Unfinished Business

Building a fresh consensus on workplace pensions

Executive summary

Automatic enrolment has brought six million more people into the workplace pensions system.

However, its impact is threatened by a failure to build on the initial policy success and a focus by policymakers on new savings initiatives. Products such as the Help-to-Buy ISA and the forthcoming Lifetime ISA are disconnected from the world of work and priortise goals other than retirement saving.

Meanwhile, the so-called pensions freedom reforms that came into force in April 2015, have undermined the assumption that the purpose of a pension is to provide for an income in retirement by allowing savers greater scope to cash pensions in from age 55. This puts at risk employer support for retirement saving.

Automatic enrolment has also been destabilised by a change in the government's approach to policy-making which, in recent years, has favoured bold and dramatic changes over slow, patient consensus building to underpin enduring reform.

If automatic enrolment is not to be condemned to a minor role in the UK savings landscape, we need greater urgency in developing plans to build a workplace pensions system that caters to as many workers as possible and allows them to build up sufficient savings for a decent standard of living in old age.

This report utilises original research by the TUC into the reach of automatic enrolment and modelling by the Pensions Policy Institute of potential policy remedies.

The main findings are:

- Automatic enrolment has brought members of many key groups into the workplace pensions system.
- However, as it is currently constituted, many low-paid and part-time workers are missing out on workplace pensions. Women and those from certain ethnic minorities are most likely to fall into this category.
- Contribution levels remain inadequate for a decent standard of living in retirement.

Our key policy recommendations are:

- The 2017 review of automatic enrolment should be as wide-ranging as possible and used as the opportunity for the government to engage with trade unions and the government to develop a long-term plan for the development of auto-enrolment.
- Abolish the earnings threshold for employer contributions.
- Simplify radically the system of band earnings.
- There should be a pathway to increase contribution rates with serious consideration given to an additional flat-rate contribution and auto-escalation.

Introduction

Automatic enrolment into workplace pensions has the potential to be one of the great policy successes of our time. It was the product of the deliberations of the Pensions Commission, featuring three commissioners with roots in the trade unions, business and academia. Its success is due in part to the consensus about the direction of UK pensions policy that endured after the Commission finished its deliberations a decade ago.

Some six million people have joined pension schemes with an employer contribution since automatic enrolment began in 2012. Roll-out has been gradual and the smallest employers are only now being included.

How auto-enrolment works

- Employers must enrol all eligible jobholders into a qualifying pension scheme.
- Eligible employees are aged between 22 and state pension age, not already in a workplace scheme.
- To be eligible, an employee must be earning more than £10,000.
- Those eligible workers who do not want to participate must actively opt out of a scheme.
- Those earning more than £5,824 but less than £10,000 are not automatically enrolled can actively opt-in.
- The total minimum contribution is currently two per cent of a band of earnings (of which at least one per cent must be paid in by the employer). This will rise to eight per cent from April 2019 – made up of at least three per cent from the company, up to four per cent from the employee, and one per cent tax relief.
- The band of earnings on which contributions are calculated is between £5,824 and £43,000 for the 2016/17 financial year.

Opt-out rates have been a far lower-than-expected 10 per cent of the eligible workforce, suggesting that a policy of soft compulsion for savers, with obligatory employer contributions, is an effective combination. Some 13.9 million people are now actively contributing to a pension.[1] Modelling by the Department for Work and Pensions suggests that automatic enrolment will halve the number of people retiring with no private pension at all from 27 per cent to 12 per cent in 2050. This reverses a prolonged trend of falling pension saving.

The smooth introduction, so far, of auto-enrolment underlines the value of evidence-based policy-making backed by consultation and consensus-building. It has even been delivered under-budget.[2]

[1] Department for Work and Pensions (2015). *Official Statistic on Workplace Pension Participation and Saving Trends of Eligible Employees: 2004–2014*

[2] National Audit Office (2015). *Automatic Enrolment to Workplace Pensions*

However, despite auto enrolment's significant successes, there remains a lack of clarity about how far the policy has taken us towards ensuring that workers receive a decent income in retirement.

While some six million workers have been enrolled, a similar number have been excluded from the auto-enrolment system, the vast majority of them women, due to their age or low earnings. Figures from the Pensions Policy Institute suggest that only half of working age people are eligible for automatic enrolment. And contributions at the minimum mandated levels are widely regarded as insufficient to ensure people have a good chance of a decent standard of living in retirement.

