Raising the bar: A framework for increasing auto-enrolment contributions

November 2023

A WPI Economics report for Phoenix Group

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Which?

Please note that these organisations participated in an advisory capacity, and the report and its recommendations represent the views of WPI Economics and Phoenix.

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About Phoenix Group

Phoenix Group is the UK's largest long-term savings and retirement business with £259 billion of assets under administration. As life expectancy continues to increase and the pension landscape continues to shift, we offer our 12 million customers a broad range of pensions, savings and life insurance products across our family of brands which include Standard Life, SunLife, Phoenix Life and ReAssure. Our vision is to help even more people on their journey to and through retirement, providing the right support at the right time.

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Foreword

Since its introduction just over a decade ago, automatic enrolment has undoubtedly transformed retirement savings in the UK, allowing millions of workers to effortlessly save for their future. The latest available data shows 79% of employees – 22.6 million people – contribute to a workplace pension, an increase from 47% prior to auto-enrolment's inception in 2012. That is a significant achievement.

However, there is also a growing body of research that shows many people are not saving enough for retirement. Modelling from Phoenix Insights, Phoenix Group's longevity think-tank, shows that 2.4 million people – or 40% of Defined Contribution savers – expect at least the Pensions and Lifetime Saving's Association minimum income, but are not on track to achieve it. We need to acknowledge that the current contribution level of 8 per cent is simply insufficient to adequately provide for individuals in retirement.

Contributing more through increasing both employer and employee contributions will make all the difference to ensure people can have a comfortable income in retirement, but of course these are challenging times for both savers and businesses. High inflation, energy costs and a tight labour market are just some of the many headwinds the UK economy faces. So while now is not the time increase automatic enrolment contributions, as we enter the second decade of automatic enrolment contribution, it is important to begin to reflect on how and when contributions might increase to ensure individuals have financial security in retirement.

This report provides some suggestions and solutions as to how policy makers might set about increasing contributions, when the economic conditions are right. If we continue on the current trajectory, the repercussions will be severe, the strain on social support systems and the potential increase in poverty among those in retirement are issues that we can't ignore. Therefore it is imperative we begin the discussion and take decisive action to address the problem of insufficient long-term savings.

The data from this report serves as a reminder that while automatic enrolment has been successful in boosting retirement savings, we must not become complacent. The urgent need to increase contribution levels is evident, and the future implications of inaction are too significant to overlook. By exploring practical solutions and taking steps towards increasing contributions, we can ensure a brighter and more secure retirement for all individuals in the UK.

Andy Curran, CEO, Standard Life, part of Phoenix Group

Executive Summary

Auto-enrolment (AE) has been a huge success, significantly increasing the number of people with pension savings. The next stage of AE policy needs to ensure people save enough to live a decent retirement – and there is growing consensus that increasing default contributions from 8% to 12% is required to achieve this. However, households and businesses face a range of financial pressures at present, and some would argue that it would be better to increase contributions in a more favourable economic climate. This report lays out a framework to help policymakers determine the right time to increase default contributions in AE.

Our framework sets out three sets of 'tests' to support decision making around increasing default AE contributions. We used the following principles to shape the design of our framework:

- **Pick metrics relevant to employer and employee contributions** – ultimately, pensions are a form of remuneration, and form part of an employer's payroll costs. As a result, the most relevant metrics to determine whether contributions should rise relate to (a) pay and earnings and (b) the costs of employment.
- **Choose a small number of metrics** – there should be a limited set of metrics for simplicity. These should reflect a wider set of economic conditions that affect employer and employee capacity to contribute to pension saving.
- **Design a framework that supports an increase** – there is a clear policy need to increase contributions in auto-enrolment. As a result, the system should be designed to help to facilitate an increase at the right time and pace.
- **Provide clarity and certainty for businesses** – as with the National living Wage, employers need to the ability to forward plan to pay for increases, and receive clear communication about when this should happen. The system should be designed with this in mind.

Our proposed framework is summarised in the table below. We recommend that legislation is put in place for a new Statutory Requirement to support long term pensions adequacy, with a review required annually to assess the need to increase contributions against the criteria similar to those in the framework.

Figure 1: Auto-enrolment decision making framework

Area of framework	Description	Tests
Start/go ('starting the journey')	Demonstrates whether contributions should begin to rise from 8% to 12%.	• That these changes are needed to address pension saving adequacy, and AE opt out rates are not above a certain threshold (e.g. 20%). • Real Household Disposable Income per person (RHDIpp) has risen in one of the last two quarters. • Vacancies are between 2% and 3% of total employment.
Pause ('handbrake')	Determines whether increases in contributions should be temporarily paused due to extreme wider conditions.	• RHDIpp has fallen every quarter for a year. • Vacancies are above 3.5% or below 1.5% of total employment.
Wider considerations in increasing contributions rates	A set of metrics that wouldn't prevent/slow rate increases, but that government should address with wider policy measures.	• High overall employment costs, including those driven by e.g. Employer's NICs. • Rising household debt among low-income households. • Increased risk of over saving by those on lower incomes.

Source: WPI Economics analysis

We can apply our tests to historic data to show when our 'start/go' and 'handbrake tests' would have prevented contributions from rising had they been in operation at that time. Reflecting the relative turbulence of recent years, the thresholds on our 'start/go' and 'handbrake tests' would have been breached a number of times over the past 15 years – including during the aftermath of the financial crisis, the Coronavirus pandemic, and indeed the current cost of living crisis. This shows that our framework can provide assurance to Government, employers and other stakeholders that meaningful safeguards are in place against short term costs during particularly challenging times, while also allowing for increases in pension saving needed to improve security for future retirees over the long term, when economic conditions ameliorate.

CHAPTER 1 Introduction

There is a clear need to increase default contributions in auto-enrolment from 8% to 12% to ensure more people have a decent income in retirement.

However, there is understandable reticence to take this step currently, given the range of pressures on workers and businesses.

This report sets out a series of key tests to indicate when the environment has changed sufficiently to precipitate increasing default contribution levels from 8% towards 12%.

