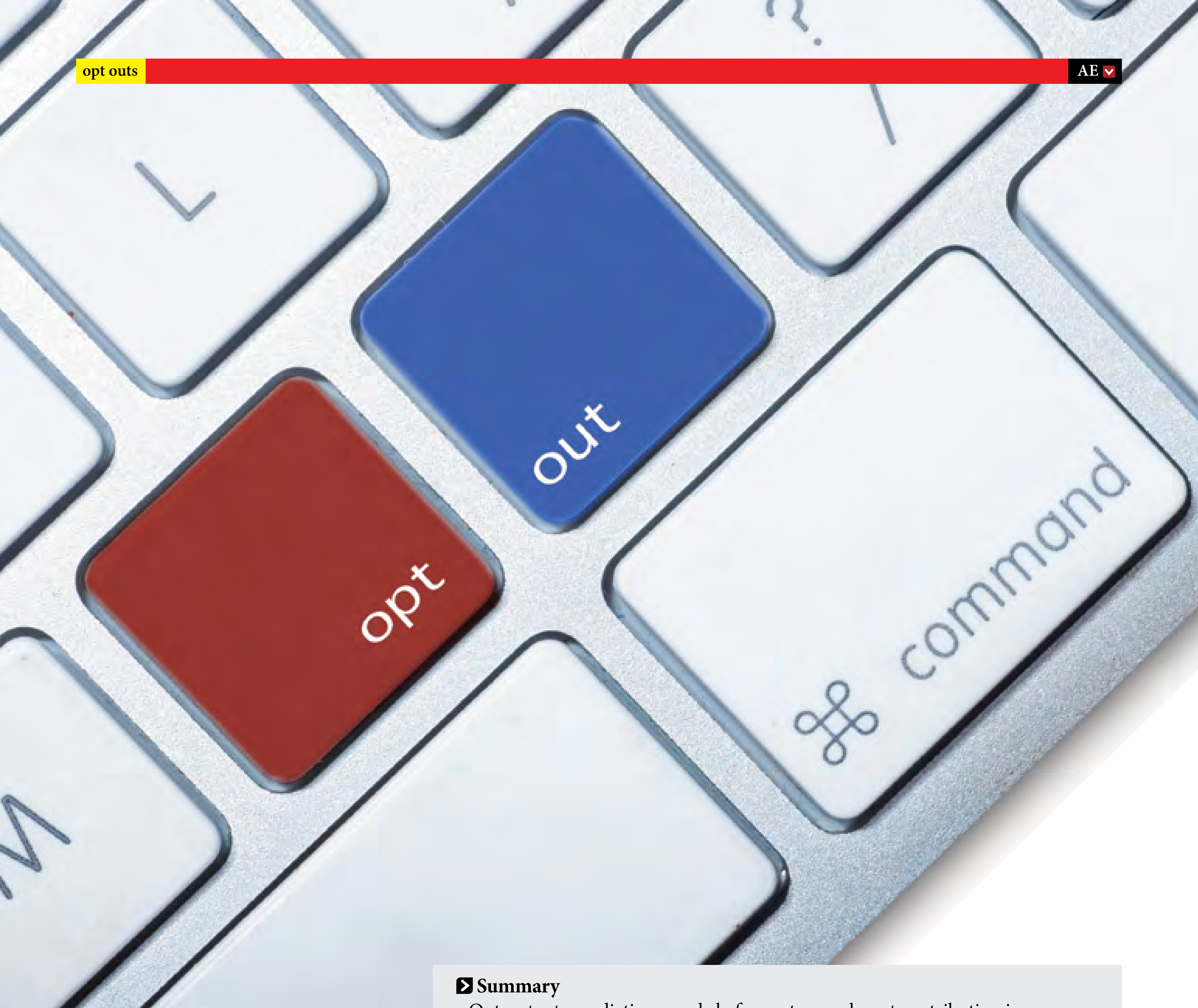

Summary
- Opt-out rate predictions made before auto-enrolment contribution increases seem to have been mostly inaccurate.
- Although the success of auto-enrolment policy cannot be denied, relatively low opt-out rates may point to uninterested savers rather than engaged ones.
- Those who opted-out of workplace pensions may be saving via other platforms, such as ISAs, bonds or banking investments.