There are two impetuses for consideration of auto-enrolment at this stage. One is the Department for Work and Pensions' review of auto-enrolment to take place in 2017. The government is committed by legislation only to review certain aspects of the operation of the state-backed National Employment Savings Trust (NEST), quality requirements for defined benefit schemes and the certification requirements which allow employers to use existing pension schemes to meet their automatic enrolment duties. But rather than interpreting its task so narrowly, the government could undertake a broader review of automatic enrolment. The case needs to be made now for the latter approach as an opportunity to develop a long-term programme for auto-enrolment and rejuvenate a process that shows worrying signs of stalling. In the Autumn Statement 2015, the Chancellor of the Exchequer announced a further delay to bringing total contributions up to eight per cent of the band of earnings, the second such pause since 2011. This marked the latest in a series of missed opportunities to boost auto-enrolment's reach: there has been only very limited progress, such as the decision to freeze the earnings trigger at £10,000 for the third successive year for 2016/17.[3]

Meanwhile, a decade on since the Pensions Commission published its final report, it is useful to assess whether the assumptions underlying auto-enrolment remain robust. For instance, the Commission proposed a minimum contribution rate of eight per cent (of a band of earnings) but asserted that there may be a need for voluntary contributions above this level. The Commission also warned that establishing a default rate of contribution "may be seen as a standard, to which some employers may level down".[4]

Any changes required will take time to be implemented. This paper is therefore intended to help kick-start a debate about the future of auto-enrolment so that the policy can realise its potential for transforming the prospects for retirement of millions of British working people. It will consider the evidence on the policy's operation and impacts and will conclude with policy options for how auto enrolment could better benefit middle and low earners. However, we remain mindful that in pensions, perhaps more than any other policy area, discussion and consensus-building are the keys to sustainable, lasting

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[3] Department for Work and Pensions (2015). *Review of the Automatic Enrolment Earnings Trigger and Qualifying Earnings Band for 2016/17: supporting analysis*

[4] The Pensions Commission (2005). *A New Pension Settlement for the Twenty-First Century: the second report*

policy development. Our ambition is for this analysis to support the next phase of consensual improvements in pension provision for working people across the UK.

The winners

- low-paid blue collar workers
- younger workers
- women in full-time work
- some part-time workers in the private sector.

Until auto-enrolment began to be rolled out in 2012, pensions saving in the UK was inadequate and getting worse. In 2012, membership of workplace pension schemes dropped to 46 per cent. This meant nearly nine million workers were not saving for their old age, against 10.5 million who were. Millions more were saving inadequate sums.

There had been a particularly stark decline in pension provision in the private sector and for men. Just 32 per cent of private sector workers were in a workplace scheme in 2012 against 83 per cent of public sector employees.[5] For men, the proportion contributing to private pensions fell steeply from 54 per cent to 34 per cent between 1996/97 and 2012/13.[6] The result was a gulf between the extent of public and private sector pension provision. In 2010/12, a much higher proportion of employees in the public sector (85 per cent) belonged to an occupational pension scheme than their counterparts in the private sector (40 per cent). Public sector workers also tended to have far larger pensions savings.

There were stark gender inequalities, too. The Wealth and Assets Survey shows that in 2010/12, 34 per cent of adults aged over 16 contributed to a private pension. The percentage varied by gender with 37 per cent of men making contributions compared with 31 per cent of women.

Securing overall improvements in pension savings rates is important but narrowing these gaps by improving outcomes for women and private sector workers should also be a key goal of pensions policy.

There is strong evidence that auto-enrolment has halted and reversed the long-standing decline in pensions saving, particularly in the private sector and for low-paid public sector workers. Opt-out levels have consistently been around ten per cent, which is much lower than had been expected.

Data from the latest *Annual Survey of Hours and Earnings* published by the Office for National Statistics shows that workplace pension scheme membership has increased to

[5] Office for National Statistics (2013). *Annual Survey of Hours and Earnings: Summary of Pension Results 2012*

[6] Office for National Statistics (2014). *Pension Trends,* Chapter 7: "Private Pension Scheme Membership"

59 per cent in 2014, from 50 per cent in 2013. 2013 was the first year in which pension scheme membership had increased since 2006.

Many low-paid people, especially if they are in full-time work, are benefiting from auto-enrolment. In 2014 there was an increase in pension membership in every earnings band for full time employees in the private sector. The largest rise in participation was among those earning between £200 and £500 a week. Those in blue collar jobs have been particularly strong beneficiaries. Broken down by occupation, process, plant and machine operatives saw the largest increase in workplace pension membership from 34 per cent in 2013, to 52 per cent in 2014.

Auto-enrolment has been particularly effective in bringing younger workers into the pensions system. Saving rates among young people have risen as a result of automatic enrolment, with 54 per cent of eligible 22-29 year olds making regular contributions in 2014, more than double the proportion doing so in 2012 (24 per cent).[7] Increases in participation were particularly notable among young people in the private sector. We do not know whether this is because younger workers are more likely to experience inertia in relation to financial decisions, now increasingly enthused by the prospect of pension saving or more likely to be working for employers who previously did little to encourage pension savings. It should also be noted that these figures exclude those ineligible for auto-enrolment, such as through not reaching the earnings trigger.

A key benefit of auto-enrolment has been the closing of the gender gap on pensions among at least some groups of workers. The DWP has noted that, among those eligible for auto-enrolment in the private sector, 63 per cent of both men and women are now participating in a workplace scheme. In the public sector 91 per cent of women compared to 92 per cent of men are in a scheme. Compared to 2013, the highest growth in the proportion of employees with workplace pensions was for full-time female employees in the private sector at 17 percentage points.