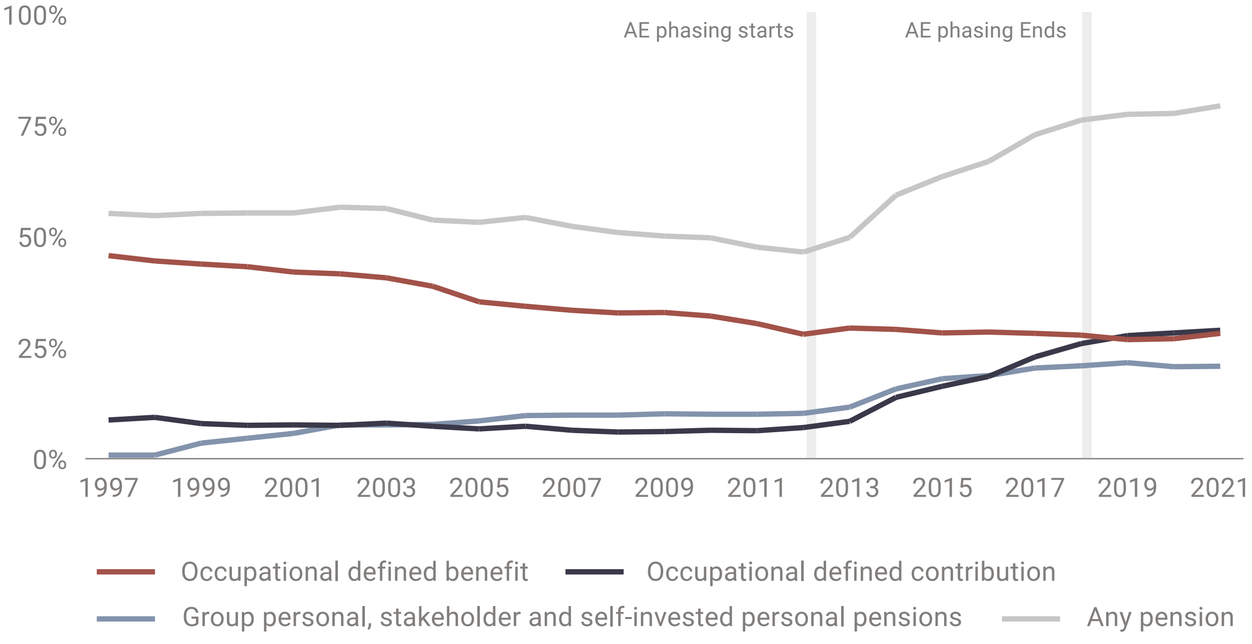
- **Chapter 2** sets out the context for the report, including the case for increasing contributions and the wider pressures on households and businesses.
- **Chapter 3** examines a set of indicators or metrics which show the pressures on employees and employers.
- **Chapter 4** sets out how these metrics are used to construct tests which determine when contributions should rise.
- **Chapter 5** looks at the wider policymaking process for determining when contributions should rise.

The tests for determining when contributions should rise are based on Real Household Disposable Income per person (RHDIpp) and Vacancies data. We argue that, ideally, these tests should be underpinned by a statutory requirement for the Government to consider long term pensions adequacy.

CHAPTER 2 Background

Automatic enrolment (AE) into workplace pensions has been one of the most successful policy interventions in recent decades. AE has resulted in most employees contributing to a Defined Contribution (DC) pension, and has transformed pension savings in the UK as a result. Since its implementation in 2012, AE has helped increase private pension saving participation across the workforce. Today, 22.6 million employees contribute to a workplace pension (see chart)[1]:

Figure 2: Proportion of employees with a workplace pension by type of pension



Source: ONS[2]

In addition to increasing levels of savings overall, AE has had a particularly big impact on groups who were previously less likely to be saving. For example, the proportion of women saving into workplace pensions increased by 50% between 2012 and 2021. In addition, the 22-29 year old demographic doubled their participation in pension saving during the same period.[3]

A case for increasing contributions?

While AE has been successful in boosting participation in pension saving, current contribution levels are unlikely to provide a decent income in retirement for those on median incomes. An increase in contributions is required to meet the shortfall. This is based on looking at two different metrics for adequacy in retirement - relative (replacement rates) and absolute (PLSA Retirement Living Standards).

Analysis by the Pensions Policy Institute (PPI) for the Pensions and Lifetime Savings Association (PLSA) has set out the likely replacement rates in retirement for different groups of earners, assuming different scenarios, and how they relate to the Pensions Commission Replacement Rates.[4]

Figure 3: Impact of lowering age to 18 plus removal of band earnings on Pensions Commission Replacement Rates

	Current Situation	Cumulative impact on Pensions Commision Replacement Rate		Target Replacement Rate
		Lowering age to 18	Plus removal of band earnings	
Twice median female	30%	30%	33%	60%
Twice median male	32%	32%	38%	60%
Median female	52%	52%	55%	67%
Median male	57%	58%	60%	70%
Half median female	92%	92%	97%	80%
Half median male	100%	100%	106%	80%

Key: Red denotes savers are not projected to achieve their PCRR, Green denotes savers are projected to achieve their PCRR after our proposals, Purple denotes savers are expected to exceed their PCRR, Amber denotes savers are within proximity of their PCRR but are not expected to hit it.

Source: PLSA (2022) Time for a new consensus[5]

The analysis shows that the current situation, a default of 8% of earnings between £6,240 and £50,270, is unlikely to result in the target replacement rate for median or higher earnings in retirement set out by the Pensions Commission.

The Government has rightly set out that it will implement the recommendations of the 2017 review of auto-enrolment, by removing the lower earnings limit and lowering the participation age to 18. As the table above shows, these changes will increase the replacement rates of median and higher earners. However, these changes alone will be unlikely to be sufficient to achieve the Pensions Commission target replacement rates for these groups.

The PLSA Retirement Living Standards (RLS)[6] set out three different standards of living in retirement:

- Minimum - £12,800 a year[1]
- Moderate - £23,300 a year
- Comfortable - £37,300 a year

The PLSA have carried out analysis on what this means in terms of building up a DC savings pot. Their analysis sets out that an increase to 12% would increase a female median earners retirement income from £17,177 to £19,825.[7] This again makes clear that current contribution levels are unlikely to provide a decent retirement for those on a median income, and that a 12% contribution would help bring more people closer to a moderate standard of living in retirement.