False prophecies

Automatic enrolment opt-out rates have been lower than anyone anticipated, but does this show greater engagement in workplace pensions or does it just highlight the apathy that savers feel? Jack Gray examines the underlying factors

In the build up to the first auto-enrolment workplace pension contribution increase in April 2018, from 2 per cent to 5 per cent, Department for Work and Pensions' (DWP) analysis forecast opt-out rates of 25 per cent. However, this has not turned out to be the case. Following the contribution rises, opt-out figures remained relatively stable at around 9 per cent, according to government statistics.

Although this looks good on paper, it may not tell the whole story. It is hard to argue that workers paying more into their pensions is not a good thing, but it could be primarily due to apathy rather than greater interest in saving for retirement.

Some argue that it doesn't matter that workers aren't engaging as long as they are saving, while others believe that more needs to be done to help people understand how to make the most of their pensions. It has also been suggested that the early predictions were speculative and based on opinion, rather than any kind of reliable evidence.

Opt-out rates can also differ depending on the employer. Smaller companies have been found to have a higher average opt-out rate than larger employers, although the discrepancy was not as high as some predicted before the increases.

Pleasantly surprised

Opt-out rates of 9 per cent is lower than anyone imagined prior to the contribution increase in April 2018, leaving industry members and policy makers pleasantly surprised at the success of automatic enrolment. It seems as if even the savers themselves were unable to predict how they were going to act, as Nest Insight executive director, Will Sandbrook explains: "Prior to the launch of auto-enrolment, a survey was conducted asking people whether they thought they'd opt out of the programme."

The DWP communications' research conducted in May 2015 found that 16 per cent of auto-enrolment savers would "definitely or probably" opt out, while a further 42 per cent were "unsure".

"One of the things we know from behavioural economics however is that people don't always follow through on their intentions. Auto-enrolment is today helping around 10 million people to save for their retirement."

Although the number of savers leaving auto-enrolment schemes was fewer than most people expected, some have argued that the industry may have been pessimistic when estimating the number of workers that would opt out of schemes.

Fidelity International head of workplace investing, Daniel Smith, highlights that early predictions may have been based on opinions and speculation, rather than facts.

"It is important to note that expectation regarding opt-out rates was largely conjecture," he says. "However, it is pleasing to see that opt-out rates have been under 10 per cent. As contribution increases have been phased over two years, this has undoubtedly helped ease people into pension savings."

Sandbrook believes that one of the main reasons that a smaller number of people are opting-out than forecast is that most people are able to cope with the take-home pay that they are missing out on.

"The low opt-out rate suggests that people aren't really noticing the 'cost' of contributing, or they're more comfortable with it than they expected," continues Sandbrook. "And, in lots of cases, they're also probably feeling relieved that they're now saving for their retirement – something many previously knew they should be doing but had never got around to."

In February, Royal London predicted that opt-outs following the April 2019 contribution rise would be 'minimal', as the reduction in take-home pay is likely to be either partly or fully offset for most savers by pay rises and a more generous income tax system.

Royal London's hypothesis is supported by last year's figures from the DWP, which found that, following the first contribution rise, the active opt-out rate was less than 6 per cent, which was lower than in the previous quarter.

Commenting at the time, Royal London director of policy, Steve Webb, said: "The figures suggest good reason to be optimistic about the impact of the next step-up in contributions. A very timely increase in the tax-free personal allowance, plus a large rise in the national living wage will all help to boost pay-packets.

"The bigger challenge is likely to be getting those 8 per cent total contributions up to more realistic levels in future."

Savers seem to be either happy with the current contribution rates, or they are having such little impact on their income that they don't realise it's happening.

