PENSIONS AND LIFETIME SAVINGS ASSOCIATION

# UNCOVERING THE PROFILE OF LOW EARNERS IN THE UK AND THE POTENTIAL FOR PENSION SAVING THROUGH AUTO ENROLMENT

Research Report | August 2023

# UNCOVERING THE PROFILE OF LOW EARNERS IN THE UK AND THE POTENTIAL FOR PENSION SAVING THROUGH AUTO-ENROLMENT

## INTRODUCTION

In the realm of pensions policy, there exists a significant knowledge gap when it comes to understanding and addressing the needs of low earners in the United Kingdom. While various segments of the population have been subject to extensive research, individuals with low incomes who are still engaged in employment have remained relatively understudied. This group represents a complex demographic, comprising diverse subgroups, who may be earning modest incomes for varying reasons and circumstances.

The PLSA commissioned the Pensions Policy Institute (PPI) to look into the issue of *low earners* with the aim of investigating whether auto-enrolment could provide a way of improving their retirement outcomes. Our research is focused on the low earners *who earn below £10,000* which means that they are not currently automatically enrolled into employers' workplace pension schemes. This affects around one in nine employees, equivalent to 3.17 million employees in 2022, who meet the age criteria for automatic enrolment but earn less than the trigger income of £10,000 a year.

We recognise that issues around low earnings impact a broader part of the working population which would include workers earning in excess of £10,000 but who are not the subject of focus of this research.

The research reveals the profiles of low earners who earn less than £10,000 and explores the potential merits of integrating this population into pension saving through the mechanism of auto-enrolment. Key questions arise concerning the characteristics of these low earners and the reasons behind their low earnings. The diversity of circumstances within this population means that low earnings might serve as the primary means of income for some individuals and households, while others may rely on supplementary sources like savings or financial assistance from other members of their household. Moreover, low earnings can be either transient, with potential for improvement in the future, while others may have long histories or futures of low earnings. Some members of this group require encouragement and support to start saving for their retirement and achieve better retirement outcomes, while others might be better to prioritise protecting their current income to escape poverty in the present. All such factors need to be considered in the design of policies aimed at improving retirement outcomes.

## BACKGROUND

The introduction of pension automatic enrolment in the UK has been a significant step in addressing the challenge of pension participation. Its primary goal was to encourage more individuals to save for retirement and reduce sole reliance on the State Pension system. Under the policy, all workers over the age of 22 earning more than the £10,000 per year threshold[1] in a single job (the "10k trigger"), are automatically enrolled into a workplace pension, where the employer was required to pay 3%, and the worker 5%, of a band of earnings between £6,240 and £50,270 per year (2023/24).

In 2017, the Auto-Enrolment (AE) Review[2] was conducted to assess the effectiveness of the policy and provide recommendations for further enhancements. The review recognised the success of auto-enrolment in boosting pension participation rates, with millions of workers now enrolled in workplace pensions. It highlighted the positive outcomes in terms of increased pension coverage and emphasised the policy's importance for future pension provision.

The AE 2017 review also addressed concerns about pension adequacy. It acknowledged that the minimum contribution rates specified by the policy were insufficient to ensure individuals have a satisfactory retirement income. Consequently, the review recommended gradually increasing the minimum contribution rates over time to enable workers to build more substantial retirement savings. This measure aimed to address potential shortfalls in pension income and enhance pension adequacy for individuals. Importantly, the review recommended removing the lower earnings band requirement so that pension saving takes place from the first pound of earnings.

The AE 2017 review also proposed a recommendation to lower the minimum age for auto-enrolment from 22 to 18. It recognised that commencing pension savings earlier in one's working life can have a positive impact on pension adequacy during later years. By reducing the age threshold, young workers would establish an early and consistent savings behaviour as well as have more time to save and accumulate retirement funds, leading to improved pension outcomes and greater adequacy in the long run.

The AE 2017 review and subsequent adjustments to the policy, including those forthcoming to reduce the age at which people begin to save and remove the lower earnings band, demonstrate a commitment to continually enhance pension participation and adequacy in the UK. The Pensions and Lifetime Savings Association (PLSA) has supported these changes and further proposes a gradual increase in auto-enrolment contributions from 8% to 12% over the next decade.

