum contribution levels than GPPs.

Increasing employee engagement

Employees need to be fully aware that in times of very low interest rates contributing to a workplace pension scheme is a very effective way of funding for retirement. On the current minimum contribution basis employees should be getting tax relief on their personal contributions which is then matched by the employer – effectively a 150% return.

Increasing power for the Regulator

The Pensions Regulator has shown that it has teeth and there have been an increasing number of fines for employers. This includes fines for late or non-payment of contributions and not completing the compliance declaration in time. Moving forward, we are not fully aware of how an employer's compliance obligations will be checked. Could there be on-the-spot employer visits to check that duties and records are being complied with?

Consolidation of master trust providers?

Further, the Pensions Regulator will have increased powers over master trusts. This is imperative because there are a growing number of new entrants into this market.

In all reality, over the coming years it will be no surprise if some of those new entrants have merged, been taken over or stopped trading. This has already happened when Gen Life merged with Smart Pensions. FTadviser.com indicates that both Now: Pensions and The People's Pension have indicated they may be willing to assist and/or acquire smaller master trusts.

Choosing a pension provider

Some employers are concerned about the potential of litigation from employees or former employees on their choice of workplace pension provider and this has been highlighted by a number of MPs. Employers should consider maintaining evidence and audit trail of why a particular pension provider was chosen and what research and advice took place.

FURTHER INFORMATION

Further information
Scottish Widows – *Retirement Report 2016*: tinyurl.com/zhmhw3e
Pension Policy Institute – *The Future Book: Unravelling workplace pensions*: tinyurl.com/zo5wxnl

KEY FACTS

Information from the Scottish Widows *Retirement Report 2016* and the Pension Policy Institute's *The Future Book: Unravelling workplace pensions* (2016 edition).

- 12% is the minimum percentage of income which people consider adequate to set aside in preparation for retirement.
- 56% of people are saving adequately for retirement – compared to 46% in 2012.
- 19% of those in their forties are not saving at all.
- 24% of self-employed people are not saving at all.
- 40% of people started saving for retirement because they were auto-enrolled.
- 47% of those in their thirties and forties are saving inadequately or not at all.
- A 65-year-old man can expect to live on average to age 86.5 and a 65-year-old women to age 88.7.
- 49% of those auto-enrolled are in master trust schemes.