1. All for single individuals, there are separate standards for households. These figures are inflation adjusted.

How should we increase contributions?

Having established the case for increasing default contributions in auto-enrolment from 8% to 12%, the following section considers the process for achieving this. There are several wider considerations for delivering the increase that are not the focus of this report, but are important questions around implementation. For the purposes of our report, we assume the following:

- **The 2017 review recommendations will be implemented in full** – the Government has rightly committed to abolishing the lower earnings limit and lowering the participation age to 18. We assume that these will have been implemented in full before contributions begin to rise.
- **The increase in contributions will happen gradually over time** - the PLSA for instance have set out that contributions will increase to 10% during the late 2020s, and reach 12% in the early 2030s.[8] The Association of British Insurers (ABI) has called for contributions to reach 12% by 2032.[9] Our assumption is that contributions will rise gradually, likely in no more than one percent per year increments.
- **We will move towards parity in employer and employee contributions** – Our assumption is that the future 12% contributions will be met via a '6 and 6' approach, split between the employer and employee, in comparison to the current split of 5% for the employee and 3% for the employer, although Government could choose a different route. This means that the vast majority of the increase in contributions will be met by the employer, with employees only facing a 1% rise. It is worth noting that standard labour market economics would suggest that whichever side pays the additional contributions, at least some of the incidence is likely to fall on the employee through lower pay than otherwise.
- **There may be measures to address risks of over saving** – to reduce the risk of over-saving for retirement for those on lower incomes, the Government may introduce measures which improve liquidity for people when they need it. This includes the introduction of a savings sidecar where some contributions remain available for emergency access by the individual.[10] The government could also review the level of the earnings trigger, to take more lower earners out of auto-enrolment. Furthermore, Government could introduce the ability to 'opt down' rather than opt out – to save less than the default contribution but remain auto enrolled. While helping to reduce the risk of over-saving, these interventions could also mean the benefits of increasing contributions to 12% on retirement incomes are more limited, and so the Government will need to carefully strike a balance.

All of these will be important considerations for how an increase in auto-enrolment is implemented. The focus of this project, however, is on how the wider economic and financial environment should influence the timing of an increase in contributions.

But is now the right time?

While there is a clear need to increase default contributions within auto-enrolment, there is some reticence currently to take this step given the range of pressures on workers and businesses. For instance:

- Real Household Disposable Income per person fell by 3.1% in 2022.[11]
- Around three quarters of firms faced hiring challenges in July to September 2023[12]
- Nearly half (49%) of adults say that their cost of living had increased compared with a month ago. However, this has fallen from 80% of adults during a similar period one year ago.[13]

There is, however, an urgent imperative to move towards a level of saving which can provide a decent retirement for median earners, and a balance needs to be struck between short term pressures and the long term needs of future retirees. This report sets out a framework which looks to address this balance.

CHAPTER 3 Selecting the metrics

We have carried out our own analysis and worked with our advisory stakeholders – representing businesses, employees, financial charities, as well as the pensions industry - to carefully select the indicators which will make up our framework. In order to support this, we selected a set of principles for determining which indicators to choose.

Principles

The following principles for selecting our indicators and designing our framework were drawn from our own research and thinking, as well as extensive stakeholder engagement, including conversations with our advisory group:

- **Pick metrics relevant to employer and employee contributions** – ultimately, pensions are a form of remuneration, and form part of an employer's payroll costs. As a result, the most relevant metrics to determine whether contributions should rise relate to (a) pay and earnings and (b) the costs of employment.

- **Choose a small number of metrics** – ideally, there should be a limited set of metrics for simplicity. However, these should reflect a wider set of economic conditions that affect employer and employee capacity to contribute to pension saving.

- **Design a framework that supports an increase** – as Chapter [2] has set out, there is a clear policy need to increase contributions in auto-enrolment. As a result, the system should be designed to help to facilitate an increase at the right time and pace.

- **Provide clarity and certainty for businesses** – as with the National living Wage, employers need the ability to forward plan to pay for increases, and clear communication for when this should happen. The system should be designed with this in mind.

With these principles in mind, we considered a range of different options for metrics to help determine when contributions should increase.

Primary indicators

The starting point for deciding whether to increase AE contributions is whether this is the right thing to do from a pension savings perspective. As a result, this is the focus of our primary indicators.

The first test is whether an increase in default contributions is needed to increase levels of pension saving to a point where people can have a decent standard of living in retirement. As discussed in Chapter [2], we think that an increase in contributions is needed, whether we look at this from a relative income perspective (Pensions Commission Replacement Rates) or absolute perspective (PLSA Retirement Living Standards). As a result, we believe this test has been met.

The second element is around AE drop-out rates. Ultimately, if there are very significant AE drop-out rates, then it would not make sense to start increasing contributions, as this would blunt the potential to improve pension savings levels overall. However, our understanding is that we are not seeing individuals opt out of or stop saving into auto-enrolment in unusually large numbers at present, despite the wider cost of living crisis. Data collected by DWP suggests that rates of opt out (those who opt not to be enrolled into a workplace pension) and of those who stop saving (active workplace savers who stop contributing) has fluctuated since early 2020, with some increases in particularly difficult periods.[14] As we will go on to say, saving into a pension is not the optimal outcome for all income groups today, and so some opting out is to be expected. However, it is important to note that opt out rates have remained consistently below those anticipated prior to auto-enrolment's implementation.

Figure 4: Proportion of opt outs, cessations and stopping saving to August 2022

Source: DWP analysis of private pension data

Household or employee indicators

Part of the increase in AE contributions would be met by employees, either directly (employee contributions) or indirectly (potentially lower pay in the short term from rising employer contributions). As a result, employee and household finances will be a key consideration in whether now is the right time for default contributions to rise. We have considered a range of metrics which could potentially act as the household or employee indicators.

