Pensions Policy Institute

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Executive Summary

How will automatic enrolment affect pension saving?

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Executive summary

Automatic enrolment into workplace pension schemes has now (July 2014) reached its second stage, and employers with between 50 and 249 workers have three months from their staging date (between April 2014 and April 2015) to automatically enrol all of their eligible workers into a qualifying workplace pension scheme. Workers then have a month to opt out. The required level of contributions that employers and workers who do not opt out must jointly make into a pension scheme is being phased in from 2012 to reach 8% minimum total contributions on band earnings (£5,772 to £41,865 in 2014/15) by 2018.

At minimum levels, the 8% will be made up of 3% from the employer, 4% from the employee and 1% from the Government in the form of tax relief, though employers can choose to pay more than 3% and thereby reduce the amount that their employees are required to contribute. If the employer chooses to pay the entire 8% themselves, then employees who do not opt out are not required to make any contributions under automatic enrolment regulations, though their employer may still expect them to contribute.

Employers and employees may choose to respond to automatic enrolment in different ways

While employers are required to automatically enrol eligible workers into qualifying schemes and pay contributions on behalf of those who do not opt out, they can choose:

- Which type of scheme to enrol their workers into (as long as the scheme meets certain standards);
- Whether to contribute into employees' pension schemes at minimum required levels or above.

Eligible workers also have choices regarding how to respond to automatic enrolment, such as:

- Whether to opt out of their pension scheme after being automatically enrolled;
- Whether, if they remain in their scheme, to contribute at minimum required levels or above.

The choices that employers and employees make in response to automatic enrolment will affect the future numbers of people saving in pension schemes and the aggregate value of future workplace pension scheme assets (contributions plus investment growth over time).

The current opt-out rate from automatic enrolment is around 9-10% on average

The first stage of automatic enrolment, with employers of 250 workers or more, is now complete. This has allowed for some analysis of how larger employers and their workers are responding. The following trends in behaviour among larger employers, during the first stage of automatic enrolment have been identified:

- Employers with existing provision (offering access to a scheme and employer contributions) were less likely to offer minimum contribution levels for new, automatically enrolled, employees than those without existing provision who were offering access to a new scheme;
- Employers who did not offer pension provision prior to automatic enrolment were more likely to say they intended to pay the minimum required level of contributions.

The following trends in employee behaviour have been identified:

- 9-10% of workers have opted out on average;
- Older workers and women are more likely to opt out, on average, than other workers;
- Those opting out cited financial constraints as the main reason.

Factors other than the choices made by employers and workers, such as scheme charges or market factors (including the level of investment return on pension funds) may all influence the number of people saving in pension schemes and the aggregate value of workplace pension scheme assets.

The self-employed are excluded from the analysis as they are not eligible for automatic enrolment, though they are not prohibited from voluntarily joining a pension scheme and paying contributions. The take up of private pension saving by self-employed people has declined over the last decade and in 2011 only 34% of self-employed people were active members of a pension. Unless a significant proportion of self-employed people choose to join a pension scheme, pension saving may remain low among this group even after automatic enrolment.

Modelling the effects of employer and employee response

This report uses stylised scenarios to explore the possible effect that employer and employee responses could have on the numbers of people actively saving and total aggregate assets (contributions plus investment growth over time) in private sector workplace pension schemes. Though there is some evidence available on the responses to the policy by large employers and their workers, there is limited evidence on how medium to smaller employers and their workers may respond or how all workers may respond once minimum employee contributions reach their full level of 4% (5% including tax relief). Therefore the scenarios in this report illustrate the potential impact of a range of scenarios rather than implying that any scenario is likely, or more likely, to occur.

