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The impact of automatic enrolment in the UK as at 2016

The Pensions Policy Institute (PPI) funds and supports a number of PhD students researching into areas of distinct policy relevance to pensions in the UK. The PhD Briefing Note Series has been set up to allow analysis undertaken as part of the PhD to be fed into public debate and reach a wider audience than would normally be the case, and to encourage researchers to consider the policy implication of their findings.

Connecting policy with the personal: UK pension reforms and individual financial decision making

The ESRC is funding a 3 year PhD studentship in a collaboration between Manchester University and the PPI. The study will examine employee responses to recent pension reforms in the UK. The research will inform our understanding of real-life financial decision making in an increasingly individualised system where people are expected to take high levels of responsibility for their own financial welfare in later life. This collaboration offers exceptional insight into how the work of researchers feeds into policymaking and policy impact, including how evidence is utilised by key actors such as Members of Parliament, government officials and other stakeholders.

Hayley James is a PhD student at The University of Manchester Institute for Collaborative Research on Ageing (MICRA). Her Thesis looks at the impact of automatic enrolment into workplace pensions on individual decision making, based on qualitative research methodology. Hayley has a background in Economic Anthropology, having previously completed research on community currencies in London. Her research interests concern anthropological perspectives on money and value, and how meaning is created through these tools.

Introduction

This briefing notes considers what is known about the impact of the introduction of auto-enrolment into workplace schemes on pensions saving in the UK so far, as at the end of 2016.

Auto-enrolment means that employers are obligated to automatically enrol workers into a qualifying pension scheme. Employees are able to opt out from the scheme at any point, but they will be re-enrolled every three years. Eligibility for the policy covers all employees aged between 22 and the State Pension Age and earning over £10,000 per year. The aim of the policy is to encourage more private pension saving by increasing the number of savers and the value of savings, in order to reduce the burden of funding for state pensions in the long term.[1]

This note will examine the number of participants, the contributions, and opt-out rates in workplace pensions, since the introduction of auto-enrolment in the UK.

Background

Auto-enrolment was phased in from October 2012, starting with large and then medium sized businesses. Smaller organisations (those with fewer than 50 employees) were phased in from 2016. By 31st July 2016, 206,137 large, medium and small employers had completed the auto-enrolment process.[2] In this period, around 6.5m eligible workers have been newly enrolled.[2] Additionally, more than 9.5m employees were found to be already members of workplace pensions.[1,3]

At September 2016, it is estimated that there were still 1 million small or new employers (who came into existence after October 2012) who will still go through the auto-enrolment process before February 2018, with around 5 million eligible workers to be auto-enrolled.[1,2,4]

The policy set a value of total minimum contributions for auto-enrolment at 8% on band earnings, comprised of 4% employee contribution, 3% employer contribution and 1% government tax relief on the contributions. This is being phased in by 2019. Until then, total contributions are 2% of qualifying earnings until April 2018, increasing to 5% until April 2019, before rising to the full 8%. It is anticipated that the rising contributions may affect the number of participants and opt-outs under auto-enrolment in future.

The first section of this briefing note will examine the number of people participating in pensions since the introduction of auto-enrolment.

Number of participants

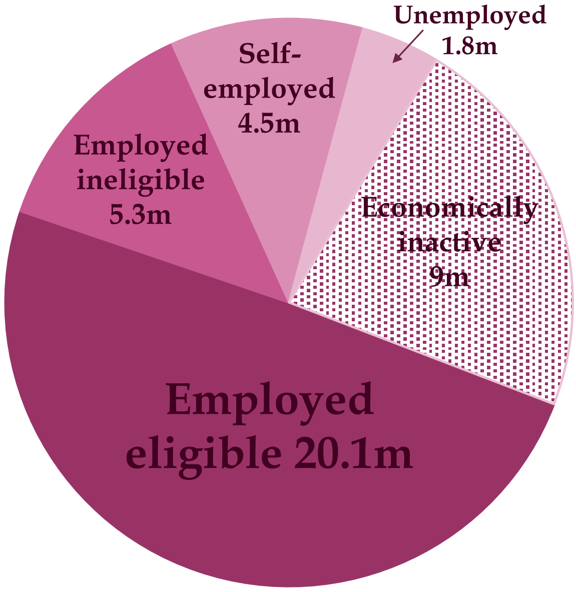
Auto-enrolment has increased the number of people participating in workplace pensions. By September 2015, the proportion of all workers enrolled in a private workplace pension scheme reached 66%.[3,5] This represents the highest proportion since the last peak of pension coverage in the 1967 when 53% of workers were members of a private or occupational pension.[6]

