

Enabling and encouraging saving: the evidence around pension reform and saving

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Summary

Individuals are living longer, meaning that savings have to fund a longer period of retirement. However there has been a well documented decline in pensions saving over time. This has led to a number of Government policies designed to stop and reverse this trend. This document sets out the evidence around the impact that single tier, automatic enrolment, and other elements of Welfare Reform are expected to have upon the saving incentives individuals face, both financial incentives, and whether the system provides clarity that it is worth saving.

There are an estimated 11 million people in the current workforce who are not saving enough and face an inadequate income in retirement¹. There are a number of reasons that people do not save enough for their retirement, including:

- **Myopia** – many people do not think about retirement as it's too far in the future and therefore they do not engage;
- **Lack of knowledge and understanding** – the complexity of the state pension system means people do not understand and face difficult choices and are therefore put off from making decisions;
- **Poor financial incentives** - loss of means tested benefits, or perception of loss, means that people feel penalised for positive action and so do not save; and
- **Affordability** – one of the main cited reasons for not saving or saving enough is people feel that they cannot afford to.

Automatic enrolment will mean up to 11 million workers will be automatically enrolled into a workplace pension and have the opportunity to save or save more for their retirement, of which we expect 6-9 million to remain enrolled.

Automatic enrolment is intended to work by turning on its head the inertia and myopia that currently inhibits saving. This will overcome people having to proactively make a decision about their future as they will be automatically saving for a private pension unless they decide to opt out.

Analysis suggests that under the current system it will pay to save for the large

¹ Department of Work and Pensions, *Estimates of the number of people facing inadequate retirement income*, July 2012

majority of people. However, complexity within the current state system means that there remains a concern that some people newly automatically-enrolled into a pension will not gain from saving or will not perceive that they will gain.

Single tier provides a clearer foundation for saving, removing multiple tiers of State Pension and reducing interaction with means testing. Evidence suggests that:

- a clearer system means people make better financial decisions;
- a more complex system can make people believe the financial incentives to save are weaker than they actually are; and
- the clearer state pension makes people more likely to think about their saving decision.

We can't quantify the impact of a clearer system, or the impact of reduced interaction with means testing on the amount people save, but the strong consensus among academics and industry is that a clearer system with less means testing will make the decision to continue to save much easier.

Universal Credit also contains a disregard for pension saving – which means pension contributions will not be counted as earned income for the purpose of calculating Universal Credit awards.

The single tier pension and the pension contribution disregard in Universal Credit will together mean that it will be clearer that low and medium income groups automatically enrolled into workplace pensions for the first time will benefit from pension saving.

Together single tier and automatic enrolment have the effect of reducing the rate at which pensioner benefits are withdrawn from individuals as savings increase (marginal deduction rates²). Following reforms we expect nearly 80% of people to have a marginal deduction rate of 20% or less in 2040 and nearly 90% in 2060 compared to 66% under the current system in 2020. Those with full state pension entitlement and who are enrolled in a private pension (through automatic enrolment or otherwise) are likely to see the lowest marginal deduction rates and benefit more for every pound saved. And it is those with lower incomes that are likely to benefit the most from the reforms through the largest reductions in marginal deduction rates.

² Marginal deduction rate is the amount of every additional pound of income that is taken away through reduction in benefit entitlement. A marginal deduction rate of 20%, for example, means that an individual will receive 80p of every additional pound net of means tested benefit reductions

The reforms are also expected to reduce by half the proportion of pensioners retiring after 2017 who are in the scope of means-tested Pension Credit by 2020.

Overall the package of reforms have been designed to reduce and remove barriers to saving – laying a strong foundation for individuals to have a decent income on retirement. People can be more confident they'll benefit from saving.

Current situation

- **A large number of people aren't saving enough to sustain their living standards in retirement. (Estimates vary, but latest DWP estimates suggest around 11 million)**
 - **There are a number of reasons for people not saving enough, including:**
 - **unwillingness to engage with pensions,**
 - **difficulty understanding the system; and**
 - **fear of saving without seeing any benefit.**
 - **Current programme of reform aims to tackle some of the biggest barriers to people saving for a sufficient retirement income**
1. Analyses of the level of saving in the UK in recent years suggest a significant degree of undersaving for retirement on the part of individuals and households. This is not a new problem. The issue of undersaving for retirement has been acknowledged, and potential solutions have been debated, for some time.³ The issue is made more challenging with an 'ageing population' and the need to ensure sustainable solutions to provide for the projected increase in the numbers of people in retirement, as was highlighted in the Pensions Commission report (in 2004 *et sub.*).
 2. Despite economic theory stating that a rational individual aiming to maximise their lifetime utility would save for retirement, in reality this is not always the case. DWP has estimated 11 million of today's working age population face inadequate incomes in retirement⁴.
 3. The number of undersavers is sensitive to precisely how benchmarks for adequacy are set and modelling assumptions – DWP are working on further estimates of undersaving later this year, which will look at issues such as how we take account of housing costs and wealth. However, there is a range of evidence that shows that many people who reach retirement with low levels of pension saving regret not saving more:
 - The National Association of Pension Funds (NAPF) 2012 Workplace

³ See, for example, Mitchell, Olivia S. and Fields Gary S, *Retirement, Pensions and Social Security*, MIT Press, 1984

