Pensions review phase 2 must build on auto-enrolment's success

A decade after the deadline for the first SME employees to automatically enrol in a pension scheme, it's time to refocus on pension savers' outcomes.

On 1 April 2015, all businesses employing 50 or more people had to enrol employees into a workplace pension scheme unless they opted out. This was the second stage of the automatic enrolment (AE) revolution, which officially started in October when companies with at least 250 workers had to start complying.

This second wave of AE was significant because it started enrolling workers at small and medium-sized enterprises (SMEs). It's easy to forget that SMEs employ more than 60% of UK workers and, without SMEs, AE wouldn't have succeeded. By April 2017, employers with fewer than 30 employees had signed up.

At first glance, AE has been an undisputed success by getting workers into the savings habit and providing a pension for all employees aged 22 and over. Since 2012, more than 11 million people have been newly enrolled into a workplace pension, and private pension participation has more than doubled from 42% in 2012 to 86% in 2023.

The insight behind AE was that humans tend towards inertia – leaving things as they are instead of making a change. That meant millions of people weren't members of their employers' pension scheme because they simply hadn't got round to it.

By making employers enrol their workers in a pension scheme, AE bypassed our inertia bias and turned it to an advantage. Once people were paying in to a pension, they were highly unlikely to leave. This has proved to be truer than the government expected – even during the cost of living crisis.

More of us are saving but we're not saving enough

But though AE got more of us saving, many of us aren't saving enough and this is partly because of AE: most workers are enrolled on the minimum 8% contribution and many assume this must be sufficient.

However, by the government's own calculations, more than 12 million people are setting aside too little money for a comfortable retirement. Inertia strikes again.

As far back as 2017, the Department for Work and Pensions spotted changes to AE that could help solve this problem. The ideas were: reducing the age for AE to 18 from 22, giving a saver four more years of contributions; and scrapping the lower band of qualifying earnings so that contributions apply to every pound of salary.??

But successive governments – and this is the fourth since the review was published – have sidelined these measures. So, it was encouraging when the new Labour government set up a review of the UK pension market soon after taking office.

The first phase of the review focused on investments and how pension funds could support economic growth. The government is due to publish the results of phase 1 soon.

The second phase was to look at retirement adequacy, including auto-enrolment. But Chancellor Rachel Reeves put phase 2 on hold in December, reportedly because she didn't want to impose an extra burden on businesses after increasing employers' national insurance (NI) contributions at the October budget.

Hopes are rekindled for phase 2 of the review

Torsten Bell, who became Pensions Minister in January, revived hopes for the second phase at the Pensions and Lifetime Savings Association (PLSA) conference in March. Bell said getting the best value for savers came before a discussion about savings levels – and that phase 2 would naturally follow phase 1.

If this signals an imminent start to phase 2, then we welcome it – not least because a close look at outcomes for pension savers is more pressing than ever. Here are some issues for the next phase to consider:

- The pensions industry has been calling for measures beyond the recommendations of the 2017 review – including a proposal for minimum AE contributions to rise gradually from 8% to 12% (the government likes to look at the Australian pension market for inspiration and minimum contributions down under are now 12%)
- The cost of living crisis has left pensioners and pension savers poorer. The PLSA's most recent retirement living standards estimate that a couple living outside London would need £43,100 for a moderate retirement – up 31% from the year before. We expect updated figures from the PLSA in early summer
- Women on average have much lower pensions than men. For example, last year the average defined benefit pension lump sum we paid to a female member was only 55% of that paid to a male member
- We need to think now about the challenges facing younger pension savers – insecure work, squeezed budgets and reduced opportunities for property ownership are just a few of their barriers to a comfortable retirement

Employers could act now to boost saving

Here are a couple of things employers could do even before the phase 2 review:

- Introduce salary sacrifice for pension contributions, where they haven't already done so. This could help with the increase in NI and, if the employer passes on NI savings, it will boost pension savings
- Put in place a "save more tomorrow" arrangement, where workers agree today to give up some of their future salary increases for a bigger employer pension contribution (with the potential benefit of reduced wage inflation)

As the UK's biggest private sector pensions administrator, we're thinking about these things a lot. We're upgrading our technology and training our people to give savers and retired members the support they need and expect. And we want our new member app to help people engage with their pensions as well as finding out the basics.

But in the end we all rely on signals from the government. AE has succeeded beyond expectations in getting people saving for retirement. Let's apply the same spirit to help employees – at the biggest companies and the smallest SMEs – save enough for the later life they expect.

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