Inflation

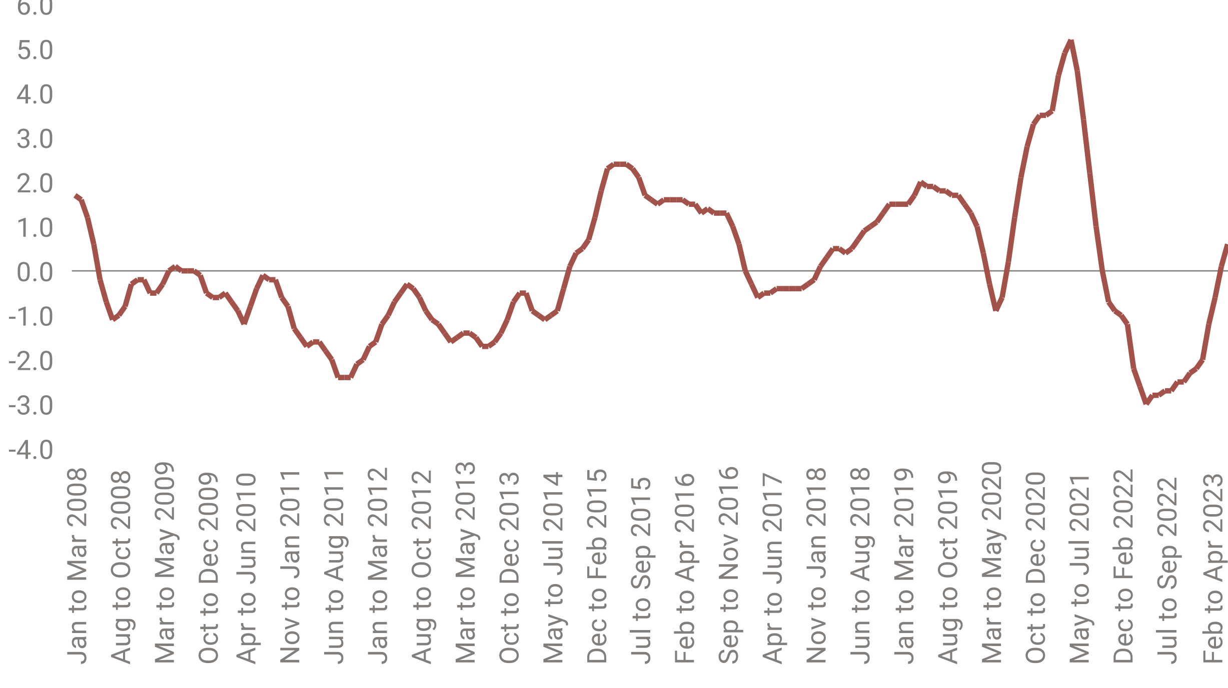
Inflation is currently exceptionally high in the UK at 6.3% in August 2023,[15] and is a major driver of the present cost of living issues. By increasing the cost of everyday goods, inflation increases costs for households, particularly those on lower incomes.[16]

However, inflation ultimately only shows one part of the picture for household finances, missing the crucial impact of changing pay and incomes. As a result, we have not picked inflation as our household indicator.

Real terms pay

Real terms pay growth is a well-recognised metric which takes into account earnings and inflation to give a useful picture of household income. Real terms pay has performed poorly for some time, although it rose by 0.6% on the year in July 2023, which was the biggest increase since August to October 2021 when it rose by 1.0%.[17]

Figure 5: Real annual pay growth (%)



Source: ONS[18]

While real terms pay growth has value as a metric, it also has limitations. Chiefly, it does not take into account taxes or means tested benefits, which are an important part of the financial picture for many households. As a result, we have chosen what we view to be a more complete metric for our analysis, which accounts for these impacts.

Real Household Disposable Income per person (RHDIpp)

We have used RHDIpp[19] as our primary metric of household and employee finances. This considers labour income, taxes and benefits, and non-labour income, and takes into account inflation. It is for these reasons that RHDIpp is considered the main measure of living standards in the UK. This data is sourced from the the Office of National Statistics (ONS) and is forecast by the Office for Budget Responsibility (OBR).

We think RHDIpp as published represents the best available metric for producing the household finances element of our framework, and our analysis for this report is carried out using this metric. As part of our stakeholder engagement, many have highlighted that it would be better to have a metric more focussed on our target group for the analysis – i.e. low to median earners. We therefore recommend that, in taking our framework forward, Government should consider how a metric that more closely targets this group could be produced. In addition, NEST Insight and Phoenix Insights are collaborating on work to explore household finances and pension contributions on a more granular level, which could be utilised for this exercise.

Indicators for business

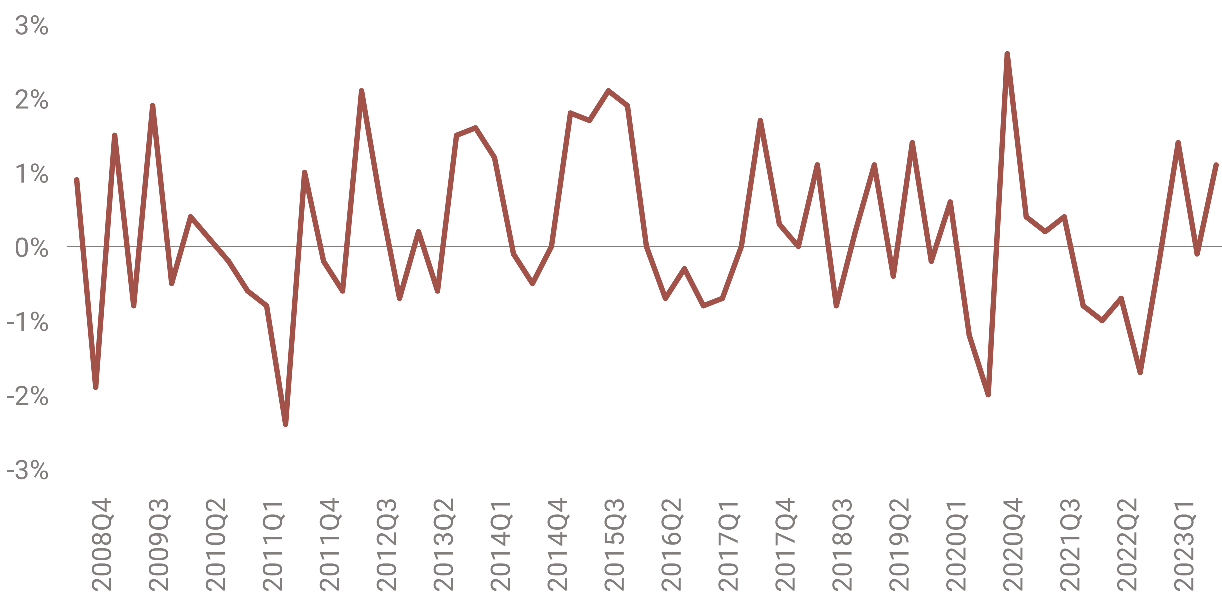
As discussed, much of the direct cost of increasing default pension contributions will be met by employers. Therefore, it is important to consider the broader pressures that employers are currently under, and key indicators that could help to demonstrate a change.