⁴ Department of Work and Pensions, *Estimates of the number of people facing inadequate retirement income*, July 2012

Pensions Survey⁵ showed people's confidence about their financial well-being in retirement declines markedly with age, suggesting they regret not having saved more, as they get closer to the point of retirement;

- Evidence from the 2012 Attitudes to Pensions survey⁶ also found that around a third of retired people strongly agreed that they should have started saving for their retirement sooner
- Various studies⁷ show that there is disconnect between intentions and behaviour – people state they want to and wish to save but in reality do not save or save the amount desired

Income and substitution effects

Economists look at financial incentives to save based on income and substitution effects. For example, if the additional pension you get for each £1 of saving is reduced then there may be two effects - people may:

- decide to save more to make up for their lower pensions income in the future (income effect); or
- they may decide to save less because the extra pension they get for each £1 of saving is worth less, substituting spending now for saving for the future (substitution effect).

This is difficult to model and we have little direct evidence on how it impacts long term saving so this paper does not consider these effects in great detail.

4. There are a number of reasons that people do not save enough for their retirement, including:
 - **Myopia** – many people do not think about retirement as it's too far in the future and therefore they do not engage;
 - **Lack of knowledge and understanding** – the complexity of the state pension system means people do not understand and face difficult choices and are therefore put off from making decisions;
 - **Poor financial incentives** - loss of means tested benefits, or

⁵ National Association of Pension Funds, *2012 Workplace Pension Survey*, March 2012

⁶ Department of Work and Pensions Research Report No. 813, *Attitudes to Pensions: The 2012 survey*, 2012

⁷ National Institute on Ageing, *Growing Older in America: The Health and Retirement Study*, 2011

perception of loss, means that people feel penalised for positive action and so do not save; and

- **Affordability** – one of the main cited reasons for not saving or saving enough is people feel that they cannot afford to.

5. The Attitudes to Pensions report⁸ gives a range of evidence supporting these barriers to saving. While financial reasons were given as the main reason for not having a private pension (59 per cent) significant proportions gave other reasons such as 19 per cent stating that it is too far in the future; 13 per cent not interested in it or got round to thinking about it and 11 per cent stating that they do not know enough about pensions.
6. Automatic enrolment and single tier both aim to reduce these barriers, to get people saving enough for adequate retirement incomes. Automatic enrolment will address myopia and inertia while single tier aims to reduce complexity and reduce interaction with income related benefits – especially for those on lower incomes - thereby decreasing marginal deduction rates.

⁸ Department of Work and Pensions Research Report No. 813, *Attitudes to Pensions: The 2012 survey*, 2012

Automatic-enrolment

- **Automatic-enrolment means people will be enrolled into a workplace pension by default – overcoming their unwillingness to engage with pension decisions.**
 - **Estimates suggest the policy will mean 6-9 million more people saving.**
 - **Previous analysis of savings shows that the large majority of people automatically enrolled will benefit from pension saving, with no easily identifiable group that will not.**
7. Part of the strategy to reduce the number of people with inadequate retirement incomes is the introduction of automatic enrolment. Over the course of roll out between October 2012 and October 2018⁹ up to 11 million eligible workers will be automatically enrolled into a workplace pension scheme and have the opportunity to be saving for the first time or saving more into a private pension. Their contributions will be a minimum of 8% of earnings, with at least 3% coming from the employer and 1% through tax relief.
 8. Automatic enrolment is intended to work by turning on its head the inertia that currently inhibits saving. This will overcome people having to make a proactive decision now about their future as they are automatically saving for a private pension unless they decide to opt out. The Department expects around 70 per cent of individuals to remain saving in a workplace pension following automatic enrolment¹⁰. In the United States, case studies show automatic enrolment increased membership of similar schemes among new employees from around 20-40 per cent to around 90 per cent.
 9. Research has shown that employer contributions act as the biggest employee pull to workplace pension saving¹¹. Half of UK workers currently save into occupational pension schemes, but take-up of workplace schemes is 80 per cent where employers make contributions.
 10. Previous DWP analysis¹² has shown that the vast majority of people

⁹ Employers due to be staged in from October and November 2012 will be able to automatically enrol eligible workers from July, August and September 2012, if they wish to do so.

¹⁰ Department of Work and Pensions Research Report No. 813, *Attitudes to Pensions: The 2012 survey*, 2012

¹¹ Bryan et al, *Who Saves for Retirement?*, December 2011

¹² Department of Work and Pensions Research Report 558, *Saving for retirement: Implications of pensions reforms on financial incentives to save for retirement*, 2009

automatically enrolled into pensions with an employer contribution can expect to benefit, even under the current tax and benefit system. Under automatic enrolment, individuals' contributions will be effectively doubled by the employer contribution and tax relief from the Government¹³.

11. Previous DWP analysis¹⁴ – based on reforms put in place in the 2007 and 2008 Pension Acts - shows that after automatic enrolment:
- Over 95% of savers can expect to get back at least as much as they contributed, even after taking inflation into account
 - For the large majority - around 70% - the expected improvement is more than twice what they put in, and
 - There is no readily-identifiable group in the working age population who cannot, **on** average, expect to gain back more than they put into a workplace pension.

