CSFI
Centre for the Study of Financial Innovation

PENSION INSURANCE CORPORATION

Auto-enrolment: Competing in the new mass market for pensions. A CSFI/Pension Insurance Corporation Pensions Fellowship round-table with Tim Jones (NEST), Morten Nilsson (NOW: Pensions), and Darren Philp (B&CE/The People's Pension)

To be held on Monday, March 24, 2014, from 12.30-2.15pm.
At the London Capital Club, 15 Abchurch Lane, London, EC4N 7BW.

Three million people have been "auto-enrolled" into a workplace pension under the regime brought in by the UK government in October 2012. Altogether 35,000 employers will be affected this year. The target by 2018 is the 750,000 firms that had no scheme and the seven million workers making little provision for retirement.
All three pension providers reported very low opt-out rates so far of about 7%. Young people had proved much less likely to opt out (2-3%) than older ones. At this stage, the amount employees are paying is very small – about 1% of "banded" salary, which does not kick in until £10,000 has been earned.

It is a daunting task for employers, especially as smaller ones are phased in. During 2017 – the peak will be about £100,000 "micros" a month. The legislation is complicated – and should be simplified – and employers' duties are complicated. It's an HR/payroll process. Payroll integration is the key and/ or delegation to bureaux like those that take care of "nanny tax". Pension providers are trying to standardise compliance for SMEs.

The complications include "pot follows member": transfers are very expensive. The issue for consolidation is verification, or KYC, which could be solved by digital identity. Payroll technology should make it possible for contributions to be directed to different providers, like paying salaries into different bank accounts.

Charges: each of these providers had a different charging structure, which added up to about 50bps of the savings pot a year. Trading costs were a thorny issue. They could be seen as a drag on performance – but worth incurring if justified by a better investment outcome. Once a fund was large enough there could be economies of scale in the investment process.

Governance: a strong case was made for independent, expert trustees overseeing the multi-employer funds (the master trust route). Managers' performance should be measured according to the outcome for members. These providers offered either no choice to members on investment policy or a very limited choice. Where there was a choice, the vast majority stuck with the default fund.

Contribution rate: in Denmark, which has been running this sort of scheme for about 20 years, the rate is now at least 12% with an average of 15%. The typical split is 2/3 employer: 1/3 employee.

Other issues:

- What does “value for money” look like? Charges is not the only thing that matters: also governance, suitable retirement products, investment performance….
- How to explain to members what they are aiming at? How much certainty can be offered? Or guarantees? (Very little, and it is expensive.)
- Transparency – to whom? Members are not financially literate, need to rely on expert governance eg on the issue of long-term investment horizons.
- Outcomes: adequacy of contributions by employer and employee; tax relief; investment performance; as well as low costs.
- Two external pluses: a) non-means-tested state pension; b) the Budget proposals, which make pensions sound more attractive.