Long shadow of today's cost-of-living crisis could see lower paid workers facing harsher retirements

With the cost of living rising, many lower paid workers aren't only struggling to meet current financial obligations but may also miss out on the long-term benefits of a workplace pension as they make tough spending choices. Legal & General co-head of DC, Stuart Murphy, considers the reality for low-paid workers and how to close the gaps in pension support

Around two-thirds (63 per cent) of workers earning less than £10,000 would need to borrow money from friends or family within a week of losing their main source of income, according to Legal & General's latest research. Across all of our respondents, nearly seven in 10 say that they can't afford to make any pension contributions whatsoever due to the rising cost of living.

These statistics underline the fragility of financial resilience among lower paid workers as inflation bites. And the pressures on today's household finances could have a very long reach as 69 per cent of low earners not currently contributing to a workplace pension say that it's because they can't afford to, even though well over half (59 per cent) say they're worried about not saving for their retirement.

With auto-enrolment coming up for its 10th anniversary, there's a lot to celebrate about a programme that's done so much to help workers prepare for better retirements. But we also know that some sections of workers are falling through the cracks in pension provision. This could be the result of factors such as being below the current enrolment earning and age thresholds, or not knowing, or asking for, what they're entitled to.

However, we also wanted to find out if the cost of living was affecting the retirement-saving choices of those workers who are most likely to need financial support in their later years – the low paid.

What our research found is worrying and confirms our concerns that many might be stepping away from making pension contributions based on short-term (if perfectly understandable) financial priorities without fully appreciating the long-term implications.

The reality of rising living costs

Low-paid workers who earn less than £10,000 a year tend to be younger or in part-time, zero-hours contract or shift work. Women also feature disproportionately due to childcare responsibilities (55 per cent of women earning less than £10,000 annually have children under 17).

When we looked at the financial resilience of low-paid workers, we found that the cost of living is bearing down hard on their limited resources:

- More than two-thirds (67 per cent) told us that keeping up with bills and credit commitments is already a heavy burden with more than one in three (37 per cent) having fallen behind, or missed, at least three payments in the past six months on credit cards, loans or domestic bills
- More than four in 10 (42 per cent) say they're always overdrawn by the time they get paid
- A rent or mortgage increase of £50 a month would be a struggle to meet for well over half (59 per cent)

Pension persuasion

Given how tight the finances are for the low paid, it's easy to see why a third (32 per cent) of those who were given the opportunity to join their employer's pension scheme, decided to opt out. But what might make a difference to their thinking and encourage them to enrol and remain in a workplace scheme?

In our opinion, there are broadly three areas we need to address to better support the lower paid.

1. Education
The rules on eligibility aren't straightforward. Pension providers and regulators need to make sure that employers are aware of their precise obligations so they can confidently convey to their employees what they're entitled to. Our research showed that more than a third (31 per cent) said their employer hadn't explained to them the eligibility rules for joining their workplace pension scheme.

More than a third (38 per cent) of low-paid workers said they would have asked their employer to join a pension scheme if they'd been aware that they had the right to ask.

Of those lower-paid workers who are not currently contributing into their workplace pension, more than half (55 per cent) believe the amount they'd be saving would be so low that it wouldn't be worth it. This indicates to us that there's still a long way to go to ensure that people understand the mathematical basics of pensions, such as how compound interest works so that even small amounts can add up significantly over time, the importance of starting contributions as soon as possible, and the value of employer contributions.

We believe that a combination of better school-based financial education would help, although we also appreciate that the government, regulators and the financial services industry need to work together on promoting pension benefits more clearly.

2. Filling in the cracks of auto-enrolment
The government's 2017 review of auto-enrolment recommended lowering the age threshold from 22 to 18 and removing the lower limit of qualifying earnings. Our research showed that this would play out well as 70 per cent of lower paid employees agreed with lowering the age threshold, while 41 per cent of those not currently contributing said they'd join their workplace pension if their employer's contributions were paid from the first £1 earned.

3. Flexibility
Our research suggested that for lower paid workers, such as those with variable earnings, flexibility could be the key to making pensions less daunting. For instance, 80 per cent agreed that they'd be interested in being able to turn their contributions on and off – in other words, to pay when they could.

Meanwhile, 84 per cent said they'd be interested in contributing to a pension if there was a tax break where the government matched their contributions up to a certain limit. They were especially keen on this idea when they were told that higher rate taxpayers get more money back from the government for every £1 than lower rate taxpayers – a position which was expressed by some as being 'not right' during discussions with our researchers.

Taking action

Auto-enrolment has been one of the most progressive and welcome additions to the pensions landscape and is already helping many workers to be more financially stable in retirement.

But we know that there's still a long way to go to provide a similar level of support for those who currently fall outside the existing provision.

It's on us – the industry professionals – to do our bit to reach these vulnerable groups with persuasive, simple messaging that means they're clear about what their workplace pensions offer, what they're entitled to, and what they might be throwing away if they don't enrol or choose to opt out.

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But we can't do it alone. While we can work on our communications with our clients, we also need the government and regulators to make workplace pensions more inclusive and attractive for these lower paid workers.

We welcome practical changes such as the recommendations to remove the age and wage thresholds, but perhaps we also need to examine the case for financial education in our schools and government awareness campaigns.

At Legal & General, we're already joining and setting up working groups to identify the reasons behind pensions inequality and the possible solutions to it. This is because it's clear to us that the increasing financial pressures of the rising cost of living may be squeezing people to take decisions about contributing to a workplace pension that could have devastating long-term implications for their later-life financial resilience.

Written by LGIM co-head of DC, Stuart Murphy

In association with LGIM