¹³ Pensions tax rules also mean that up to 25% of the pot can be taken as a tax free lump-sum, and for those with very small pots, they may be able to take the whole of their pot as a lump sum

¹⁴ Department of Work and Pensions Research Report 558, *Saving for retirement: Implications of pensions reforms on financial incentives to save for retirement*, 2009

Challenge of complexity in State System

- **The state system is complex with a two tier pension, and widespread eligibility for means tested benefits.**
- **Research shows that people make worse decisions with complex systems, and often either don't make decisions or rely on advisors.**
- **Within the pensions industry there remains concern that means-testing risks people not benefiting from private saving, making clear messages and advice about pension saving difficult.**

Complexity of pension system

12. The state pension system is still very complex. In a recent survey, the majority of respondents (63 per cent) agreed that: *"sometimes pensions seem so complicated that I cannot really understand the best thing to do"*. While this relates to all pensions, self assessed knowledge of state pensions also remains very low – nearly three quarters of 18 to 69 year olds stated that they either had patchy knowledge (37 per cent) or knew little or nothing (36 per cent) about the state pension system¹⁵.
13. Further research shows how the different elements of the state pension system – the basic State Pension and the additional State Pension – confused matters even further, one study found *"...participants needed considerable prompting before acknowledging the additional State Pension"*¹⁶.

Overview of evidence of complexity

14. The consensus among academics and industry professionals, backed up by academic theory of human behaviour, is that increased certainty and simplicity of the pensions system will lead to better incentives to save for a pension. Evidence (both on pensions and other financial products) suggests complexity faced by the customer acts as a disincentive to make the right savings decisions, and supports the belief that a simpler pensions system will lead to more saving.

¹⁵ Department of Work and Pensions Research Report No. 813, *Attitudes to Pensions: The 2012 survey*, 2012

¹⁶ Department of Work and Pensions Research Report No 787, *A simpler State Pension: A qualitative study to explore one option for State Pension reform*, 2012

15. Much of the evidence comes from looking at tax systems: the evidence specifically related to pensions is sparse. There are several potential reasons for limited evidence specifically around pension systems. One is that it is very hard to test the theory: pension saving happens over a long period of time and there are often other reforms to the pension system either at the same time, or soon after, which can make effects of specific reforms difficult to isolate, establish and estimate.

Evidence on complexity reducing impact of financial incentives

16. Empirical analysis has shown that *“if tax complexity is high, then only a small proportion of the study participants based their decision of pension participation and contributions on their after-tax return. This proportion increases significantly if tax complexity is low”*¹⁷.
17. Relating this to pension reform if people find pensions too complicated then they may decide not to participate. The same study also found that even in a simple tax system, many people do not base their decisions on after-tax returns, but instead follow the advice of an independent advisor where advice exists [or on rumour or hearsay where advice is not available].
18. Congdon *et al.* (2009) claim that *“individuals will respond not to the tax rate as it is set but as they construe it”*¹⁸, which again highlights the benefits of a simpler system increasing understanding and interaction.

Evidence on simplicity improving decision making

19. There is also evidence that simplicity / certainty helps people make a more optimal choice of financial product (be that a pension or some other type of financial product): a 2010 EU report¹⁹ found that simplifying and standardising product information, and reducing the amount of information provided helped individuals identify the optimal choice between similar investments. It is important to highlight that this refers to the simplicity faced by the customer; the product itself may still be complex but the decisions an individual has to

¹⁷ K. Blaufus & R. Ortlieb, *Is Simple Better? A Conjoint Analysis of the Effects of Tax Complexity on Employee Preferences Concerning Company Pension Plans*, January 2009

¹⁸ Congdon, W., J. R. Kling and S. Mullainathan, *Behaviour Economics and Tax Policy*, 2009

¹⁹ Chater, Inderset & Huch, *Consumer Decision Making in Retail Investment Services: A Behavioural Economics Perspective*, November 2010

make are straightforward and clear. However, there is less evidence that simplicity for the customer impacts the decision of whether to save in the first place.²⁰

Pensions Expert Views

20. In response to question 1 of the Government consultation on single tier: *'Would the current pension system, if left unchanged, meet the Government's principles for reform²¹ and provide an effective foundation for saving?'* The response says the following:

"... those who addressed this question directly, most concluded that the current state pension system did not meet the four principles for reform set out, particularly the principle of simplicity. Age UK, the NAPF, the Citizen's Income Trust, Saga, the Association of Independent Financial Advisers, the Pensions Advisory Service, ABI and the CBI were among those who said that the current system is too complicated with means-testing frequently cited as a cause of complexity."

²⁰ The Australian Tax Office said about 40% of those setting up self-managed funds had been influenced in some way by simplification measures (based on tax office enquiries)

²¹ Principles for reform were: Personal responsibility; fairness; simplicity; and affordability and sustainability

Single Tier

- **Single tier simplifies the State Pension system:**
 - **People will be much clearer about what they receive from the state.**
 - **The proportion of pensioners liable to means testing will be reduced (especially in the group likely to be automatically enrolled). Eligibility to income related benefits will reduce from 40% of pensioners under the current system to around 35% in 2040 to less than 30% in 2060 under single tier.**
 - **It will mean people can be more certain that they will benefit from saving.**
- **Evidence shows clearer proposition more likely to prompt people to think about saving.**
- **General consensus among industry that system will make savings decisions and advice easier.**

21. The single tier state pension has been designed to provide a number of advantages as an underpin to automatically enrolled private pension saving, particularly:

- 1) a simple and clear proposition of what the state provides (therefore helping people to understand what they might want to save in addition); and
- 2) a reduced reliance on means testing in the pension system.