Unemployment

The level of unemployment in an economy acts as a rough proxy for firms' appetite to hire. In this way, it helps to indicate how wider factors are impacting business sentiment, including labour costs and overall profitability. However, it does not consider firm appetite to hire as directly as vacancies, which also has a number of other strengths as an indicator (see below).

In addition, unemployment as a metric does not lend itself well to setting a threshold, with unemployment changing often very gradually over time. This is demonstrated by the chart below.

Figure 6: Unemployment rate (aged 16 and over, seasonally adjusted %)



Source: ONS[20]

Given the practical requirements of our metrics in constructing a framework to determine if auto-enrolment contributions should rise, this feature makes unemployment challenging to use as a metric.

Job vacancies

Job vacancies as a metric directly capture employer appetite to hire (as well as supply of labour), even more accurately than unemployment. Whether firms are advertising for roles demonstrates their overall sentiment towards the economy, in combination with other factors such as labour costs and profitability. While low vacancy rates tend to suggest difficult circumstances for firms and a lack of willingness to hire, the high vacancy rates firms are experiencing currently are an indication of difficulties around hiring driven by labour shortages, which is putting upward pressure on wages. The Vacancies data is sourced from the Office for National Statistics (ONS).

In addition to these strengths, the trends in vacancy rates means the metric lends itself to easily setting a threshold, and so is practically useful for the purposes of building our framework to determine if/when auto-enrolment contributions should rise.

Using the metrics to determine when contributions should rise

Having established our key metrics for households and employers, the following section looks at how these are practically applied to determining if/when contributions should rise, by using them to construct a measurement framework.

CHAPTER 4 Building a framework

Working with our advisory group, internal experts at Phoenix Group, and a range of other stakeholders, we have used these metrics outlined in Chapter 3 to construct a series of tests that help to determine when contributions should rise. We have constructed three layers of tests for our framework:

- **Start/Go tests** – for determining if it is the right time for auto-enrolment contributions to 'begin the journey' of increasing from 8% to 12%.
- **Handbrake tests** – for determining if the process of increasing indicators should be temporarily halted once it has begun.
- **Wider factors** – criteria which should not influence whether contributions rise, but flag to Government that it should consider using other policy levers to address other issues.

The next sections set out our tests for this framework in turn.

Start/Go tests

Our first start/go tests are the primary indicators set out in Chapter 3, which consider whether increasing AE default contributions is needed from a pension savings perspective. These are summarised in the table below.

Table 1: Primary indicators

Area of framework	Description	Tests
Overall pensions savings levels	Are current savings levels insufficient for adequacy?	This demonstrates the need for increasing default contributions in the first place
AE drop out rates	Are people still overwhelmingly contributing to AE pensions? E.g. are opt out rates below 20%	This suggests whether increasing contributions will be effective at increasing pension savings

Source: WPI Economics analysis

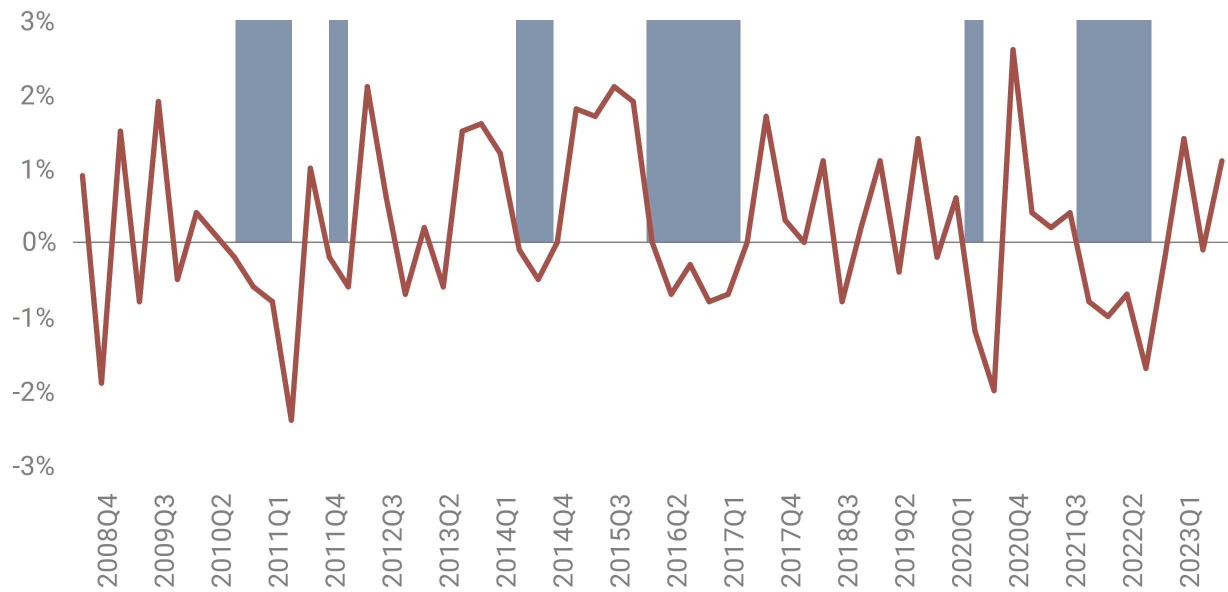
As stated earlier, **we think that these tests are met at present**. Chapter 2 sets out how an increase in contributions is needed to help achieve an adequate income for people in retirement. Furthermore, there is no evidence that the cost-of-living crisis has caused individuals to opt out of their AE pensions.