Employee response

This report explores how different opt-out rates by workers (continuing until 2030 and including both those newly enrolled and automatically re-enrolled) might affect the number of people saving and the value of aggregate assets (contributions net of investment returns and charges) in private sector workplace pension schemes. The following scenarios are explored:

- **The "no automatic enrolment" scenario** – a baseline scenario which explores the impact of not introducing automatic enrolment

- **The "central opt-out rate" scenario** - a scenario which explores the impact of a 15% opt-out rate
- **The "low opt-out rate" scenario** - a scenario which explores the impact of a 9% opt-out rate
- **The "high opt-out rate" scenario** - a scenario which explores the impact of a 25% opt-out rate

A summary of the results of the analysis is shown below (Table A).

Table A: Effect on scheme membership and value of assets in private sector workplace pension schemes in 2030 based on different opt out scenarios (2014 earnings terms)

Scenario	Total private sector scheme membership	Private sector DC scheme membership	Private sector workplace pension scheme assets (DB &DC)	Private sector DC workplace pension scheme assets
No automatic enrolment	6.5 million	6 million	£1,050 billion	£350 billion
25% opt out	13 million	12.5 million	£1,160 billion	£455 billion
15% opt out	14 million	14 million	£1,180 billion	£480 billion
9% opt out	15 million	14.5 million	£1,200 billion	£495 billion

Scheme members (DB & DC)

- **By 2030** between 6.5 and 8.5 million people could be newly saving in a private sector workplace pension scheme
- **By 2030** between 13 and 14.5 million people in total could be saving in a private sector workplace pension scheme
- Assuming a 15% opt-out rate, 57% of private sector savers could be members of automatic enrolment multi-employer schemes in 2018.

DC scheme members

- **By 2018** the number of people saving in private sector DC workplace pension schemes could range between 12 and 13.5 million
- **By 2030** the number of people saving in private sector DC workplace pension schemes could range between 12.5 and 14.5 million

Total assets (DB & DC)

- **By 2030** the value of assets in private sector workplace pension schemes could range between £1,160 billion and £1,200 billion (2014 earnings terms)

DC assets

- **By 2018** The value of assets in private sector DC workplace pension schemes could range between £340 billion and £345 billion
- **By 2030** The value of assets in private sector DC workplace pension schemes could range between £455 billion and £495 billion (2014 earnings terms) (Chart A and B)

Chart A[1]

The number of people actively saving in private sector DC workplace pension schemes in 2030 could range between 12.5 and 14.5 million depending on opt-out rates

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Number of active scheme members in DC workplace pension schemes by year under different scenarios of opt-outs

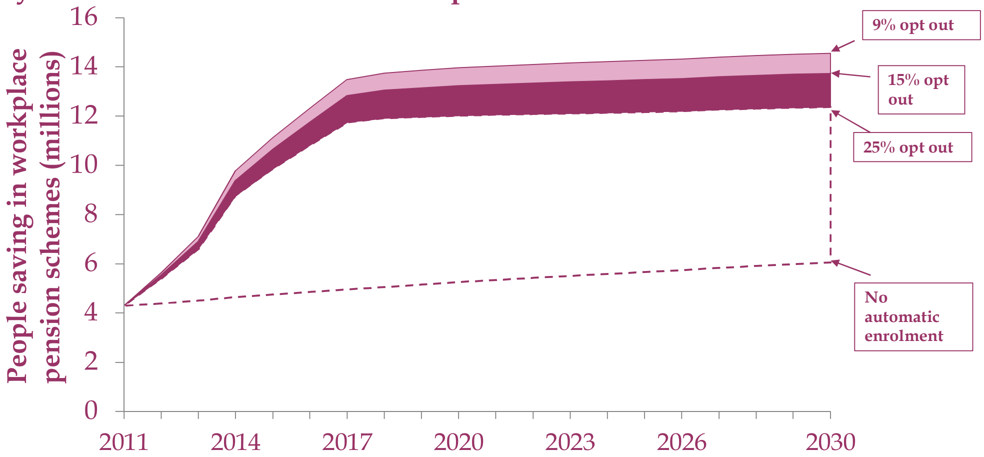

Chart B[2]