However, as the next section will show significant numbers of people, particularly women, are not benefiting from the roll-out of auto-enrolment.

The challenges

- Eligibility criteria are locking out members of many underpensioned groups.
- Size of wages are still a key determinant of pension participation.
- Many women are effectively locked out of retirement savings due to part-time hours.
- Members of many black and ethnic minority groups are disproportionately affected.

Auto-enrolment has brought members of many typically underpensioned groups, such as women, members of black and ethnic minority groups and part-time workers into the workplace retirement savings system.

[7] The Pensions Regulator (2015). *Automatic Enrolment Commentary And Analysis: April 2014–March 2015*

The key factor is the eligibility criteria governing automatic enrolment. The Pensions Policy Institute has concluded that of 40.7 million Britons aged between 16 and 64, just 20.1 million are eligible for automatic enrolment (although around 1.4m of this group are employed and contributing to workplace schemes independently of automatic enrolment).[8] The others are either self-employed, not working or do not meet the eligibility criteria. Those in the latter position have insufficient earnings to reach the earnings trigger for auto-enrolment – which in the current financial year is set at £10,000 – is the key factor, excluding 57 per cent of those employees who are ineligible.

So while there is evidence that auto-enrolment has had the biggest impact on participation in workplace pensions at lower income levels, this hasn't eradicated the link between earnings and workplace pension scheme membership. This is particularly true in the private sector, where full-time employees with earnings of £600 per week and over are three times more likely to be members of a workplace pension scheme than those earning less than £100 per week, according to the Annual Survey of Hours and Earnings (ASHE).

There is also a persistent gender gap in pension saving, despite many more women being brought into the system. For it has tended to be those women in full-time employment who have benefited from auto-enrolment. Pension coverage remains relatively sparse among part-time workers in the private sector despite recent increases. In the private sector between 2013 and 2014, there was a seven percentage point increase in pension membership among part-time female workers. Workplace pension membership of part-time male employees saw a 10 percentage point increase from 12 per cent in 2013, to 22 per cent in 2014, presumably driven by auto-enrolment. For females, the increase was seven percentage points from 20 per cent in 2013, to 27 per cent in 2014. Far more women than men are part-time workers, as explored in more detail below.

TUC analysis of official data shows that the eligibility criteria for automatic enrolment has a particularly dramatic effect on the eligibility of part-time workers and shows that this overwhelmingly means women. Set out in the table below is a breakdown of the UK workforce in relation to the £10,000 automatic enrolment earnings trigger.

It shows that of the 26.4 million employees in the UK, 4.6 million (or 17.6 per cent) earn less than the £10,000 trigger level. Of these, 3.4 million (around three quarters of the total number of workers earning less than the trigger level) are women. Indeed, more than a quarter of female employees earn less than the auto-enrolment trigger.

The problem is particularly acute for part-time workers. More than half – 56.8 per cent – of part-time workers earn less than £10,000. Their number includes more than three million female part-time employees compared to fewer than one million men.

[8] Pensions Policy Institute (2015). *Who Is Ineligible For Automatic Enrolment?*

Employees with earning above and below £10,000 earnings trigger

Earnings bands		Below £10,000 earnings threshold	>= £10,000
All employees %		17.6	82.4
All employees no	26.4 million	4.6 million	21.7 million
Male %		8.9	91.1
Male no	13.4 million	1.2 million	12.2 million
Female %		26.3	66.3
Female no	13 million	3.4 million	9.6 million
Full time %		2.2	97.8
FT no	19.4 million	427,000	19 million
Part time %		56.8	43.2
PT no	6.9 million	3.9 million	3 million
Male FT %		0.9	99.1
Male FT no	11.8 million	106,000	11.7 million
Male PT %		58.3	41.7
Male PT no	1.6 million	910,000	600,000
Female FT %		3.1	96.9
Female FT no	7.6 million	237,000	7.4 million
Female PT %		56.3	43.7
Female PT no	5.4 million	3 million	2.3 million

It is reasonable to assume that a small number of low earners, on less than £10,000 a year, will be brought into the pensions system because their workplace schemes do not have earnings restrictions. However, their number is likely to be very small given the prevailing pattern of workplace pensions provision. Also, unsurprisingly, few low earners with wages of less than £10,000 take up their right to opt in. Just six per cent of those who are ineligible to be automatically enrolled are actively opting in to the pensions system.[9] There is a particular problem for those who have two or more part-time jobs, whose combined wages might take them over the earnings trigger. Despite their earnings they are not automatically enrolled. The PPI calculates that if the income from both first and second jobs was taken into account when assessing eligibility for

[9] Department for Work and Pensions (2015). *Automatic Enrolment Evaluation Report 2015*

automatic enrolment, then a further 80,000 people (60,000 women and 20,000 men) would earn enough to meet the qualifying criteria.