Household and employee test

As set out in Chapter 3, our analysis has led us to use RHDI Per Capita (RHDIpc) as our metric for whether it is the right time for contributions to begin to rise from a household or employee perspective. To determine whether contributions should begin to rise from 8% to 12%, we have developed a test whereby **contributions will not begin to rise if RHDIpp has fallen in both of the last two quarters**, similar to the way that a recession is measured.

We have applied this test to historical trends data in the chart below. The blue shaded areas indicate where the test would have **blocked** a rise in contributions.

Figure 7: RHDIpp growth (q-o-q) (2 negative quarters in a row shown shaded)



Source: WPI Economics analysis of ONS data

This analysis shows that, if applied historically, this test would have **prevented contributions from starting to rise during six periods of time**. These were:

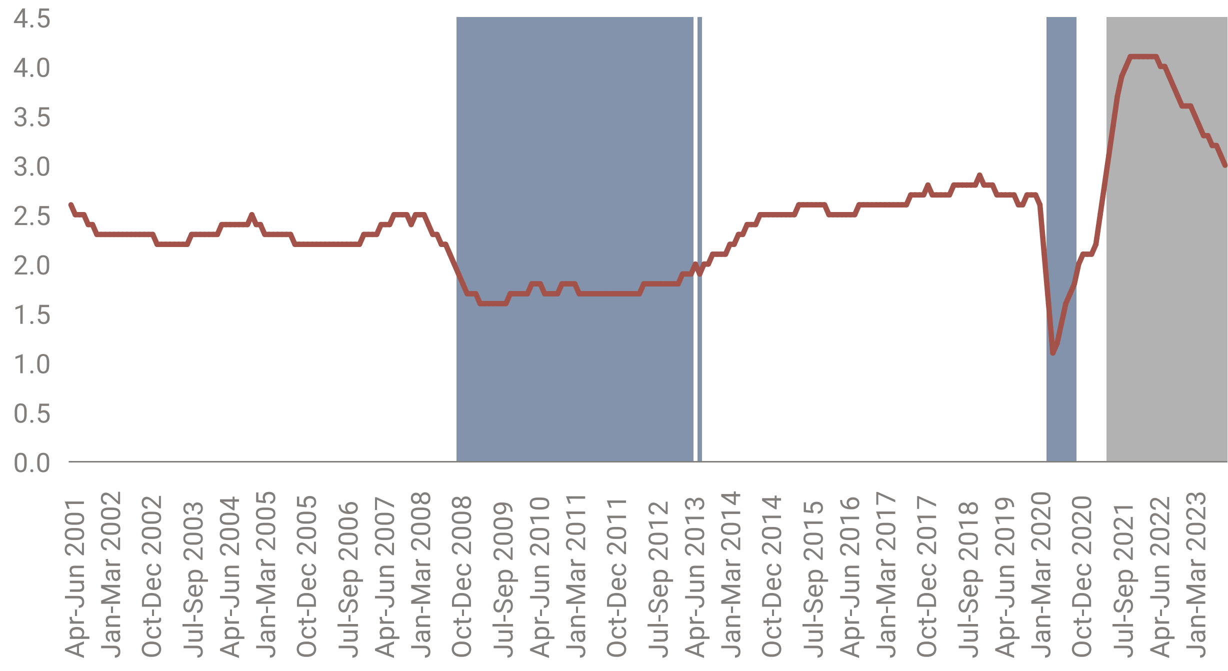
- Twice in the aftermath of the financial crisis (2010 and 2011).
- The period surrounding (before and after) the EU referendum (2016).
- The initial stages of the Coronavirus pandemic (2020).
- The invasion of Ukraine and cost of living crisis (2022).

Since the last quarter of 2022 the RHDIpp measure has returned to growth. As a result, this suggests contributions could in theory begin to rise were this test currently in place.

Employer tests

As with the RHDIpp test, we applied a Vacancies test to historic data. However, we are unable to analyse projections as vacancies are not forecasted by the OBR. The test we have proposed is that **vacancies have to be between 2% and 3% of jobs for default contributions to begin rising**, which is a range that vacancies appear to stay in during relatively normal times. The blue and grey shading in the graph below shows where this test would have stopped contributions from beginning to rise.

Figure 8: Vacancies per 100 employee jobs (>3 and <2 shaded)



Source: WPI Economics analysis of ONS data

According to our vacancies test, contributions would have been prevented from rising during three periods of time.

- An extended period from the Global Financial Crisis (GFC) to mid-2013 (below 2%)
- The initial stages of the Coronavirus pandemic (2020) (below 2%)
- The invasion of Ukraine and cost of living crisis (2022-23) (above 3%)

While vacancies have not yet fallen below the 3% mark, they are falling sharply from their peak of over 4%. As a result, we expect that the test to allow contributions to rise is likely to be met in the coming months.

Handbrake tests

The previous section sets out the criteria which determine when default contributions could begin to rise. Once the process of increasing contributions has begun, extreme circumstances could mean that the process should be stopped. This could be delivered through a handbrake mechanism, where meeting certain tests would temporarily pause a further increase in contributions.

We suggest that more stringent thresholds for a pause should apply than for the stop/go metrics, for two key reasons:

