Institute and Faculty of Actuaries

Automatic enrolment and earnings thresholds review 2015/2016

Response to the Department of Work and Pensions

25 November 2014

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Alison Evans
Department for Work and Pensions
Automatic Enrolment Programme
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SW1H 9NA

25 November 2014

Dear Ms Evans

IFoA response to Automatic enrolment (AE) earnings thresholds review and revision 2015/2016

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. This response has been led by IFoA members who design and advise Defined Contribution (DC) pension schemes. We have limited our response to those questions that require specific actuarial comment.

Automatic enrolment trigger

Question 2: 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.

2. Most payroll functions are sufficiently flexible to deal with changes to the threshold. The flexibility enables the correct deductions, as they are only one variable, amongst many, within the system. Any limiting factor would be the number of variables within a specific system.

Question 3: Which of the four options do you favour and why?

3. As the IFoA also commented in the response to the equivalent consultation for 2012/13, we would not favour any one of the proposed changes to the thresholds, in comparison to the others.[1] Nonetheless, the impact of any change should be considered against the three principles that underlie the policy approach. If an option failed to meet the requirements of the principles, it should rank lower than the others.

4. The Impact Assessment in Annex C shows that the maximum impact of selecting any one option will be small, when considered across all new participants in workplace saving. However, the impact for one potential new scheme member will be relatively greater. The lower the threshold at which contributions commence, the proportionately greater will be the impact on those affected individuals. One possible outcome of the lowest threshold may be that the lowest paid would opt out from workplace pensions.

[1] http://www.actuaries.org.uk/research-and-resources/documents/department-work-and-pensions-workplace-pension-reform-automatic-enr

5. The IFoA co-sponsored a research project undertaken by the Pensions Policy Institute, which considered the complex link between welfare benefits, particularly housing benefit, and income in retirement.[2] The threshold for contributions meets an immediate requirement to establish eligibility for AE. As no contributing member can receive any confirmation that future policy changes would not result in an offsetting of future benefit payments, the establishment of the threshold, at any level, could have significant consequences for an individual's total income during retirement. While the short-term need to set a threshold for determining participation in AE cannot be reconciled with longer-term policy developments, there could be unintended consequences arising from threshold changes.

6. The IFoA would repeat its view from 2012 that longer-term changes to the threshold could be established, perhaps for the fixed duration of a Parliament. This would allow all AE stakeholders to undertake some planning. Even if the threshold were aligned to the threshold for paying income tax, which could be subject to significant change, the impact of such change could be identified easily for participants in pension schemes.

Question 4: What pensions tax relief arrangement do you (or your clients) use and why?

7. Our members' experience to date has been mixed. The consultation paper has identified the reasons why certain schemes, or employers, use a particular approach to tax relief. As AE moves towards smaller employers, it is more likely that employers will use approaches that minimise any administrative responsibilities. If that were to lead smaller employers to use contract, or master trust, arrangements, new participating employers would be more likely to use relief at source arrangements; thus, increasing the number of enrolled members who would benefit from tax relief.

Question 6: Would any of the four options have a disproportionate or unreasonable impact upon any particular sectors of the population? Please explain why and how.

8. As indicated in our response to question 3, there is the possibility that benefit recipients may be subject to different outcomes, depending on the nature of the benefits they receive in retirement. If that were the case, we would envisage one of two possible outcomes:
   - Employees would not participate in AE due to uncertainty about their future income; or
   - If employees join schemes, they may look to benefit from the proposed flexibility within the pensions system and take accumulated funds as cash for immediate expenditure.

   Given these possibilities, we would encourage further research to consider any link between the AE threshold and welfare benefit changes.

9. If you wish to discuss any of the points raised please contact Philip Doggart, Policy Manager (philip.doggart@actuaries.org.uk/ 01312401319) in the first instance.

Yours sincerely

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[2] http://www.pensionspolicyinstitute.org.uk/publications/reports/automatic-enrolment-report-the-benefits-of-automatic-enrolment-and-workplace-pensions-for-older-workers