The problem has been caused by linking the earnings trigger to the threshold for paying income tax. This threshold has been raised substantially in recent years as a deliberate government policy aimed at helping low-paid workers. The impact on female workers' pension entitlement has been dramatic. For example, raising the 2011/12 value of the automatic enrolment trigger from £5,035 to £7,475 excluded 600,000 individuals, 78 per cent of whom were women. This problem has only been recognised by government recently. Ending the connection between the earnings trigger and the income tax threshold to freeze it at £10,000 from April 2015 has brought an estimated additional 20,000 into the scope of auto-enrolment, of whom 70 per cent are women. But this does little to undo the damage done by previous increases.

The impact on pension savings is stark. The DWP estimated last year that there were around 10 million workers in the eligible target population for automatic enrolment, of whom just under two in five (37 per cent) were women. This will rise to just 38 per cent in 2016/17.[10] This matters because pension provision among women is still very low. In 2014 around 40 per cent of women did not have a private pension. While the government predicts that by 2060 this will fall to around 15 per cent, this will still see millions of women suffering a poor standard of living in retirement.[11]

The effect of the earnings trigger on female workers is mirrored in other groups who are likely to be in low wage work. The PPI has found that Pakistani, Bangladeshi and Black/African/Caribbean workers are less likely to meet the qualifying criteria for automatic enrolment than other groups. For instance, close to a third of Bangladeshi and Pakistani employees do not meet the eligibility versus 23 per cent of white workers and 19 per cent of Indian workers. Women are more affected than men with more than half of female employees of Pakistani origin ineligible for auto-enrolment. Again, the earnings threshold is the major stumbling block. Some 91 per cent of the Bangladeshi workers, 80 per cent of Chinese workers, 78 per cent of Indian workers, and 63 per cent of Black/African/Caribbean workers who do not meet the qualifying criteria fall foul of the earnings threshold. This compares to 56 per cent of ineligible white employed people.

Likewise 30 per cent of employed carers are ineligible, 71 per cent of them due to low earnings. And only 55 per cent of people employed in the service sector meet the qualifying criteria for automatic enrolment (though some may be independently saving in a pension). This is in comparison to between 70 per cent and 90 per cent for those employed in other sectors.

Recent work by the Resolution Foundation has also highlighted continued issue of pension provision among the self-employed, and self-employed women in particular. The self-employed have only fallen behind employees on pension membership since the turn of the century. Even as their numbers have swelled, fewer self-employed people

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[10] Department for Work and Pensions (2015). *Review of the Automatic Enrolment Earnings Trigger and Qualifying Earnings Band for 2016/17: supporting analysis*

[11] Department for Work and Pensions (2015). *Pensioner Income Projections, March 2015*

have been contributing to pensions. But the self-employed are not a homogeneous group: those running businesses with employees (17 per cent of all self-employed people) appear more prepared for retirement than 'own-account' workers. This latter group will include a number of the falsely self-employed who are doing the same work as contracted employees but on poorer terms. The Resolution Foundation's work suggests a particular problem with the proportion of self-employed women ending their contributions to pensions in recent years.[12]

Finally, there are high opt-out rates among older workers. However, this seems less of a significant policy concern. NEST estimates that more than 28 per cent opting out among those aged 60 and over. For this group, it is not issues of trust or concerns about the expense but reservations about long-term benefits when starting later in life which are likely to be driving these trends. NEST found that 31 per cent of those over 51 years old who opted out said that it was because they were too close to retirement for it to make a difference. While many in this group may still be facing low incomes in retirement, it seems unlikely that auto-enrolment is the right means to address this challenge.[13]

Contribution rates

- Contributions at auto-enrolment minimums are inadequate for decent retirement.
- But there are signs that minimums are becoming a norm and voluntary contributions are not forthcoming.
- Average contribution rates are plunging.
- Band earnings have a significant distorting effect.
- We have a poor understanding of likely outcomes from current policy.

While automatic enrolment is having an impact on pensions coverage – albeit with notable gaps, it is at best having a neutral impact or possibly even a negative effect on contribution rates.

The Pension Commission proposed a system of contributions involving partnership between the individual, their employer and the state, in building savings for old age. It fixed on an overall rate of eight per cent of earnings split between workers, employers and the government. The assumption was that this level, while inadequate for a good income in retirement, would be supplemented in most cases by additional contributions by the employer and/or the individual themselves.

Auto-enrolment contribution rates are still being phased in. From October 2012 to September 2017 the minimum is two per cent of an employee's qualifying earnings of which at least one per cent must come from the employer. It will not be until 2019 that the eight per cent level will be reached. This will be made up of three per cent from the

[12] D'Arcy, C. (2015). *The Self-Employed and Pensions*, Resolution Foundation
[13] NEST (2015). *NEST Insight 2015*

employer, four per cent from the employee and one per cent from the government in the form of tax relief.

But problems are already emerging. A particular difficulty is caused by the decision to apply contributions to a band of earnings, rather than base them on a full salary. For 2015/16 the band of earnings was from £5,824 at the low end to £42,385 at the top. This means that the median earner can actually expect a contribution rate of 6.3 per cent and 3.3 per cent for those with income at the level of the earnings trigger.