Sandbrook concurs: "This is consistent with recent Nest Insight research, which found that following the first increase in minimum contributions, very few Nest members (one in 20) thought that too much of their income goes into their pension, and over a quarter told us that they've thought about increasing their contributions further."

Apathetic or enlightened

Concerns over member apathy were compounded by the DWP earlier this year, as it said that "very few" workers were aware that there would be changes to auto-enrolment contribution levels in April 2019 and that, despite not being aware of the increase, savers' reactions to the news "tended to be either neutral or positive".

Furthermore, The People's Pension has conducted a study which found that savers were unaware of the advantages of auto-enrolment, with 35 per cent unaware that the government contributes tax relief to their pensions and 55 per cent did not know how much the tax relief was.

However, the industry may have played an important role in keeping opt-out rates low. Advice from industry experts has been largely consistent – stay in your auto-enrolled scheme. Aegon research that found a 22-year-old would be over £500,000 worse off when they reach state pension age if they opted out

and never re-joined. Aegon head of pensions, Kate Smith, comments: "Whilst retirement may seem distant for many young workers and is often pushed to the back of minds, choosing to opt out of a workplace pension can be a costly mistake.

"Immediate priorities such as saving for a house deposit will inevitably be the focus for those starting on the career ladder. However, young employees should not choose to forgo their pension contributions as they could stand to lose out on a significant pension pot if they fail to re-join."

The message was reiterated by many in the industry, including Profile Pensions, who says that saving just £27 per week from the age of 30 could result in a pension pot of £125,000 by state retirement age. Although it is difficult to quantify what kind of impact this has on shaping worker's opinions, it is likely that the message filtered through via employers, advisers and peers.

The relatively low contribution levels have helped encourage savers to remain in their schemes, but some argue that further increases could undo some of the good work that has been done up until this point.

"Auto-enrolment is a little like a cheap balloon at a kid's party. The more you inflate, the better it gets, but at some point it cannot take anymore," explains Hargreaves Lansdown senior analyst, Nathan Long. "The focus now needs to switch to getting people to understand how paying in more personally or improving their investment returns may boost their income or allow early retirement, rather than forcing them to pay more in automatically."

Hargreaves Lansdown head of policy, Tom McPhail, agrees: "The fact so few have opted out so far is testament to the effectiveness of this nudge *[to auto-enrolment]*; most people knew they needed to do this and are just glad someone has helped them make it happen.

"The pensions industry keeps demanding the government increase the statutory minimum contributions but they're barking up the wrong tree. The answer to getting contribution rates up to an adequate, or even a good level lies in engaging members to make individual choices about how much they should be saving."

Despite the low opt-out rates so far, we still do not have official figures on the number of workers opting-out of their auto-enrolment schemes following the April 2019 increase. It is therefore hard to predict what impact increasing the contribution level further would have, although most agree that the latest increase will not significantly impact the opt-out rate.

Differences in size and model

Government research found that opt-out rates amongst workers at smaller companies was, on average, 12 per cent, while those working for larger employers had an average opt-out rate of 8 per cent. Commenting on these statistics, the Institute of Fiscal Studies labelled the discrepancy as a "puzzle", and that can't be explained through pay, occupation, gender or age.

Its research paper states: "It could be that people who do not think or worry about their retirement are particularly likely to work for smaller employers, or that smaller employers encourage employees to opt out to save on the cost of providing the pension.

"Alternatively, it could be that small employers are less effective at communicating the benefits of saving in a pension, particularly if this is the first time that they have provided one."

In some instances, workers may leave the scheme they are automatically enrolled in for other saving methods, such as ISAs or bonds. Smith believes that employers may have been more active in helping their employees save since the introduction of auto-enrolment.

He says: "We have seen an increased interest from employers keen to offer employees additional savings vehicles. Both to provide flexibility for employees for whom pension savings are not tax efficient and younger employees who have short-term financial goals."

Written by Jack Gray