Are auto-enrolment contributions sufficient?

Steven Leigh explores whether AE policy is working, why earnings levels can affect people's views and how schemes and sponsors can take some simple steps to help members

Few can doubt the success of automatic enrolment (AE) in increasing participation in pension savings. However, there is a consensus that even the April 2019 increase in minimum contributions, to typically 8% in total, will not be enough to achieve adequate provision for retirement for many. The reality is that this depends on how much is needed in retirement.

How was 8% designed?

The original *Pension Commission report 2004*[1] that determined the AE contribution rates specified that lower earners needed a higher proportion of pre-retirement earnings, while higher earners could get by on a lower proportion, or replacement rate. Taking the state pension into account (which makes up a far higher portion for lower earners than higher earners) and assuming savings commenced at age 22, the figure of 8% was deemed to be appropriate for the majority.

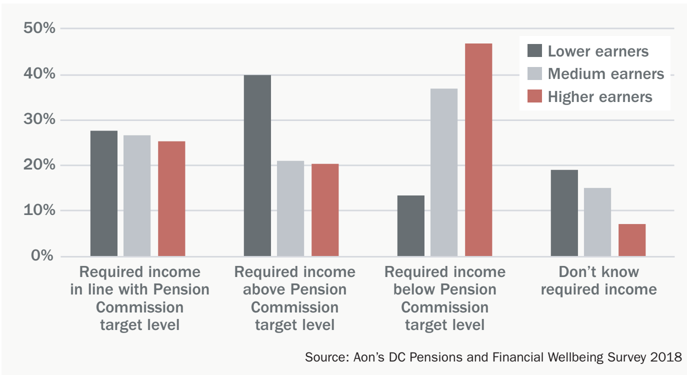
How does the AE design look in today's reality?

As part of Aon's 2018 DC and Financial Wellbeing research, we asked over 1,000 UK employees how much they thought they would need in retirement in addition to the state pension.

Overall, around 25% of people estimated their income needs roughly in line with the AE design and 15% said they did not know. Just under 60% either over- or under-estimated compared to the AE research.

This is where it gets

1 Pensions Commission, Pensions: Challenges and Choices. The First Report of the Pensions Commission (2004); available at: http://image.guardian.co.uk/sys-files/Money/documents/2005/05/17/fullreport.pdf



interesting, as we found that lower earners (shown in black in the above chart) tended to over-estimate the level of income they need, whereas higher earners (shown in red) tended to under-estimate.

The implications of this are that those with lower earnings may have an overly negative view of pension savings, mistakenly believing they are unable to save as much as they might need. Conversely, higher earners may need to be woken up to the fact that their target level of savings might not be sufficient to maintain their standard of living in retirement.

We also asked what level of income people expected to receive from their company pension arrangements. Distressingly, we found that around a third of workers with defined contribution (DC) pensions expect a fall in their living standards based on what they expect to receive compared to what they think they will need, while around a quarter said they do not know how much they expect to receive.

This may be why we found people are expecting to retire later in life, with over half now expecting to retire after age 67, up from around a third of people in our 2014 survey.

Do people connect how much they *need* with how much they *save*?

The statement required by The Pensions Regulator that contribution levels are a key factor in the outcome from a DC pension, may seem obvious, but we found most individuals do not consider how much they will need in retirement when deciding how much to save.

Only 5% of individuals consulted an adviser when deciding how much to save into their pension and only 3% used an online tool. The clear majority either went with the default rate (43%), the maximum 'employer match' level (20%), or just as saved as much as they thought they could afford (17%), which could leave them short or even ahead of what they actually need.

What can we do to help?

There are two things schemes and sponsors can do to help members target an adequate retirement:

1. Engage members with personalised target setting to help them understand how much to save
2. Ensure the scheme design supports the majority who do not actively engage, by providing the opportunity to deliver a sufficient level of savings

Understanding the profile of the individuals within a scheme is key to both methods.

The engagement challenge is best addressed by targeting communications not just based on hard facts, such as age and earnings levels, but also considering factors such as when to engage, how people respond to different types of messaging, and how to facilitate actions for different types of individuals.

While the scheme design method can be a blunt tool in terms of delivering to members' needs, it can be honed by understanding more of the hard facts about members. How much are they on track to receive? What impact would changes to the investment return, retirement age or contribution levels have?

The best DC pensions use a joined-up approach where scheme design and communication plans are built on solid evidence about member behaviours and projected outcomes. This drives improvements through a combination of defaulting and engaging members to get them on track for retirement, regardless of the starting point of minimum savings rates.

You can request a copy of the findings from Aon's 2018 DC Pension and Financial Wellbeing Survey at: https://aon.io/2PQUPl9

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