Impact on Individual decision making

22. The single tier offers greater clarity in understanding what the state will provide, which will allow individuals to see what they need to save in addition to fund their desired living standards in retirement. Recent qualitative research commissioned by DWP suggested that having greater clarity could prompt people to "*...think more seriously about planning for retirement, as they would have a more concrete idea of how much they will need to save to fund the lifestyle they want*"²².

23. Evidence has shown that a simpler and clearer system increases engagement.

²² Department of Work and Pensions Research Report 787, *A simpler State Pension: A qualitative study to explore one option around State Pension reform*, Jan 2013

In this way, single tier may also encourage some people to seek information relating to their private provision so they are aware of their likely overall income in retirement:

“I think you’d start saving more if you knew this [clarity around what state pension will provide]” and “[single tier] sets the platform, so if you want your luxuries, you know what you have to step up to get your desired standard of living”²³

24. Overall the main focus of the single tier, and the main savings incentive will be to reduce the complexity of the decision to save for the future. All things being equal, a simpler system should engender a higher level of cognitive trust²⁴ in a simplified pension system. Thus as Ring (2005) notes:

“If a base line of economic security in retirement is guaranteed through the State Pension then people may be more willing to save more of their income for retirement because the ‘heat’ has been taken out of the planning.”²⁵

Pensions industry views

25. The consensus opinion that a single tier system is beneficial for an individual’s engagement and knowledge was shown in the responses to the Government consultation paper²⁶ on state pension reform options:

“The majority felt that the single tier proposal met the Government’s principles²⁷ for reform. In particular because of the perceived simplicity and clarity.”

“The majority of organisations who responded saw the reduction in reliance on means testing under single tier as important to improving savings incentives and providing individuals with a solid foundation to save for retirement.”

26. Responses to the Government consultation paper²⁸ broadly reflected the view

²³ Department of Work and Pensions Research Report 787, *A simpler State Pension: A qualitative study to explore one option around State Pension reform*, Jan 2013

²⁴ In effect trust based on rational judgement rather than emotions or ‘gut feelings’.

²⁵ Ring, P, *Trust in UK pensions policy – a different approach?*, Policy & Politics Vol.33, No. 1 pp.55-74, 2005

²⁶ DWP Consultation paper, *A state pension for the 21st century: A summary of responses to the public consultation*, 2011

²⁷ 4 principles set out in the Green paper (DWP, ‘*A State Pension system for the 21st century*’ April 2011), are personal responsibility; fairness; simplicity; and affordability and sustainability

²⁸ DWP Consultation paper, *A state pension for the 21st century: A summary of responses to the public*

that increased clarity from the amount Single Tier provides will provide a simple message for people to base their savings decisions on.

27. Dr Ros Altmann, Director-General of the Saga Group, stated *"A single-tier pension would definitely help personal responsibility for future retirees, because it would help people realise what the state will pay, so they can plan to provide more for themselves if they want it"*.
28. Greater clarity should help to improve perceptions of the value of saving. In particular reducing some of the barriers to greater saving which include:
- myopia
 - lack of knowledge and understanding; and
 - poor financial incentives

*"For some, means-testing adds complexity and appears to contribute to confusion about pensions...[but] knowledge sufficient to predict whether entitlement to benefits will be diminished by saving is not widespread."*²⁹.

Impact of Earnings Related Tier on Private Saving

29. A study by Oranzio and Rohwedder³⁰ found that the earnings-related tier of the state pension scheme had a negative impact on private savings with relatively high substitution elasticities – the analysis suggests that people choose not to save because the state system provides some sort of earnings replacement. The analysis suggests that the flat-rate single tier will not substitute for private pension saving, and so suggests the introduction of single tier is likely to reduce the disincentives to save that were inherent in previous systems.

consultation, 2011

²⁹ DWP Research Report 562, *Incentives to save for retirement: understanding, perceptions and behaviour. A literature review*, 2009

³⁰ Attanasio, Orazio P., and Susann Rohwedder., *Pension Wealth and Household Saving: Evidence from Pension Reforms in the United Kingdom*, *American Economic Review*, 93(5): 1499-1521., 2003

Universal Credit

- **Many people say they can't afford to save for a pension³¹**
 - **Universal Credit includes a disregard for pensions saving - this is line with the current disregard of pension contributions in tax credits but is more generous than the current 50% disregard in Housing Benefit and the income related benefits.**
 - **This disregard means that £10 saved into a pension will not count toward your income for UC calculations, and the UC award will then be higher by £6.50. Effectively, the disregard means that someone on UC could contribute nearly £6 into their pension pot at a net cost of only £1.**
 - **This helps to ensure that low income workers automatically-enrolled will benefit from saving.**
30. Universal Credit (UC) will increase the disregard for occupational and private pension contributions from 50% for people on income related benefits (IRBs) and housing benefit to 100%.
31. This policy change will benefit individuals who have been automatically enrolled or have opted into pension saving and would have received one of the legacy income-related benefits that are replaced by UC. This means that it will only effect individuals who are earning more than around £107 a week and who are eligible for housing benefit (as the threshold for all other IRBs is generally below this amount). This could affect households such as a single person, a lone parent or a couple with children. Those on low incomes and in receipt of UC who are not automatically enrolled, can also opt-in and benefit from UC pension disregard arrangements.
32. Under UC, the £10 saved into a pension would not count towards earned income in UC calculations. The UC award would then be £6.50 higher (at 65% taper rates). This means that £10 saving would only cost the individual £3.50. Under automatic enrolment the £10 per week saved into a pension is also matched through employer contributions and tax relief; this means that an individual saving into a workplace pension will only pay £3.50 for £20 pension contribution - £6 goes into the pension pot at a cost of only £1.