Impact of band earnings on contributions based on 8% contribution

Annual salary	Annual contribution (qualifying earnings)	Annual contribution based on every £ of earnings
£10,000	£334.08	£800
£15,000	£734.08	£1,200
£20,000	£1,134.08	£1,600
£27,000	£1,694.08	£2,160
£40,000	£2,734.08	£3,200

Source: Now: Pensions

There is little evidence that the voluntary contributions anticipated by the Pensions Commission have been forthcoming. The lowly starting rate of two per cent appears to have effectively become the standard contribution rate for those automatically enrolled in many sectors. This has had the effect of dragging down overall contribution levels. The Office of National Statistics' Annual Survey of Hours and Earnings shows that in 2014 in the private sector, 33 per cent of employees with workplace pensions made contributions of greater than zero but under two per cent, compared with 11 per cent in 2013.

Likewise, the proportion of active members of occupational defined contribution pensions with employer contribution rates of less than four per cent increased from 22 per cent in 2013 to nearly 69 per cent in 2014.[14]

There is mounting evidence that feared "levelling down" – employers reducing payments to the pensions of existing staff to the auto-enrolment minimums – is coming to pass. From 2007 to 2012 around six per cent of workers had their employer contributions, or other outcomes reduced. This rose slightly to eight per cent of workers between 2013 and 2014. However, it was more noticeable in the private sector where recent DWP analysis found that 13 per cent workers had contributions levelled down in 2014.[15]

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[14] Office for National Statistics (2015). *Active Members of Occupational Pensions: employer contribution rates and characteristics by pension benefit structure, 2014*
[15] Department for Work and Pensions (2015). *Automatic Enrolment Evaluation Report 2015*

Levelling down is most common in those sectors which have tended to have weak provision. This risks exacerbating existing pensions inequalities. The industry with the highest prevalence of levelling down in the private sector, between 2012 and 2013, was distribution, retail and hotels with 20 per cent, closely followed by banking, finance and insurance at 14 per cent. DWP analysis found that employers staging in 2014 who offered no previous schemes or stakeholder schemes tended to offer the statutory minimum contribution.[16] This suggests that those who have previously been excluded from the pensions system are vulnerable to getting less than established savers.

The DWP itself has little expectation of a vast increase in employer contribution rates. It has estimated that 44 per cent of eligible employees in automatically enrolling organisations will receive an employer contribution of three per cent; 29 per cent are likely to receive between three and six per cent; and, 28 per cent are likely to receive six per cent or more.[17]

Others are even more pessimistic. Based on employer behaviour so far, including the tendency of employers who previously had no pension provision to give contributions at only the minimum required level, the Pensions Policy Institute (PPI) estimates that two thirds of those enrolled in pensions in 2030 will be on minimum contributions.[18]

This is of great concern because the PPI has found that at minimum contribution rates savers are unlikely to amass enough savings for a decent income in retirement. Under the baseline scenario of starting to save at age 22, retiring at SPA and following a traditional lifestyle investment approach, a lower earner has a 63 per cent probability of achieving their target replacement income, compared to 49 per cent for a median earner and 40 per cent for a higher earner. Lower earners have a higher probability of achieving their target replacement rate because the single-tier state pension introduced from 2016 will represent a higher proportion of lower earners' pre-retirement earnings than for median or higher earners.[19]

The DWP's own analysis shows that the number of people undersaving has fallen from 12.2 million to 11.9 million, a fairly modest drop. However, there is some evidence to suggest the degree of undersaving has improved.

This is a problem because it is reasonable to assume that savers contributing to pensions do so in the expectation that it will lead to a reasonable level of income in retirement. There is also a risk of low contribution rates becoming cemented as the norm. Vulnerable groups, working in sectors such as retail who have typically been badly served by pensions provision in the past, are particularly likely to have low contributions.

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[16] Department for Work and Pensions (2014). *Automatic Enrolment Evaluation Report 2014*

[17] Ibid

[18] Pensions Policy Institute (2014). *How Will Automatic Enrolment Affect Pension Saving?*

[19] Pensions Policy Institute (2013). *What Level of Contribution is Needed to Acquire an Adequate Retirement Income?*

The great task is to work out the most effective way of raising contribution levels while minimising the impact on the incomes of savers, the profits of companies and opt-out rates.

In the meantime we need a more sophisticated analysis of adequacy: of what constitutes a reasonable retirement income and how current and potential future provision might deliver this. This is most obviously a task for government. The government should conduct a major modelling exercise designed to show the likely retirement income and replacement ratios that current workers are likely to achieve following the introduction of the new state pension, changes in the labour market developments and current auto-enrolment contribution levels and patterns. This could then form the basis for a long-term plan for the development of auto-enrolment.

Policy solutions

- abolition of the earnings trigger
- reform of band earnings
- a route map towards increased contributions
- introduction of auto-escalation
- flat-rate contributions to boost low earners.

