Delving into saving habits

Institute for Fiscal Studies (IFS) associate director, Rowena Crawford, chats with Duncan Ferris about recent research from the organisation that looked at life-cycle pension saving habits from before the implementation of automatic-enrolment (AE)

Could you explain the motivation behind the research?
There is a lot of debate, now that AE has been fully rolled out and bedded in, about what comes next, though this has slightly been paused by Covid concerns. There is a fair bit of concern from some quarters that people are not saving enough even though AE has done wonders for pension membership and got a lot of people saving, because the default contribution rates are not going to give a lot of people enough to maintain their standards of living in retirement. I think we felt that a lot of the debate was at risk of going on without much evidence or understanding of how people currently change, or might want to change, their pension saving over their lifetimes.

That matters for several reasons, such as projecting how many resources people might have on the basis of current savings and how they might change their pension saving in the future. It also matters because some of those behaviours might persist after AE comes along, with previously active savers continuing to behave as they used to. If we want to think about new policies and things that might change around AE, you need to understand what people might be doing in the absence of those policies to understand the possible effects.

What can be learnt by examining retirement savers' behaviour from before AE?
Of course, it would be very interesting to examine the situation after implementation of AE as well, it is just slightly more complicated to do that because we don't have a lot of data for that period. The staged rollout and increases in contribution levels make it a bit more difficult to pick out how people are behaving.

Ultimately, we want to think about how people are behaving now and compare that to our pre-AE picture to get a much fuller overview of how it has affected people and their behaviours, as well as the headline enrolment figures. In the short term we have been driven by data limitations.

Does a broad, catch-all solution like AE mask a lot of the problems with pension saving in the UK?
Before AE there was a big problem with under-saving and declining pension saving, as well as the state pulling back from the provision of pensions. AE was a broad effort to stem some of those trends and it has been very successful and is a very good policy, but it does have some limitations. For example, people who are not covered by AE, like the self-employed. They are an important group of concern because they have an even faster decline in pension membership than we saw for employees, which has continued in the recent period.

It's also the case that AE is not necessarily generating the right level of saving for a lot of people, so higher earners in particular might want to be saving more but are not getting any nudge to do so and so still might be at risk of not having enough at retirement. There is also a small group of people for whom AE might be encouraging too much saving, as they may be better off having slightly more take-home pay in the short term.

I'm not sure I'd say that it is masking problems as it's not a policy that was designed to fix everything perfectly for everybody.

Is there a concern that 'nudging' savers into contribution increases at certain life stages might also result in some savers putting away more than they should?
This is always a risk, and we know the defaults provided by AE have proved to be very strong, perhaps stronger than people anticipated, and I think a lot of the support for the policy was because people were not being forced to save. There are about 10 per cent of people that do opt out but very little explains why they do. If you look at opt-out rates by measures of financial distress you really don't see that opt-out rates are

much higher in any particular group, although you would expect that if anyone was going to opt out it would be the group in financial distress.

I think we need to think very hard about changes to defaults or new nudges and changes, as, while the obvious objective is to encourage some people to make a better decision, there is always the risk that it is not going to be right for everybody. That's why we are thinking so carefully about timings. If you do want to encourage people to save more, let's think carefully about when is the best time in their lives to do it because we don't want to force them into it at a time that is not convenient.

What did you learn about the gender pensions gap by examining pre-AE behaviours?

The gender pensions gap is a big issue and most people look at it in terms of differences in income that people are getting in retirement or differences in private pension wealth among current working age people. What we were trying to do, and what we are still trying to do, is think about what is driving that by working out if there are differences in pension saving rates, earnings or other factors.

So, it is determining if there is a pension-specific problem or if it is a product of other labour market choices. What we found was that, before AE, the saving rates of men and women were very similar, with women saving more due to being more likely to work in the public sector, where there might be generous employer contributions to defined benefit schemes.

But if you look at the private sector you see a gap opening up from around age 30 to 35, where men start saving more than women, and that is driven by a gap in pension membership growth. For men, membership increases with age but for women it goes sort of flat. AE has obviously changed that dramatically because there isn't much of an age gradient in pension membership rates, though women are still slightly less likely to be members of a scheme because they are less likely to earn more than the £10,000 threshold.

So, it has really changed the nature of the bit of the gender pensions gap which was stemming from different saving decisions, but it is still true that there is a gender pay gap and some women spend less time in the labour market as they take time out to have children. There will still be a difference in pension wealth and pension income in retirement.

Written by Duncan Ferris

Life-cycle patterns in pension saving

With the publication of its life-cycle research, IFS emphasised the need to explore the drivers behind big-picture trends when considering potential new pension policies, highlighting concerns around the pensions gender gap and impact of AE in particular.

A report from the group, *Life-cycle patterns in pension saving*, found that whilst there is an age profile in defined contribution (DC) savings, with average total contributions increasing through working life, the magnitude of these is "relatively small".

In particular, the IFS estimated that, across all private-sector employees, including those not saving in a DC pension at a particular time, mean contributions into DC pensions increase by around 2 percentage points of gross pay between the early 20s and mid-50s.

It explained that much of this increase was driven by net movements into saving in a workplace DC pension, particularly amongst those in their 20s and early 30s.

Indeed, it estimated an increase in the membership rate of DC pensions of 10 percentage points during people's 20s, although it clarified that this is followed by smaller increases in membership rates for the age groups after this.

It also found that average pension contributions amongst those saving into a DC pension increased "steadily but slowly" throughout the whole of working life, increasing by around 5 percentage points of gross pay between the early 20s and late 50s, due to increases from both the employer and employee.

However, the report warned that AE has further flattened age profiles, as it has increased pension membership among younger individuals.