By April 2015, 75% of eligible employees were saving into a workplace pension, an increase of 20 percentage points since the introduction of auto-enrolment.[3] The majority of new participants work in the private sector, where the proportion of participating eligible workers increased by 28 percentage points to 70% in 2015.[3,7] This is greater than the increase in overall employment, which grew from 70.5% in January 2012 to 73.4% in December 2014.[7,8] In the same period, public sector participation has increased by three percentage points to 91%,[3] while total public sector employment fell by 10%.[8]

However, many people are ineligible for auto-enrolment, either through not being employed (i.e. self-employed, unemployed or economically inactive) or not meeting the criteria of the scheme regarding earnings and age.[9,10] In 2015, 5.3m employees had been found to be ineligible for auto-enrolment based on the criteria of the scheme.[9] Analysis from the PPI suggested that a further 4.5m self-employed people do not meet the criteria for auto-enrolment, as shown in Chart 1.[9] These people may save in a pension independently of auto-enrolment. However, pension participation tends to be low amongst these groups. In 2015, just 18.5% of full-time workers with between £100 and £200 gross earnings per week were participating in a pension scheme, with £192 a week being the cut-off point for eligibility for auto-enrolment.[11] Pension

Chart 1: Half of working age people are eligible for automatic enrolment

Total working age population (age 16 to 64) UK, 2015 by different categories



participation amongst the self-employed was around 17% in 2014.[1,9,12]

A previous briefing note by the PPI explored who is ineligible for auto-enrolment and found that women, minority groups, people with disabilities and carers are less likely to meet the eligibility criteria, as are people who work for small employers or in service industries:[9]

- Around 4m (32%) female workers do not meet the qualifying criteria for automatic enrolment, compared to 16% of male workers.
- 32% of Pakistani workers, 33% of Bangladeshi workers and 29% of Black/African/Caribbean workers do not meet the qualifying criteria, compared to 23% of white workers.
- 30% of disabled workers and 81% of employed carers do not meet the qualifying criteria for automatic enrolment, compared to 23% of disability-free employed people.
- Of those working for smaller employers, with 10 or fewer employees, only 61% meet the qualifying criteria for automatic enrolment, while 90% of employees working for larger employers, with 500 or more employees, meet the qualifying criteria for automatic enrolment.
- Only 55% of people employed in the service sector meet the qualifying criteria for automatic enrolment in comparison to between 70% and 90% for those employed in other sectors.

DWP analysis suggests these discrepancies in eligibility between groups are driven by employees not meeting the earnings threshold.[4] These groups are also among those who are most likely to have many of the other 'alarm bell' characteristics that are associated with lower pension incomes, part-time working and periods of unemployment or inactivity.[9,13] This means that auto-enrolment may not improve pension outcomes for groups who already have a high risk of becoming under-pensioned and dependent on state funding.[13]

For those eligible, participation is a positive first step but may not ensure pension adequacy if participants make low levels of contributions.[9,14] Therefore, this briefing note next considers the impact of auto-enrolment on employee and employer contributions.

Employee and employer contributions

Auto-enrolment has furthered a pre-existing trend towards defined contribution (DC) pension schemes, and away from defined benefit (DB) schemes. Before 2012, there were 1.4 million active DB scheme members and around 8 million DC scheme members.[15,16] Most people who have been auto-enrolled have joined a DC scheme: 88% of those auto-enrolled up to March 2015, and 91% of those auto-enrolled from March 2015 to March 2016.[2] This has increased the total number of active DC savers to 12.3 million, compared to 1.5 million active defined DB savers in 2015.[2] For the majority of savers, pension outcomes will therefore be explicitly dependent on the value of contributions made.

Workplace pension savings are expected to increase by £17bn by 2019/20.[4] Since 2012, total contributions in workplace pensions increased from £73.7bn to £80.3bn in 2014.[1,17] However, this represents a decrease per participating saver from £6,885 in 2012 to £5,776 in 2014.[17] Total contributions into workplace pensions are made up of employee, employer pensions and tax relief, and these three items will be considered separately.

First, total employee contributions into workplace pensions grew from £19.8bn in 2012 to £24.2bn in 2014.[17,18] This equates to a reduction per participating saver from £1850 in 2012 to £1741 in 2014,[17] which suggests that the increase in total saving has been primarily driven by the increase in numbers of savers. As shown in Chart 2,[2] median employee contribution rates in DC schemes have decreased to 1% for group personal pensions and 2.4% for DC trusts from 2012 to 2014.[2] This is a result of new joiners paying just the minimum contributions. It is unclear how the phased increase of minimum contributions up to 2019 will affect saving through auto-enrolment as more people may decide to opt-out at higher rates of contribution. Also, it is not known if the contribu-