We have identified a two-fold problem: one of inadequate coverage, which risks exacerbating existing inequalities; and another of insufficient contributions making it extremely unlikely that workers will amass enough savings to provide for a decent standard of living in retirement. We are deeply aware that sustainable solutions to these problems require the rebuilding of a consensus about what the direction of UK pensions policy. This requires open debate and discussion.

No change is a very poor option. If minimum contribution rates remain static at eight per cent of a band of earnings from 2018, then we can expect participation to decline as people become increasingly aware that contributions are unlikely to deliver them a decent income in retirement. Meanwhile, millions of part-time workers, most of them women, will remain excluded from workplace pensions. Below are the TUC's proposals for reform.

Thresholds

The earnings trigger should be abolished and the lower contribution threshold for auto-enrolment pensions should be removed. Employer contributions should be made from the first pound of earnings. There is an important debate to be had about whether employee contributions should start at this point or whether this is an excessive call on the incomes of low-paid workers.

Such a move would bring groups such as low-paid workers and part-time women into the system, allowing them to benefit from employer contributions. It would simplify the situation for employers: they would simply know that contributions had to be paid for all workers who meet the age criteria.

The argument is often made that those on low earnings will see a sufficient high level of replacement income when they take the state pension and that they therefore have no need for additional savings. Many also highlight that those on low pay have multiple other pressing calls on their current resources that should be prioritised as well as expressing concern that the small pot of savings such people would amass would be expensive for the pensions sector to administer.

However, this is flawed on a number of levels. The earnings trigger disregards the wider family circumstances of a low-paid worker. For instance, a woman working part-time and earning below the £10,000 threshold may have a partner earning more. She would therefore have the capacity in family income and may be out of the scope of means tested benefits in retirement. Workers may also from time to time find themselves falling under the earnings trigger but during other periods earn more. It is therefore excessively simplistic to bracket them as very low-paid workers who should not be automatically enrolled in a workplace pension.

The current system makes no allowance for a worker who has more than one job with combined earnings of more than the £10,000 trigger threshold. Tweaks to the current system would fail to fairly incorporate this group into the auto-enrolment system. It is hard to obtain data to show a worker's two jobs add up to more than £10,000 a year in earnings. It would also be difficult to determine which employer should be liable for contributions. Ensuring contributions are made on all earnings would avoid these conundrums.

There is a clear unfairness in the current system that those workers on higher incomes essentially receive an additional tranche of pay, albeit deferred, through their employer pension contributions, that is not claimed by the bulk of those on lower incomes who are not automatically enrolled. This exacerbates prevailing income inequalities.

It should also be noted that even a relatively small amount of pension savings could provide a lump sum that could provide real benefits to savers in retirement, such as to pay off debts.

Recent analysis by the PPI found that removing the qualifying earnings band entirely has a greater positive impact on retirement incomes than increasing minimum contribution levels to 10 per cent. Modelling showed this change would have a particularly big impact on contributions for lower earners who make lower proportional contributions when subject to the earnings band.[20] This suggests that there is a strong case for major reform of the system of band earnings, ideally in combination with a programme to raise overall contribution rates.

Contributions

The additional voluntary top-ups that the Pensions Commission had assumed would supplement the basic provision have not materialised. There is a real risk that without

[20] Pensions Policy Institute (2016). *The Under-Pensioned*

action, employers who currently give at least some staff contributions above minimum levels will level down to this insufficient level.

Too often the issue is characterised as a problem due to savers putting too little aside, as if pension saving was a matter for the individual alone. We dismiss that explanation as too simplistic. It ignores the myriad barriers to pension saving whether they be behavioural characteristics, the complexity of savings products or lack of disposable income.

Set out below is an examination of the different available approaches to raising contribution rates from engaging with savers at key dates to introducing flat-rate lump sum payments. While we look in this section at the impact of raising overall contribution rates we have not sought to investigate the impact of varying the division of contributions between the individual, the state and employers, which requires separate analysis. However, we note that there is a potential deterrence effect of requiring large contributions directly from an individual's wage packet.

We reiterate that **we believe the most important thing is to establish a consensus around a long-term routemap for improved pension contributions.**

Nudge in the right direction

More effort could be put into encouraging additional contributions. Evidence shows that changing jobs emerges is a focal point for taking a decision about a pension.[21] A case can therefore be made that providing people with information about the merits of higher pension contributions when they start new jobs could encourage additional payments. However, this goes rather against the use of inertia that has been such a success. It seems to us that while such an approach may have some effect at the margins, there is a risk that its overall impact is likely to be limited.

Others have suggested that approaching savers at key life stages, such as reaching the age of 30, to encourage them to raise savings rates may be effective. But again, we fear that this requires levels of engagement and decision-making by individuals which have not been evident in the past. It would also put the onus on improving contributions onto individuals, with little additional demands on employers or the state.

Improved, better targeted messaging on pensions can therefore only be a small part of the solution to the contributions conundrum.