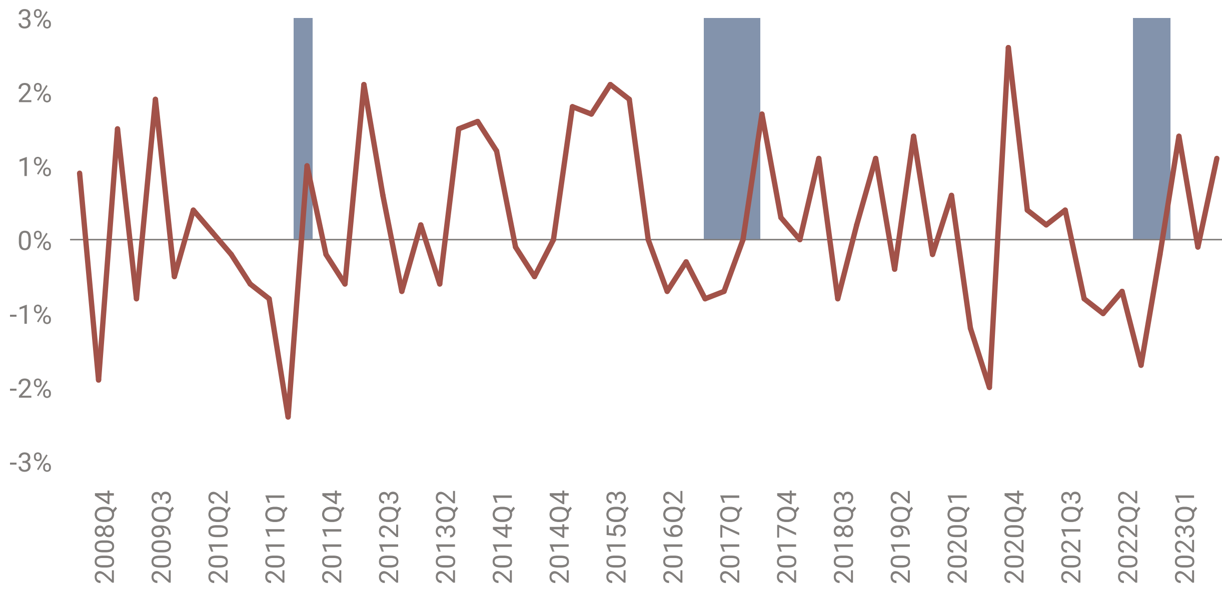
- Frequent stop/starting would (a) cause uncertainty for business and (b) cause a significant delay to needed pension saving.
- AE's initial rollout continued despite very difficult wider circumstances, as shown in the previous section.

As a result, we propose using the same indicators to construct stretch tests which could temporarily pause contributions, but with much higher thresholds. Both handbrakes could apply to both employee and employer contributions, or each handbrake could apply to its respective set of contributions.

Household/employee handbrake

For our household handbrake test, we propose that **RHDIpp falling every quarter for a year could pause an increase in contributions**. The blue shading in the graph below shows where this handbrake would have been activated historically.

Figure 9: Figure 9: RHDIpp growth (q-o-q) (4 negative quarters in a row shown shaded)



Source: WPI Economics analysis of ONS data

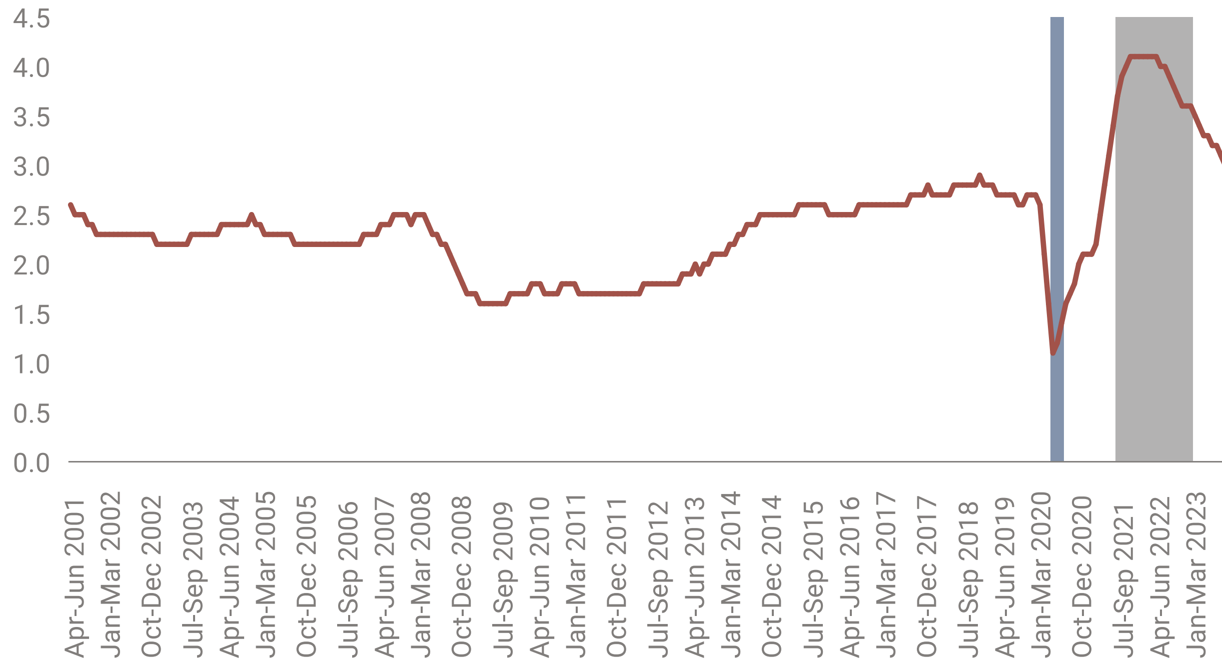
This shows that the handbrake would have been pulled three times:

- In the aftermath of the financial crisis (2011).
- The period after the EU referendum (2016).
- The invasion of Ukraine and cost of living crisis (2022).

Vacancies handbrake

For our employer handbrake, we propose a test of the vacancy rate being above 3.5% or below 1.5%. The blue and grey shading in the graph below shows where this handbrake would have been activated historically.

Figure 10: Vacancies per 100 employee jobs (>3.5 and <1.5 shaded)



Source: WPI Economics analysis of ONS data

This shows that the handbrake is pulled twice:

- The initial stages of the Coronavirus pandemic (2020)
- The invasion of Ukraine and cost of living crisis (2022-23)

While we have set high thresholds for the handbrakes, this analysis shows they are meaningful tests that can provide assurance to employers, households, and Government that increases in contributions can be paused if circumstances indicate that the economy is under significant pressure.

Other factors to consider

We have set out our core tests and indicators that should determine when the right time is for default contributions to rise. In addition to these, there are a range of other factors Government should take into account when making decisions around pensions savings and surrounding policy. While these factors should not block contributions from rising, there are other policy levers Government can use to address the issues that they present.

Some of these key factors are as follows:

- **Overall costs of labour** – for employers, pension contributions are one element of the overall cost of employment, alongside wages and policy driven costs such as Employer's National Insurance Contributions (NICs). In increasing employer pension contributions, Government should have an eye to the broader cost of employment and look to manage these, such as by not further increasing Employer's NICs. Allowing the costs of employment to rise too much can cause harm to businesses and the economy, by making hiring difficult and limiting growth.