Our proposal suggests a 50/50 split between employers and employees, with no immediate changes until the current cost of living crisis has passed; both measures are examples of ways in which we propose to reduce any affordability risks of increased saving on low earners.

[1] The AE earnings trigger is reviewed within each tax year, see DWP, (2023) Review of the Automatic Enrolment Earnings Trigger and Qualifying Earnings Band for 2023/24: Supporting Analysis

[2] DWP, (2017) Automatic Enrolment Review 2017: Maintaining the Momentum

The PLSA presented these proposals in a consultation document titled "Five Steps to Better Pensions" in October 2022. We are currently reviewing the responses and conducting additional analysis to gain a deeper understanding of the issues, with the aim of improving pension adequacy. This research report forms part of the evidential basis we have built to assess the impact of our proposals.

## RESEARCH FINDINGS

### Identification of key low earner profiles

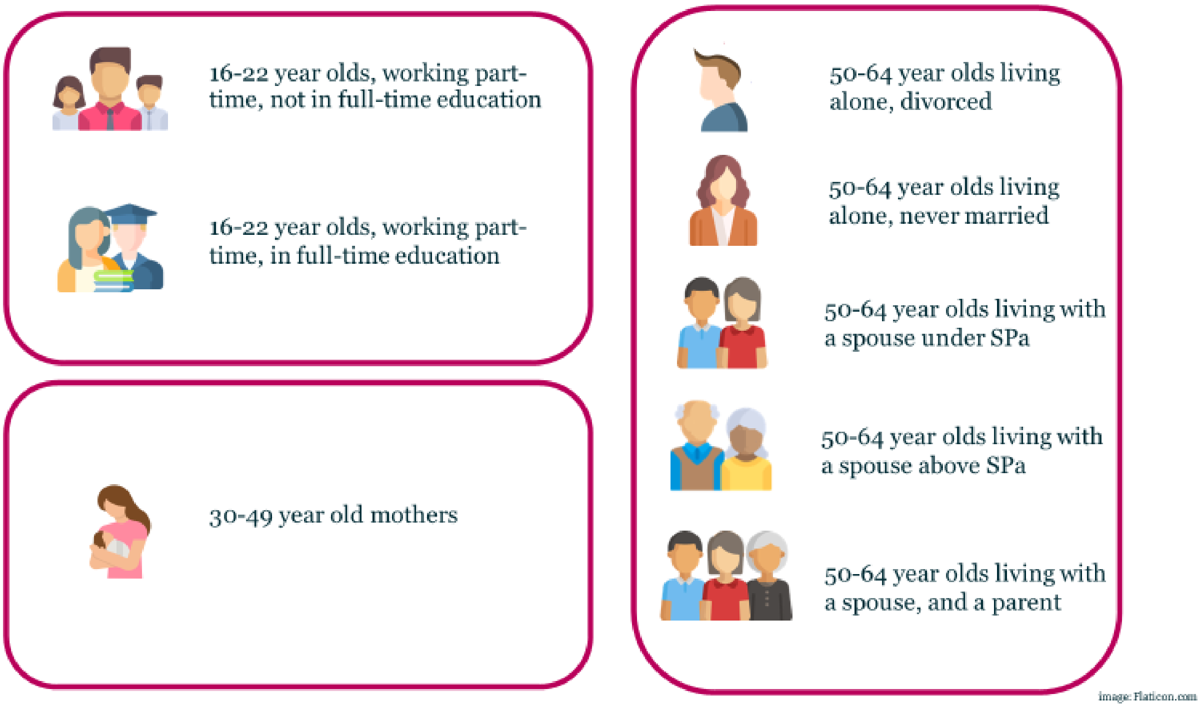
PPI analysed the detailed data within the Understanding Society datasets to investigate if subgroups of low earners could be identified. The datasets provided comprehensive information on the demographics and household characteristics of the low earner population and key subgroups were identified by comparing the size of the characteristic in the low earner population with the wider earning population to see which variables were over-represented.

The analysis demonstrated that among low earners younger people are the most over-represented demographic group, but there are also a significant number of people at the upper pre-retirement age, and an over-representation of females.

The analysis produced segments that represented key subgroups:

- young people aged 16-22 working part-time, who may or may not be studying
- low earning 30-49 year old mothers and
- people aged 50-64 across a range of household circumstances.