³¹ 85% of people with no resources for later life agreed with statement that they cannot afford to save for retirement. Department of Work and Pensions Research Report No. 813, *Attitudes to Pensions: The 2012 survey*, 2012

Marginal Deduction Rates on Income in Retirement

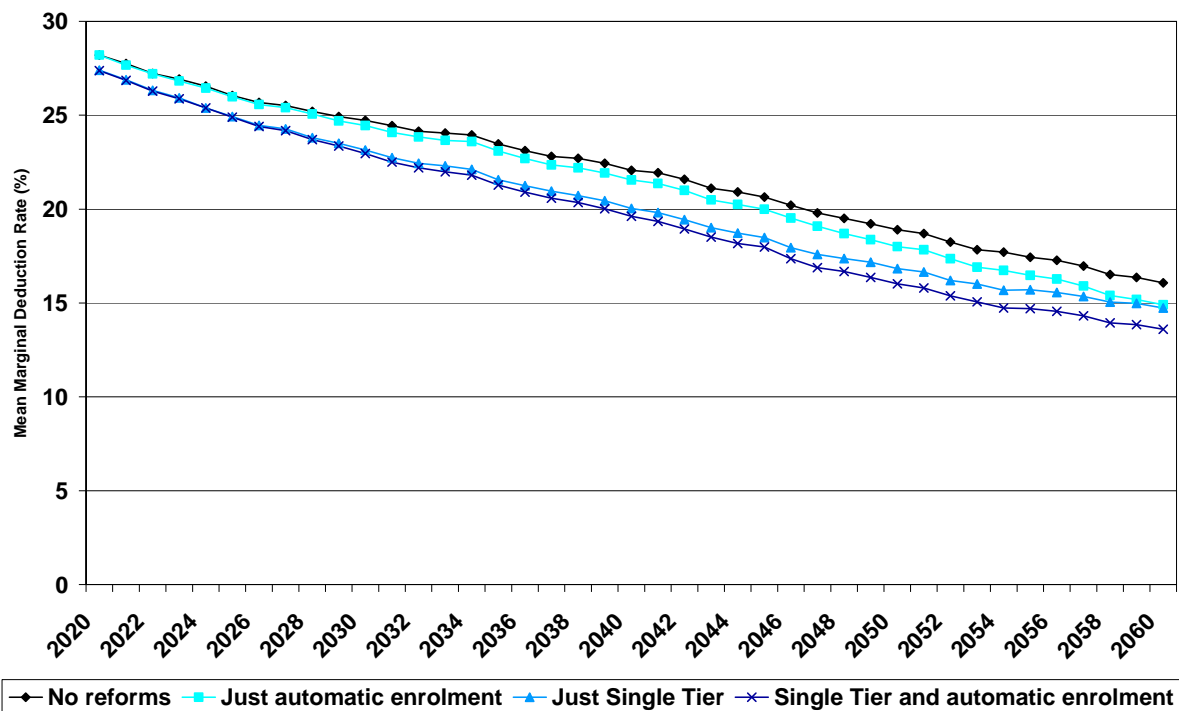
- **Lower marginal deduction rates mean people keep a greater proportion of their savings and thereby improve incentives to save.**
 - **Automatic enrolment and single tier will reduce the average marginal deduction rates.**
 - **Following reforms we expect nearly 80% of people to have a marginal deduction rate of 20% or less in 2040 and nearly 90% in 2060 compared to 66% under the current system in 2020.**
 - **Lower income groups are likely to see the largest fall in their marginal deduction rates on additional savings following reforms.**
 - **People with a private pension are less likely to be in the group facing high marginal deduction rates.**
33. Marginal Deduction Rates (MDR) are the combined effect of income tax and the withdrawal of means tested state benefits on a person's income. The MDR is the percentage of an extra pound of income an individual keeps after a reduction in entitlement to means tested benefits is taken into account.
34. Marginal deduction rates are a useful indicator of how much people are benefiting from saving and may play a role in an individual's decision to save more³². A high marginal deduction rate, of say 80%, implies that for an extra pound of pension income from private saving, their net income increases by only 20p. A lower MDR means that a saver would keep more of every pound.
35. The analysis presented in this section is based on Pensim2, the Department's micro-simulation model of pensioner incomes. The analysis in most cases illustrates how it is the introduction of the single-tier pension that lowers marginal deduction rates and so affects an individual's incentives to save. We use 2040 as a medium term comparison but it will not be until 2060 when nearly all pensioners retiring would have been under single tier and automatic enrolment the majority of their working life – and therefore showing the full impacts of the reforms.
36. The single tier pension will be set at a rate that is above the basic level of means-tested support. As a result there will no longer be a need for a complex

³² For example see Blundell, Emmerson and Wakefield, *The Importance of Incentives in Influencing Private Retirement Saving: Known Knowns and Known Unknowns*, 2006

savings reward under single tier. Removing Savings Credit will simplify the state pension system³³. Because of this the reforms are expected to reduce by half the proportion of pensioners retiring after 2017 who are in the scope of means-tested Pension Credit by 2020 (falling to 10 per cent, compared to around 20 per cent without single-tier reforms).