The value of assets in private sector DC workplace pension schemes in 2030 could range between £455bn and £495bn depending on opt-out rates

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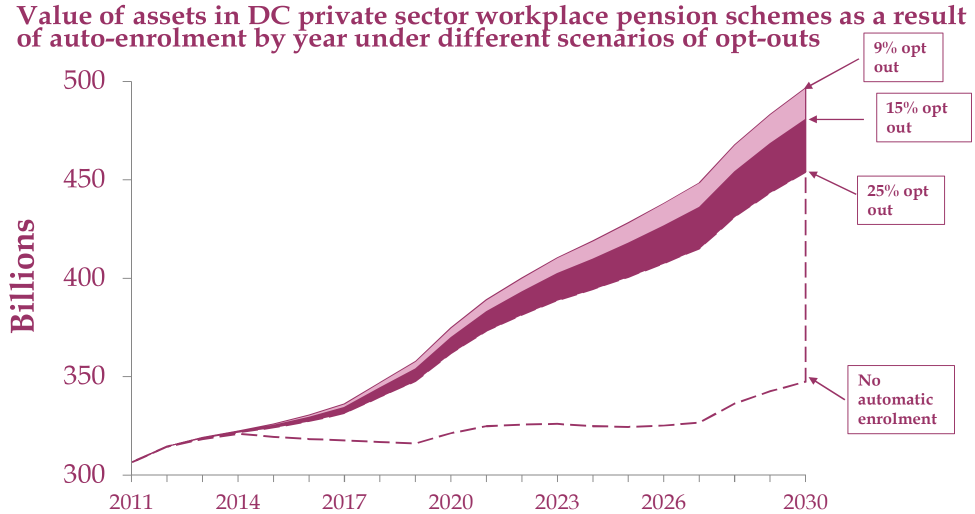
Value of assets in DC private sector workplace pension schemes as a result of auto-enrolment by year under different scenarios of opt-outs



[1] PPI Aggregate Model
[2] PPI Aggregate Model

Employer response

This report uses scenario analysis to explore how different employer responses to automatic enrolment could affect the number of people saving into workplace pension schemes and the total value of private sector workplace pension assets. The following scenarios are explored:

- **The "minimum contributions" scenario –** a scenario which explores the impact of levelling down by all employers on behalf of all workers
- **The "existing trends" scenario –** a scenario which uses emerging data on the existing trends in employer behaviour to explore the impact of current behaviour or expectations continuing throughout the automatic enrolment process and in the future
- **The "maintaining current provision" scenario** - a scenario which explores the impact of maintaining current provision and contribution levels for the workers of all employers with existing provision

The analysis indicates that, assuming a wide range of employer responses to automatic enrolment and an average employee opt-out rate of 15%, the value of assets in DC private sector workplace pension schemes in 2030 could range between £450 billion and £505 billion (2014 earnings terms) (Table B, Chart C)

Table B: Effect on value of assets in private sector workplace pension schemes in 2030 based on a reasonable range of employer responses to automatic enrolment and an average employee opt-out rate of 15% (2014 earnings terms)

Scenario	**Private sector workplace pension scheme assets (DB & DC)**	**Private sector DC workplace pension scheme assets**
Minimum contributions	£1,160 billion	£450 billion
Existing trends	£1,180 billion	£480 billion
Maintain current provision	£1,210 billion	£505 billion

Chart C[3]