**FIGURE 1: ANALYSIS OF KEY LOW EARNING SUBGROUPS**



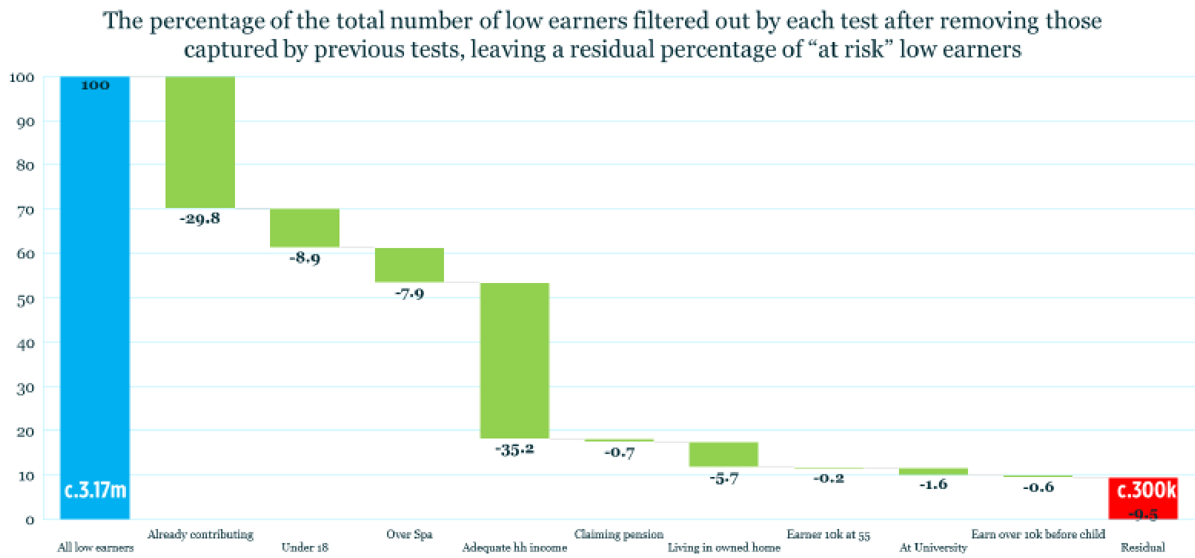
## Assessment of the impact of the removal of the £10,000 trigger on low earners

The research went on to explore the potential impact of eliminating the £10,000 earnings trigger on low earners. We explored the question: would the removal of the trigger potentially cause harm by squeezing their current income and living standards through enrolling them and making pension contributions, or could mitigating factors be identified? In order to arrive at a figure for the number of low earners who could be "at risk" our starting point was the total population of those earning less than £10,000 from which we then removed other groups for whom there was a reasonable mitigating factor removing the risk of detriment. For instance, if they were already contributing to a pension, they are already used to making financial contributions into a pension. People on a low income who reside in households with a more substantial household income would likely be safeguarded from any detrimental effects of the policy change due to the higher income of other household members.

Figure 2 shows the impact of removing each group of low earners judged not likely to be at risk from the total population of low earners. From the total population of low earners (denoted by the blue column) each individual test (the green columns) was applied.

The first test removed the 30% of low earners who are already contributing to a pension despite earning less than £10,000 and are therefore unaffected by the policy change to do this automatically. The next two tests removed those who are outside of the traditional working age; 9% representing those under the age of 18 and an additional 8% were excluded as they were beyond the State Pension (automatic enrolment would not apply to them due to their ages).

**FIGURE 2: ANALYSIS OF "AT RISK" LOW EARNERS**




Source: PPI 2023

The next tests were then focused on people who would be subject to automatic enrolment but are considered to be at low risk of detriment from the policy change.

Among the subsequent tests it is noted that the largest number of those deemed to be not "at risk" came from the "households with an adequate income" category, where the individual on low earnings is probably not dependent on their low earnings alone.

Multiple evaluations were conducted to determine the threshold for an adequate household income. Around a third of low earners were judged to be in this situation.

Applying all tests[3] resulted in a residual 9.48% of the low earner population who could be at risk of detriment from the removal of the £10,000 trigger. This equates to an estimated 300,000 people for whom automatic enrolment could be considered to present a higher risk of financial detriment. Some may have other mitigating factors outside of the key tests we have applied that lower their risk.