37. Chart 1 below shows how the mean marginal deduction rates would change over time under different systems – the current system with no reform; the current system with automatic enrolment; under single tier but without automatic enrolment; and with both automatic enrolment and single tier.
38. Even without reform the average MDR falls from just below 30% in 2020s to around 19 % in 2040 and 16% in 2060. This is due to the earnings uprating of the basic State Pension; improved coverage; changes in state pension age (through increased private savings) and also women increasingly having their own earnings and pensions.
39. The analysis covers the stock of all pensioner households.

Chart 1: Comparison of mean MDR for people retiring from 2020 to 2060 ³⁴

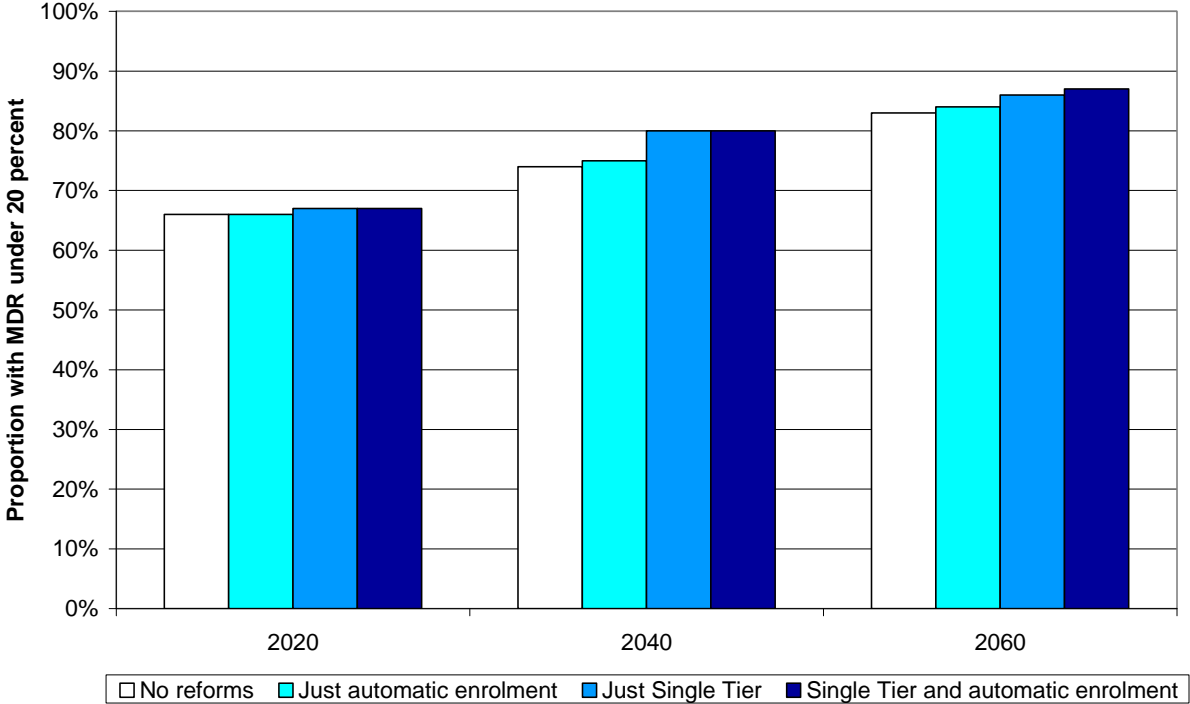


³³ Department of Work and Pensions, *A State Pension for the 21st Century*, April 2011

³⁴ The chart looks at different policy scenarios for the same group of people over time

- 40. The introduction of automatic enrolment and single tier accelerates this reduction of MDRs by around 3 percent points over the long term. In 2040 the average marginal deduction rate without reforms is over 22% and 19.5% with full reforms. In 2060 the average marginal deduction rates decreases from 16% to 13.6% respectively. This will ensure that individuals will see more of every pound saved, thereby incentivising savings or reducing the disincentives to save.³⁵
- 41. Chart 2 shows the increase in the proportion of people facing a marginal deduction rate of 20 percent³⁶ or less. Under the “no reform” scenario we expect around 75% of pensioners to face an MDR of 20% or less in 2040 and 80% in 2060. However, when automatic enrolment and single tier have been implemented this figure increases to 80% and nearly 90% respectively.

