CONSULTATION RESPONSE

AE Thresholds review 2015/16

25 NOVEMBER 2014

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ABOUT ROYAL LONDON

Founded in 1861, initially as a friendly society, Royal London became a mutual life insurance company in 1908.

Royal London is the UK's largest mutual life and pensions company, with funds under management of £77 billion. Figures quoted are as at 30 June 2014.

The Royal London Group's specialist businesses provide pensions, protection and investment products.

The Royal London Group key figures

Total funds under management of £77 billion.

Group businesses serve over 5.3 million customers and employ 2,900 people.

Over 2.1 million with-profits customers

With-profits fund of around £32.6 billion

Main offices are in the City of London, Edinburgh, Wilmslow in Cheshire, Glasgow, Reading, Dublin and Bath.

Figures quoted are as at 30 June 2014

KEY POINTS ON THE COMMAND PAPER

- The automatic enrolment trigger should be frozen at £10000
- To allow the figure to increase reduces the incidence of pension saving by key groups and will make these groups worse off through time as they will not receive deferred pay which others are receiving
- The budget "freedoms" further reduces the downside risk of saving in pensions
- The Lower and Upper minimum contribution bands should be maintained for now in line with National Insurance limits. There is an argument that banding of earnings for the purpose of calculating contributions should be removed through time. The end of the staging period is an appropriate time to open this debate.

ANSWERING THE QUESTIONS YOU RAISED

EARNINGS TRIGGER

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.

- SOCIETY/CULTURAL FACTORS - It is essential that as many people are brought into pensions savings as possible rather than allowing this number to reduce. Saving into a workplace pension needs to become the cultural norm where all but a very few expect to be automatically put into a pension.
- FREEDOM AND CHOICE - Now that people do not have to buy an annuity and can get their pension saving back as cash, this further removes any downside risk to saving in pensions.
- EMPLOYER CONTRIBUTION LEVELS / LOSS OF DEFERRED PAY – recent data has shown that most employers are paying well above the minimum level required by automatic enrolment regulation. Data has also shown that those that are not automatically enrolled are not likely to opt in while those that are automatically enrolled are not likely to opt out. This means that if the AE trigger to rise, more members will be losing out on valuable employer contributions.
- PHASING OF CONTRIBUTIONS – the phasing period where contributions are only paid at a low level is reducing with time. This means the contributions forgone by those not being automatically enrolled increases through time.
- OPTING OUT / STOPPING CONTRIBUTIONS – Those that simply cannot afford pension contributions will opt out or quickly stop paying. This is better than relying on those who feel they can afford to save opting in as the principle of inertia is working in the wrong direction i.e. against the policy intent of getting more people to save for retirement
- EQUALITY CONSIDERATIONS – increasing the automatic trigger adversely affects women, part time workers and the low paid. As stated this is sure to mean more of this group end up losing deferred pay in the form of employer pension contributions.

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.

- There would be no impact on us if the trigger was decoupled from the tax threshold as our systems are flexible enough to hold the appropriate AE rates.
- We are not aware of any issues this would cause the payroll organisations we have worked with to date in respect of the AE propositions they have created. Any issues here are likely to be limited to outdated legacy systems.

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

- We favour option 1 – freezing the trigger at the current level
- This allows sufficient headroom between the AE trigger and the lower threshold for minimum contributions assuming the threshold remains in line with National Insurance lower earnings limit (LEL)
- We do not believe breaking the link with threshold for paying tax will make life more complex for employers. The available technology is capable with dealing with this. The £10,000 figure also has the benefit of being easy to remember – you are automatically enrolled when you earn more than £10k
- The primary additional reasons are described in our answer to question 1 above

It could be argued that not increasing the threshold might reduce provider profitability by bringing more transient, lower paid staff into pension saving. Although this might be the case in the short term, we do believe the this is the right course of action both for the individuals affected and the AE policy in general.

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

We mainly provide workplace personal pension schemes (WPP) on a contract basis. This means we provide tax relief on a relief at source (RAS) basis. All of our customers will receive tax relief on all of their contributions at basic rate.

The pensions tax relief arrangements are not the dominant consideration when clients select pension schemes. The client will generally choose between an occupational trust based arrangement or a contract based arrangement for other reasons. Largely occupational trust schemes use net pay arrangement (NPA) and contract use (RAS) however RAS is becoming more dominant particularly as NEST, while being a trust based scheme, uses the RAS method.

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

No. We agree the options presented and reasons for preliminary excluding the others

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. Are there any ways in which such an impact could be mitigated or reduced?

As stated previously, increasing the automatic trigger adversely affects women, part time workers and the low paid. Increasing the AE trigger is sure to mean more of this group end up losing deferred pay in the form of employer pension contributions.

It is clear from the Governments own figures that pensions savings would fall by £6 million if the AE trigger moves to £10,500 with 2/3rds of the excluded group being women.

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.

There is an argument for removing the bands of earnings all together. This would have the advantage of simplicity for those administering pension schemes, easier for employers to manage and simpler for workers to understand. Removal of the band would result in a significant increase in the minimum contributions paid into plans and in due course all would recognise that this is something that will have to be considered.

At this stage, however, it would be difficult to achieve consensus between Government, employer and worker groups on such a change. We therefore agree that alignment of the lower band with NI LEL is the best approach until the end of staging. At that point a discussion on how best to increase pensions savings could incorporate abolition of the band.

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

Yes. As stated it is difficult for workers to understand their (and their employer) contributions, it adds complexity to employer and provider systems and means annual change to the figures used.

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.

See answer to Q7

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

See answer to Q8