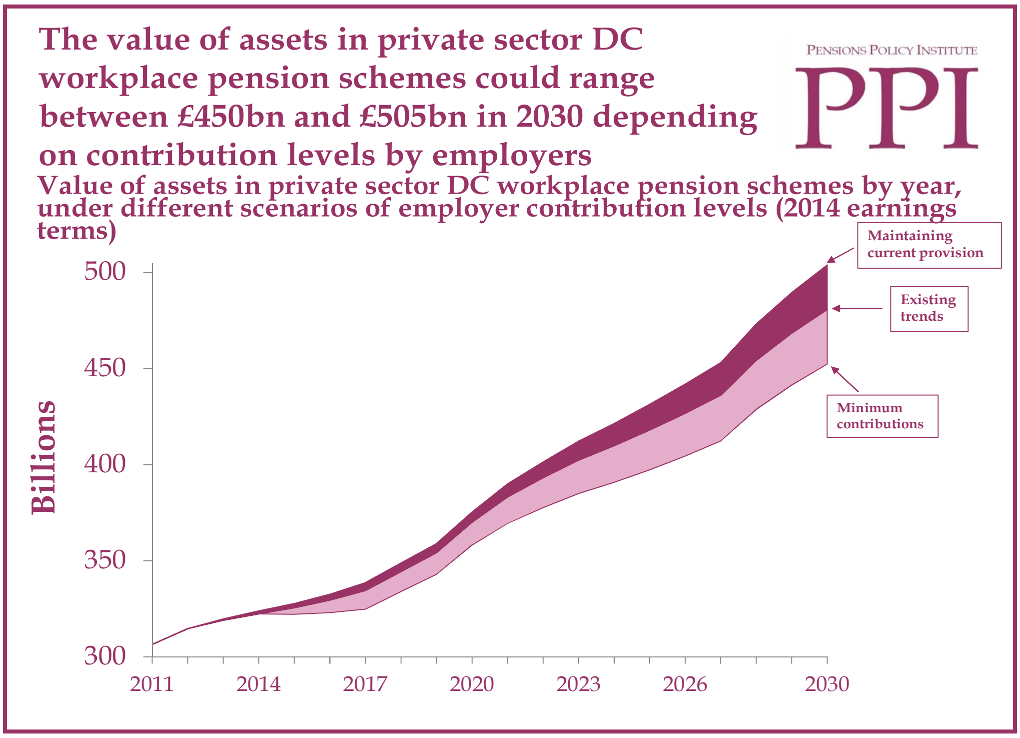


Chart C shows a narrow range of potential outcomes from the employer response scenarios in 2030, of around £55 billion. This is because all of the scenarios assume that a large proportion of those automatically enrolled (around two thirds of working population in 2030) receive minimum required contributions from their employer. This is line with the current behaviour of employers automatically enrolling, and expectations of those who have not yet automatically enrolled and includes workers who become automatically enrolled as a result of starting new jobs.

Therefore, the range above explores what the impact of a range of scenarios could be on employees of those employers who had existing provision prior to automatic enrolment. The scenarios illustrate what could happen if these employees receive either minimum required contributions, contributions in line with existing trends in employer behaviour, or are levelled up to the contribution levels employers maintained before automatic enrolment. The range would be wider if different assumptions were made for the entire working population and is also likely to widen over time.

Conclusion

The research found that that the vast majority of new private sector pension savers arising from automatic enrolment are likely to be saving in Defined Contribution (DC) workplace pension schemes. In the future, DC is likely to dominate in the private sector and the value of private sector DC assets could

[3] PPI Aggregate Model

become greater than the total value of private sector workplace DB assets in around 2036.

The number of new savers and the value of private sector pension assets in future will depend to some extent on the decisions that employers and employees make in response to automatic enrolment. Though there is uncertainty about the future, opt-out rates are currently low at between 9-10% on average, and the majority of employers with existing provision are maintaining current contribution rates for existing scheme members.

The decisions made in future by small to medium sized employers and their workers will depend on many factors including employer decisions and engagement, and workers' perceptions regarding pension saving and affordability.

It is clear that many private sector workers will be reaching retirement with DC savings in the future. From April 2015, people will also have more flexibility in terms of accessing their DC savings. This means that both the nature of the pension savings people reach retirement with and the way people take and use this as income in retirement is also likely to look very different in future from how it does today.

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