Chart 2: Proportion of people facing MDR’s of 20 percent or less



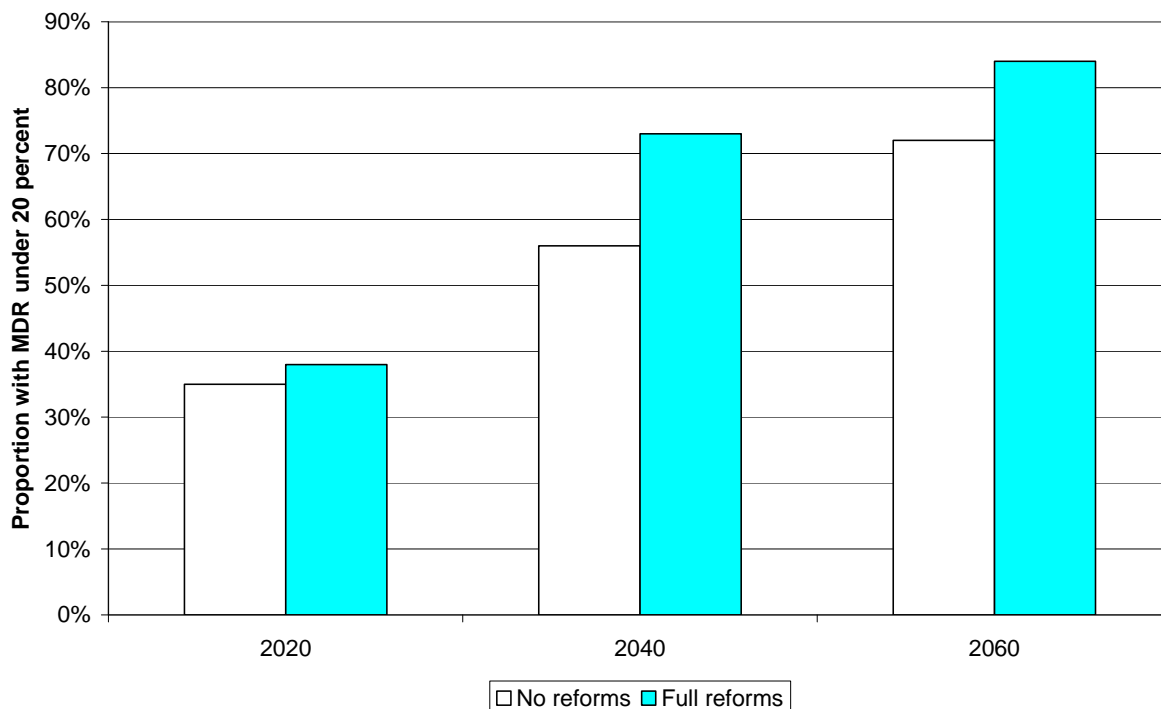
- 42. Given that those included in the 20% or less MDR condition includes only people who are either not entitled to IRBs or entitled to only tapered Council Tax Benefit, having a MDR greater than 20% after reforms have been introduced can cover several different situations. These include people with

³⁵ The decline in MDR’s is driven by single tier though automatic enrolment has the affect of increasing incomes and thereby lifting individuals out of means tested benefits
³⁶ 20% or less means either not means tested or only getting Council Tax Benefit

Guarantee Credit (GC), but would also involve anyone who was still getting tapered Housing Benefit or Savings Credit (if an individual's partner having reached State Pension age before the introduction of the single tier reforms). For example, someone with no private pension but full single tier will be above the GC threshold, but would still be likely to get a significant Housing Benefit or Council Tax Benefit entitlement.

43. The above chart focuses on the average effect over the whole cohort – including people who have good pension provision and who would be outside the scope of means testing in the unreformed scenario. When we break down the analysis by sub-groups we can see that, for some – particularly those in the lowest income quintile, the change in the marginal deduction rates as a result of single tier and automatic enrolment is substantial.
44. Those with lower incomes are more likely to receive income related benefits and therefore generally face higher marginal deduction rates. Chart 3 shows how the reforms will benefit this group the most: without reform, in 2020 around 50% have an MDR of 20% or less, compared to over 70% in 2040 and 85% in 2060 following full roll out of both automatic enrolment and single tier. At each point in time around 15% of people in the bottom income quintile face lower marginal deduction rates as a result of the reforms.

Chart 3: Proportion of bottom income quintile³⁷ facing MDR's of 20 percent or less