Chart 3: Median employer contribution rates in DC schemes are decreasing

Median employer contributions to DC pensions by year

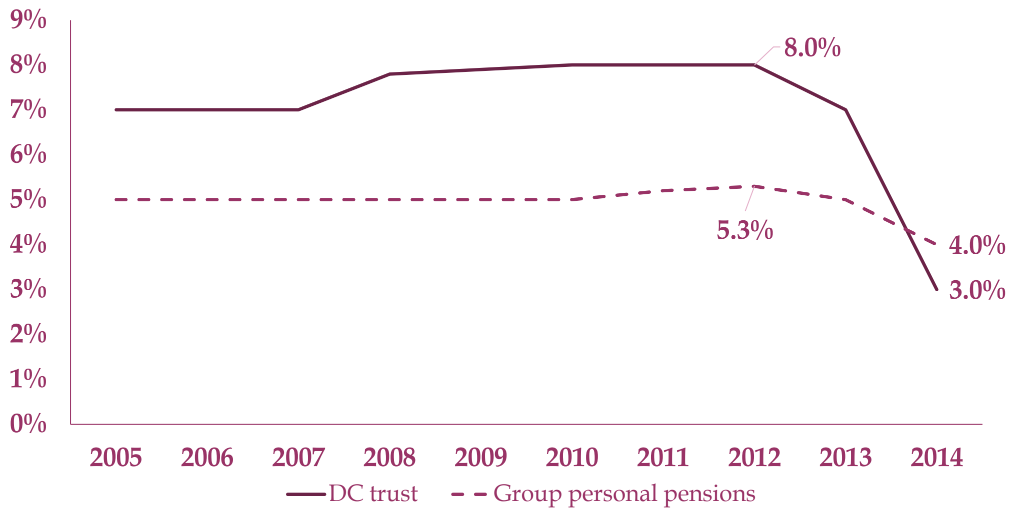


Chart 2: Median employee contribution rates in DC schemes are decreasing

Median employee contribution rates to DC pensions by year

tions have either diverted saving from other savings vehicles, or effectively depressed wages.

Second, total employer contributions have increased in total from £47.5bn in 2012 to £48.1bn in 2014, but again this equates to a reduction per participating saver from £4437 in 2012 to £3560 in 2014.[17] As shown in Chart 3,[2] median employer contribution rates have also decreased to 4% for group personal pensions and 3% for DC trusts from 2012 to 2014.[2]

This is a result of new employers paying the minimum contributions level for newly enrolled employees.[2,17] The proportion of workers experiencing some form of levelling down (where employers reduce contribution rates or other outcomes) rose slightly from 6% in 2012 to 8 per cent in 2014.[17,18,19,20] In the Employers' Pension Provision Survey 2015, the majority of employers (72%) were planning to contribute just the minimum of 3 per cent.[4,17]

Total contributions to pension saving from tax relief increased from £6.3bn in 2012 to £8bn in 2014, which equates to a decrease per participating saver from £589 in 2012 to £575 in 2014.[17]

Overall, there is a pattern of increasing total pension savings, but decreasing contributions per saver. Employee and employer contributions have anchored at the current minimum contribution levels. It is unclear what will happen as these increase. As a worst-case scenario, employees may decide to opt-out as contributions rise. It is not clear how many people might be follow this path.

It is also possible that employees may continue to contribute at the minimum levels. It is possible to anticipate that most people would do this. Yet even at the increased levels, minimum contributions may not be enough to provide an adequate pension for most people.[14]

Adequacy can be defined as the extent to which individuals have a retirement income that allows them to replicate the standards of living they had while in working life. Previous PPI research has suggested that a minimum contribution level of 11% would be required to achieve target income in retirement for three-quarters of people.[14] This analysis was based on starting saving at 22 and retiring at the state pension age which may not be the case for most people.[14] Therefore, some ambiguity remains regarding the long-term effects of auto-enrolment on individual saving and whether this will lead to pension adequacy in the future.[1,21]

Finally, this note considers the opt-out rates that have been registered since the introduction of auto-enrolment.

Opt-out rates

The opt-out rate for auto-enrolment has been lower than the predicted 15%-20%, although current estimates vary. The National Audit Office has estimated that the opt-out rate is between 8 and 14%, based on evidence from NEST and participating employers.[1] The DWP suggest that the overall opt-out rate sits around 9—10%,[1] although there are variations by age, working pattern and gender, as shown in Table 1 below.[22] Further analysis from the DWP suggests that opt-out rates vary by size of organisation. As shown in Chart 4,[2] data from 2015 show that the smallest employers have the highest opt-out rate at 17%.[2] This suggests that the overall opt-out rate may rise as more smaller employees adopt auto-enrolment.