Analysis of the characteristics of the residual "at risk" population was conducted to establish whether there was a clear way to identify those at risk. The research suggests that there is no single profile that can be drawn from the data. However, the analysis found that this group of people were more likely to be paid by the hour compared to either the whole low earner population or the wider working population. This may present a way to mitigate the risk e.g. policy makers or employers could be able to identify those who may need additional consideration if the £10k trigger is to be changed.

**Assessment of the potential benefit for low earners**

PPI's individual model[4] was applied to the subgroups identified in the analysis in order to model their retirement outcomes and assess whether they would gain a benefit from enrolment. The analysis suggested that all scenarios tested resulted in significant increases in retirement income for the low earners of between 7-13% (see table 1).

[3] Including five more: already drawing a pension income; living in an owned home; people having earned over £10,000 before age 55; people currently in work but enrolled at university; people who earned over £10,000 before having a child.

[4] The PPI's Individual Model uses the OBR's Economic Fiscal Outlook to model the development of the pension system into the future, and model different individuals under different policy situations to be able to model the effects in each case.

**Table 1: Modelled retirement incomes for model individuals under policy scenarios with and without the de minimis rule and lower earnings limit**

| | Net income at retirement under Current policy situation (£) | Net income at retirement with De minimis rule and LEL removed (£) | % improvement |
|---|---|---|---|
| **Students** | | | |
| **Woman** | 19,280 | 20,620 | **7.0** |
| **Man** | 20,550 | 21,940 | **6.8** |
| **Parents** | | | |
| **Household** | 31,790* | 34,930* | **9.9** |
| **Mother** | 13,110 | 14,760 | **12.6** |
| **Father** | 18,680 | 20,180 | **8.0** |
| **Semi-retirees** | | | |
| **Household** | 34,260** | 36,740** | **7.2** |
| **Woman** | 16,490 | 17,620 | **6.9** |
| **Man** | 17,930 | 19,390 | **8.1** |

Source: PPI 2023

**Individual incomes do not sum exactly to household income because of some small household benefits that do not go to either individual.*

***individual incomes for the semi-retirees are given for when each one reaches SPa, but the total household income is given for when the woman, who is four years younger, reaches SPa. By this point the man's retirement income is slightly lower as he has drawn down some of his funds.*

## INITIAL POLICY IMPLICATIONS AND QUESTIONS RAISED BY THIS RESEARCH

Our study, which examined the potential risks of financial disadvantages prompted by saving for retirement when a low earner, suggests that this change may have a negative impact on a relatively small but still considerable segment of the population, specifically 300,000 individuals out of a total low-earning working population of 3.17 million.

If it were decided to bring this group within automatic enrolment there are a number of approaches that could be used to reduce the risk of over-saving and all would need to be carefully considered and tested before a change in the regime. The potential policy measures include but are not limited to:

- keeping or lowering rather than fully removing the £10k trigger for some low earners
- creating other short- or longer-term savings options, such as emergency or 'rainy day' savings
- providing family or carer top ups through the welfare regime
- implementing temporary opt-down, rather than only opt-out options for contributions
- other measures specifically tailored to hourly-paid workers who might also benefit from wider financial resilience measures such as through automatic saving.

Further research on low earners, the needs of under pensioned workers more generally, and the intersectionality of different characteristics are needed before a final decision could be made on whether to amend the current £10,000 earnings threshold.

The findings of the research also suggest that eliminating the Automatic Enrolment trigger for individuals earning less than £10,000 could have a significant positive impact of around 7-13% for the retirement outcomes for the majority (90%) of individuals assessed (outlined in table 1).

Importantly, we should also remember that increases to automatic enrolment contribution levels, as proposed by the PLSA and many others in the sector, would also substantially benefit the vast majority of those in the workforce who earn more than £10,000 per year in relation to their retirement outcomes (as outlined in our research report last year[5]).

[5] PLSA (2022) A report supplement to five steps to better pensions: time for a new consensus

## ACKNOWLEDGEMENTS

We thank the Pensions Policy Institute for their detailed analysis and report which was the basis for the presentation of findings used in this summary research report. Any errors or omissions in the discussion of the survey findings are attributable to the summary research note author.

The full report can be found on the Pensions Policy Institute website:
https://www.pensionspolicyinstitute.org.uk/