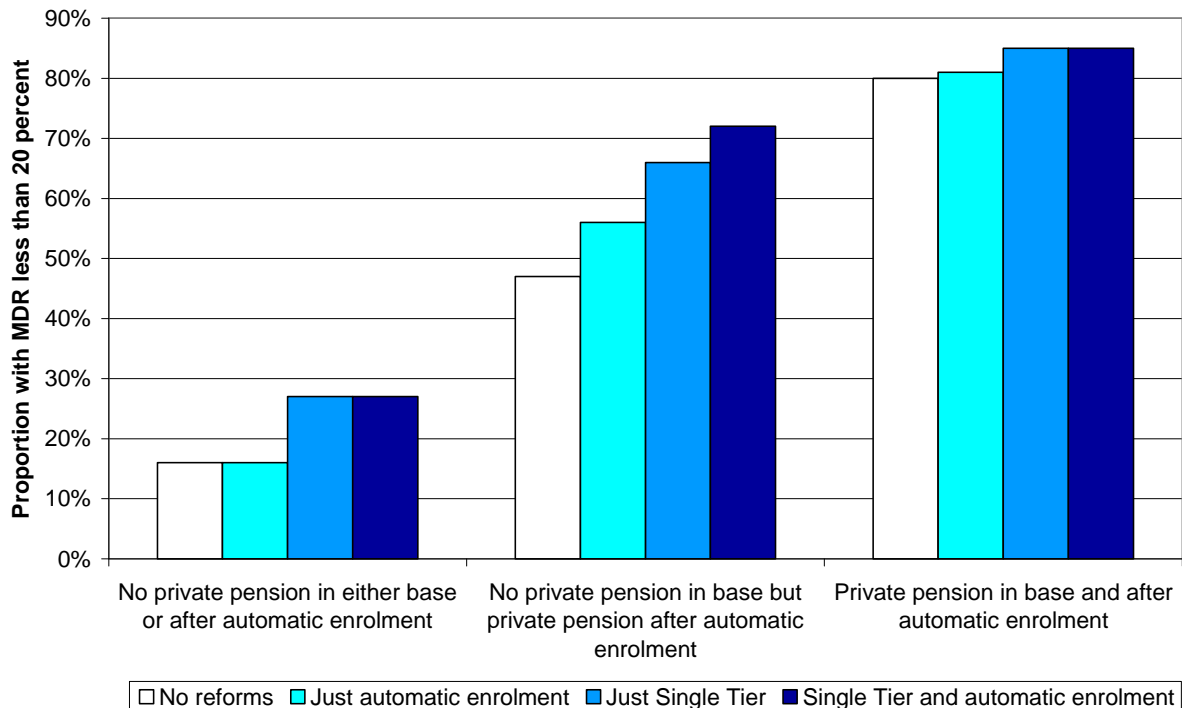


45. Chart 4 shows MDR's in 2040 by private pension coverage with and without reforms. The first group, 'No private pension in either base or after automatic enrolment', are those who do not have any private pension in the base or automatic enrolment scenarios; i.e. they have either opted out, have not been in employment or their earnings are too low and not opted in. The second group, are those who do not have a private pension in the unreformed scenario but do benefit from automatic enrolment. The third group, are those who have a private pension before and after reform.
46. Of those who would have had a private pension, regardless of reforms, 80% of people, rising to 85%, face a low MDR (i.e. 20% or less). Those who get a private pension due to reforms see a significant fall in MDR's for one of two reasons (i) the removal of savings credit and the single-tier amounts pull them clear of means testing; and (ii) the private pension income from automatic enrolment ensures little interaction with means tested benefits. This group see a 25 percentage point rise in the proportion of people facing an MDR of 20% or less.

³⁷ Quintiles are based on equivalised net benefit unit income, and this is compared within each year

47. Universal Credit will also enhance the benefits of pension saving for those who are entitled to UC and eligible for automatic enrolment schemes. Under UC pension disregards arrangements £6 saving into a pension pot will only cost this group £1.

Chart 4: Proportion of people facing MDR's of 20 percent or less by private pension coverage in 2040



48. For those who do not have a private pension before or after reforms there is a 11 percentage point rise in the proportion facing a low MDR, but the majority (around 75%) will still face MDR's of more than 20%. This is a small group of people who have been long term sick and disabled for example.

Conclusions

49. The Government has embarked on a substantial reform programme to address the challenge of people undersaving for retirement, and address historical inequalities in the system and that people are retiring with sufficient income through changing their savings behaviour.
50. Together automatic enrolment and the introduction of the single tier pension will reduce the barriers to saving, giving people a clear structure and a simpler state system to support them to make positive decisions around their retirement:
 - Single tier will provide clarity around what people can expect to receive from the state in retirement
 - It will also simplify the system so individuals will feel more comfortable making decisions about their pension provision and interacting with the system
 - The single tier pension will be set above the level of the basic means test, reducing people's interaction with means testing and thus clarifying incentives to save
 - Automatic enrolment will, if the individual chooses to remain in the pension scheme, provide individuals with a workplace pension which can be used to supplement their state pension
 - Government tax relief and employer contributions will effectively double contributions made by the individual – a clear incentive to remain in the scheme and save for their retirement.
51. Together these reforms have provided a foundation in which individuals can make informed decisions around their retirement. With improved knowledge around what people can expect to receive from the state, if individuals feel that this amount is sufficient they can make the choice not to save more. If they feel that it is not, then automatic enrolment will provide them with the opportunity to save more to supplement their state pension. They will also have access to a scheme in which they can easily save more than the amount set by their employer if they wish to do so.
52. Overall, increased simplicity and a reduced scope for means testing mean that a single-tier pension could improve both the financial and behavioural

incentives to save for retirement. This has been echoed by the CBI, who have stated that this simpler state pension combined with automatic enrolment would help raise awareness among individuals that it “pays to save” and allow them to build a sufficient retirement income from an early age.’

53. Evidence from the 2012 Attitudes to Pensions survey also found that around a third of retired people strongly agreed that they should have started saving for their retirement sooner³⁸.
54. In order to encourage individuals to take personal responsibility for their retirement, it is essential to ensure that messages around the planned reforms are well communicated and well targeted. This will increase trust in the system thereby increasing individuals’ interaction with it.

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³⁸ Department of Work and Pensions Research Report No. 813, *Attitudes to Pensions: The 2012 survey*, 2012