A quantitative study based on a sample of 50 employers by the DWP suggested that the presence of contractual enrolment before the introduction of auto-enrolment was a major factor in influencing

Table 1: Opt-out rates vary by characteristics

Age	Proportion opting out
< 30	7%
30 – 49	9%
≥ 50	23%

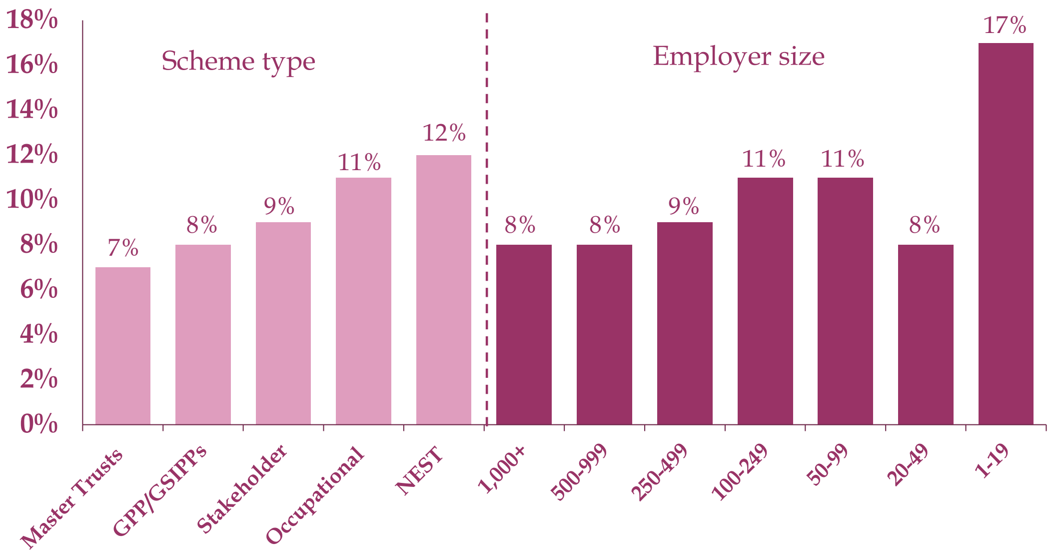
Working pattern	Proportion opting out
Full-time	10%
Part- time	18%

Gender	Proportion opting out
All	12%
Women	14%

Based on study of 46 employers (2,600 automatically enrolled workers) by the Department for Work and Pensions (2014), Automatic enrolment opt-out rates: findings from qualitative research with employers staging in 2014 DWP, London.

Chart 4: Those working for the smallest employers have the highest opt out rate at 17%

Opt outs by employer size and scheme type (2015)



opt-out rates. Where there was already a contractual enrolment scheme in place, fewer people were auto-enrolled yet opt-out rates tended to be higher at around 16% compared to the 9% average found in businesses without contractual enrolment.[23,24]

The DWP analysis also suggested that age was the main demographic characteristic that influenced the opt-out rate, with opt-out rates for people over 50 between twenty-five percent and fifty percent higher than the rate for under 50s.[23,24] This finding is also reflected in the table above.[22] Gender, salary or job status were not found to be significant factors in the prevalence of opt-outs, although they do impact eligibility for auto-enrolment (see page 1).[23,24]

A qualitative study from the DWP based on 50 employee interviews identified six types of opt-outs and suggested that most people took an active, conscious decision to opt-out, based on their ability to afford the contributions, other financial priorities, or having other provisions in place.[25] The research points to attitudinal factors such as the presence of scepticism about pension saving which may contribute to the opt-out decision. This aligns with previous PPI research which suggested that affective and attitudinal factors such as trust and risk aptitude will influence pension decision-making.[26]

These studies are unlikely to be representative since they covered a small sample including employers and employers from various industries, which may obscure industry-specific trends. More research is needed to fully understand the driving factors for opt-outs, as it may become more important as increases in minimum contribution rates are phased in.

Summary

Since the introduction of automatic enrolment:

- 6.5m people have been auto-enrolled and 66% of all workers are now participating in a workplace pension scheme, although there are significant groups who are excluded from the auto-enrolment policy.
- Total contributions have increased but median contributions have decreased as employees and employers stick to the minimum levels. It is unclear what will happen as minimum contribution levels rise.
- Opt-out rates are lower than expected with estimates ranging from 8% - 14%, but the driving factors are not fully understood. This may become more important as minimum contribution levels increase.

While this presents a positive start, the likelihood of the policy achieving adequacy for auto-enrolled savers in the long-term and maintaining low opt-out rates in the short– and medium-term is not clear. Those who are not participating, or participating only at minimum levels, risk having a less-than-adequate income to live on when they reach retirement age. As auto-enrolment is not yet fully rolled-out, there is a need for further research on these matters. This theme will be continued throughout this PhD series.

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The University of Manchester
Institute for Collaborative Research on Ageing

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For more information on this topic, please contact:
Hayley James
020 7848 3744 hayley@pensionspolicyinstitute.org.uk
www.pensionspolicyinstitute.org.uk