Raise headline contribution rates

At the other end of the spectrum, we could simply mandate higher contribution rates. The Association of Consulting Actuaries has suggested that contributions equivalent to 14-16 per cent of salary are needed to achieve an income of retirement of two-thirds of income – often seen as a satisfactory replacement income.[22]

The TUC commissioned the PPI to model the impact on pension saving of increasing contribution rates. This work assumes the continuation of the prevailing system of band

[21] Bryan, M. and Lloyd, J. (2014). *Who Saves for Retirement? Eligible Non-Savers*, Strategic Society Centre

[22] Association of Consulting Actuaries (2015). *Time to Get Real*

earnings. The analysis takes account of factors such as different earnings levels and work patterns – including typical time out of the workforce for child caring. It models outcomes against a "status quo" scenario of eight per cent of band earnings. It focuses on the impact on median and low-paid workers who we believe should be the focus on pensions policy. For full details of the work see the PPI paper *Automatic Enrolment Contribution Scenarios Post-2017* (2015).

A straightforward hike in contribution rates is attractive in its simplicity and effectiveness. Even assuming no change to the system of band earnings, raising contributions to 15 per cent would increase by 88 per cent the amount being saved in pensions by median and low-paid workers of both genders, according to PPI modelling.

However, there are risks to blanket increases to contribution rates in the short-term particularly in the early years of pensions auto-enrolment. In particular, if the bulk of the increase was in the form of highly visible additional employee contributions, workers may be incentivised to opt out if they saw a substantial reduction in take-home pay. Even those entering new employment may prefer the additional pay to retirement savings if the sums were sufficiently large. If employers were required to contribute significant additional sums, some could also reduce employment or employment growth or the hours worked by staff.

Increase in pension pot size from increased total contributions on band earnings (% above status quo)

Contribution levels (% band earnings)	Median Male	10th Percentile Male	Median Female	10th Percentile Female
10%	25%	25%	25%	25%
12%	50%	50%	50%	50%
15%	88%	88%	88%	88%

Source: PPI. *Automatic Enrolment Contribution Scenarios Post-2017* (2015)

There would be implications for the Exchequer. A flat rate of 10 per cent would cost £4.2bn in tax relief, 12 per cent £5bn and 15 per cent £6.2bn. However, reprioritisation of the tax relief budget or wider tax changes could be introduced to cover these costs.

Raising total contribution rates would have a clear impact on savings for both median and low-earning men and women. However, the impact on behaviour of both employee and employer will depend on the allocation of total contributions and other labour market trends, such as the strength of the jobs market.

Auto-escalation

There is a case for consideration of auto-escalation structures, sometimes discussed under banners such as Save More Tomorrow schemes, if they deliver similar outcomes to flat contribution rates while minimising the risk of opt-outs. Analysis by

Standard Life suggested that if introduced from 2017, auto-escalation could double the amount going into annual retirement savings by 2025.[23]

While auto-escalation is frequently raised as a means of increasing contribution rates, there are a number of means by which it could be structured, with sharply varying impacts on the retirement savings of low and middle earners.

The TUC asked the PPI to model several scenarios for bringing contribution rates up from eight per cent to 15 per cent of band earnings and the impact on the retirement savings of sample low and middle income workers.

Factors used as triggers for increasing contributions for the scenarios are:

- age – the contribution rate increases as the individual becomes older
- job tenure – the longer an individual remains in a job the higher the contribution rate is set
- pay increase – as an individual's pay rises a part of it is used to fund an increase in contribution level
- pay level – the contribution rate is linked to the earnings of the individual. Earnings are compared to National Average Earnings (NAE) to set the contribution rate.

The analysis takes account of factors such as different earnings levels and work patterns – including typical time out of the workforce for child caring. However, it is unable to model behavioural responses to changes to contribution rates – whether individuals perhaps opting out or employers hiring workers who attract lower contribution rates. It assumes the persistence of a system of band earnings.

The results show that while there are various approaches that could boost pension savings, public policy decisions have to be made about those groups the government may most wish to increase their savings rate.

- Escalation by pay *increase* delivers very similar results to a flat 15 per cent contribution rate, especially for low paid women.
- Escalation based on pay *level* produces particularly poor outcomes for women and low-paid men.
- Escalation by tenure is relatively ineffective in delivering increased contributions to all groups, but especially female workers.

[23] Standard Life (2011). *Keep on Nudging: making the most of auto-enrolment*

Impact on size of pension pot compared to status quo 8% contribution rate

	Median Male	10th Percentile Male	Median Female	10th Percentile Female
15% contribution rate	88%	88%	88%	88%
Escalation by age	78%	78%	74%	80%
Escalation by tenure	51%	51%	46%	47%
Escalation by pay increase	85%	85%	84%	87%
Escalation by pay level	76%	0%	35%	0%

Source: PPI (2015). *Automatic Enrolment Contribution Scenarios Post-2017*

Escalation by age: The impact of escalation by age is to bring the contribution level to 15 per cent by the individual's 30th birthday. As a result they spend most of the accumulation period with a contribution rate of 15 per cent. Where an individual's income is below the earnings threshold, this occurs at a younger ages and it is the lower contributions that are missed. This is a particularly strong factor in the case of the sample female worker with 10th percentile income.