- **Risks of over-saving among lower earners** – based on the value of the current state pension being maintained, some lower earners will possibly be oversaving in comparison to their target replacement rates in retirement, assuming they remain opted into AE. There are a number of ways that this could be addressed, such as greater emergency access to pensions savings, increasing the earnings trigger, or allowing savers to reduce contributions without opting out of the system entirely (opt down rather than opt out). Government should assess whether to implement these or other interventions to address the risks of oversaving.
- **Levels of household debt** – rising levels of household debt can be an indicator that budgets are tight, and people are struggling to balance ingoing and outgoings. The government should ensure that any increase in problem debt while contributions are rising is mitigated. There are a range of levers that Government can pull to help address increasing debt, including through increases in means tested benefits or funding debt advice.

There will be a range of other indicators that also fit into these 'other factors', and Government should work with stakeholders to identify these.

Building the framework into a process

Having established a framework of tests for determining if contributions should rise, it is important to consider the decision-making process that sits around these, and who has responsibility for putting the framework into practice.

CHAPTER 5 Developing a process

Having established this set of tests, there is a need to determine the process that sits around how they are used in policy decision making. The starting point for any process is Government legislation to increase contributions in AE from 8% to 12% over time, and making provision for analysis to be undertaken along the lines of the criteria we have set out.

Beyond this, a range of other decisions need to be taken about how the process should work. These include:

- How often is analysis undertaken and over what period is the remit set?
- Who does the analysis, and what is their legal basis?
- Who are they reporting to?
- To what extent is this binding?

This chapter considers each of these questions in turn. In designing this system, we have considered how the decision to increase contributions has worked in Australia, which is summarised in the box below:

Case study: Increasing Superannuation contributions in Australia

Superannuation (or Super for short) is the main retirement savings system in Australia, whereby Australians save money into an investment fund throughout their life to fund an income in retirement. A key element of this system is the Superannuation Guarantee (SG) which is the minimum contribution made by employers to an employee's Super. The Federal Government set out a roadmap for how contributions would rise from 9.5% to 12% over time, by 2025. This is set out below:

- Year starting 1 July 2020: 9.5%
- Year starting 1 July 2021: 10%
- Year starting 1 July 2022: 10.5%
- Year starting 1 July 2023: 11%
- Year starting 1 July 2024: 11.5%
- Year starting on or after 1 July 2025: 12%

This was the first set of increases to the SG since 2014, with previous planned increases being deferred numerous times by the Liberal Government of the time. Decisions about whether to increase the SG are highly politicised, with opposition to increasing contributions coming on the basis of their impact on business costs and wages. This is in contrast to the consensus-based approach which has been characteristic of auto-enrolment in the UK.

Source: Maddocks and The Guardian[21]

Our proposed process for determining if contributions should rise is set out below. This represents an overview of how the framework will be used in practice, and would be built upon as part of the legislation and policy making process.

Timelines for evaluation

As a starting point, the government should set out a broad overall timeline for increasing contributions, subject to the Start/Go and handbrake tests. The ABI and PLSA have **set out what they believe to be a broad timeline for increasing contributions**, running from the late 2020s into the early 2030s. The Government of the day will ultimately take a view on this and legislate the timeline into effect. The timeline will need to take into account various issues around sequencing, including in which order employee and employer contributions should rise, as well as maximum frequency of increases.

Once the Government has legislated that contributions will increase, **the first analysis will need to be carried out to determine if the Start/Go tests have all been met**. If all tests are met, contributions can then begin the journey of increasing from 8% to 12%.

Once the process has begun, a**nnual analysis of the handbrake tests should be carried out to see if any of them have been triggered**, or are likely to be triggered during the timeline set by Government. Furthermore, the **annual analysis should consider the wider factors affecting considerations around pension saving**, such as employment costs and household debt.

Statutory duty

There are a range of potential models for carrying out analysis of public policy decisions. In most cases, policy advice comes to Ministers from an independent civil service based within Government departments.

We have considered the benefits of the analysis being carried out by an independent body with its own secretariat, separate from Government. This could be similar to the model of the Low Pay Commission (LPC) which advises Government on increases in the minimum wage while taking into account wider economic indicators. However, based on discussion with our advisory group and wider stakeholders, we have opted to reject this approach. This is primarily because the time limited nature of increasing AE contributions means that it is unlikely that the case for an independent body would be accepted by Government.

As a result, **we recommend that the analysis is carried out by Government itself**. There remains a need for current and future Governments to be held to account for increasing AE contributions, balancing short term costs and long term needs along the lines set out by the framework. In place of an independent body, we recommend that legislation is put in place for **a new Statutory Requirement to support long term pensions adequacy**, with a review required annually to assess the need to increase contributions against criteria aligned to those in the framework. As part of this analysis, Government should also engage with representatives from employers, unions, personal finance charities and other key groups with an interest in pension contributions.

We recommend that the findings of this annual review should be shared **publicly and communicated widely.** Government should promote the review through an annual campaign, staffed with private sector experts who will design and deliver a communications strategy. As we have set out, clear and consistent communication with firms on increasing contributions is critical. Communicating with business on the clear timeline for increases in contributions will allow employers to best prepare for rises from a business planning perspective.

CHAPTER 6 Conclusion

Increasing default contributions to auto enrolled pensions is critical for ensuring that more people can live a decent retirement. Looking forward, present rates of contribution suggest a bleak picture for many future retirees, and so there is a clear imperative to act by increasing default contributions.

This report has set out a framework which could guide decisions on the timing of these increases, considering the needs of households, businesses and the wider economy today. It is based on economic analysis of the key indicators which affect employee and employer ability to contribute to pension saving, and extensive engagement with stakeholders across employers, charities, unions and others. As the analysis in this report shows, the tests we have constructed represent a meaningful safeguard against short-term costs arising during particularly challenging economic times.

All stakeholders in the pensions system should work together to ensure broad adoption and recognition of the framework, so that it can underpin a consensus approach to building better retirement outcomes in the decades to come.

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