Escalation by tenure: With the average duration of a job assumed to be approximately five years the impact is to produce an average contribution rate over the accumulation period close to 12 per cent and as such the final results are close to those achieved with a flat rate of contribution at 12 per cent. Men get slightly better outcomes than women compared to the status quo.

Escalation by pay increase: The escalation rate has been to assume that for every one per cent pay increase the individual gains their contribution rate is increased by 25 basis points. Pay escalation rates are higher at younger ages and as such the maximum contribution rate of 15 per cent is achieved by age 25 for all individuals modelled. In the case of the 10th percentile female the qualifying threshold has not be achieved until after the maximum contribution rate would apply. Nevertheless, our sample low-paid women gets almost as much benefit from this approach as a flat 15 per cent contribution rate.

Escalation by pay level: The impact of linking the contribution level to the proportion of national average earnings of the individual's current earning level. The median male achieves the maximum contribution level after 10 years, at age 32. However the contribution level reduces towards the end of the accumulation period from age 57, as the relative income level drops. This yields for him a pension pot similar to that which would be accumulated with a flat contribution rate of 14 per cent. The median female has a lower expected income and never achieves the maximum contribution rate. The impact is to generate a pension pot equivalent to that which would be achieved with a flat rate of contribution of approximately 11 per cent.

Flat-rate lump sum payment

Among the policy decisions to be made about auto-enrolment is who requires the greatest assistance in saving for retirement. **A particularly radical solution, one that would be particularly effective in raising the pension savings of low-paid female workers, would be add a £500 flat-rate additional pension contribution on top of the planned rise to eight per cent of band earnings**.

This would bolster the pension savings of a low-paid woman by 121 per cent and low-paid man by 80 per cent. However, the median male would see their pension savings increase by a more modest 33 per cent and median-earning woman by 45 per cent.

Increase in automatic enrolment pension pot size (% above current system outcome)	Median male	Low earning male	Median female	Low earning female
Current system with bonus	33%	80%	45%	121%

The impact in cash terms is set out below.

£s, 2015 earnings terms	Median Male	10th Percentile Male	Median Female	10th Percentile Female
Pot size				
Value	105,284	58,495	63,437	32,487
Increase from status quo	25,923	25,923	19,816	17,793
	32.7%	79.6%	45.4%	121.1%

Source: PPI (2015). *Automatic Enrolment Contribution Scenarios Post-2017*

This approach would have the advantage of being simple, of being progressive and in providing a strong incentive for low-wage earners to remain in the pensions system.

The PPI modelling identifies a £7.8bn cost (in 2012/13 terms) to the Exchequer if a flat £500 bonus was applied annually to workers' pension pots, compared to the status quo. This compares to the estimated £3.3bn annual cost to the exchequer of the tax relief associated with auto-enrolment of the nine million individuals expected to join. This assumes a contribution level of eight per cent.

This does assume that the £500 top-up is paid in its entirety from Treasury coffers, whereas it may be more appropriate to split the cost between employers and the state. As a comparison, we would note that the net impact of changes to corporation taxes since 2010 has been estimated at £7.9bn in 2015, a number that is likely to grow further as the main rate of corporation tax falls to 17 per cent by 2020. It sits at 20 per cent currently, having dropped from 28 per cent, while other changes such as the introduction of a preferential regime for patent income (Patent Box), and modifications to the taxation of foreign income have also cut tax take.[24] The UK now has one of the lowest tax rates in the G20.

We would also note that the Treasury can expect to recoup money through tax revenues during decumulation.

Conclusion

This paper has shown that auto-enrolment is unfinished business. Without further development, there is a risk that workplace pensions become a marginal part of the savings landscape, providing minimal contributions for only some workers.

The 2017 review of auto-enrolment should be central to developing a long-term plan for workplace savings. To be most effective this would begin with an adequacy modelling exercise setting out the retirement income and replacement ratios that current workers are likely to achieve given the introduction of the new state pension, the evolution of the labour market and current auto-enrolment contribution levels. This would inform the necessary routemap for ensuring auto-enrolment reaches its potential to become the centrepiece of most workers' retirement planning.

To help in this process, we have set out a number of policy options for improving auto-enrolment that, either in isolation or in combination, could improve savings for low and middle earners. These are:

- abolition of the earnings trigger
- reform of the system of band earnings
- auto-escalation by pay increase
- a flat-rate element to provide particular support to low-paid workers.

We are conscious that such proposals will not meet universal approval. However, we believe they are a useful starting point for the vigorous debate and discussion that is needed to build a fresh consensus about the way forward for workplace pension's savings.

[24] Institute of Fiscal Studies (2015). "Corporation Tax and Changes", IFS Briefing Note BN163