

Who Saves for Retirement? Analysing Incentives for Saving Using the Wealth & Assets Survey

James Lloyd and Timothy Fassam

In association with:



Summary

- This summarises an extensive and unprecedented research project exploring what drives pension saving behaviour. The study focuses on saver attitudes more generally, made possible by a 25,000–strong sample of the Wealth & Assets Survey.
- In terms of who saves, 45% of employees are not saving. Eligibility a key issue: while 80–90% of people employed in public administration, education or large firms are eligible to participate in a scheme, only 40% of those in retail or smaller firms can take part.
- In terms of household income and savings, relatively low levels of liquid savings are not really a barrier to pension saving. About 30% of those with no liquid savings still choose to save in a pension, and this increases to 60% for those with savings above just £2,500.
- Various factors influence people's propensity to save in different ways. Obvious ones include mortgage arrears in which people are 15 percentage points less likely to save. However liquid savings has a surprisingly small influence: 30% with no liquid savings still save in a pension; as do student loans: people with such debt are only 5 percentage points less likely to save.
- Is there a silver bullet to encouraging saving? Yes. Those with employer contributions are 70 percentage points more likely to save. It is a more powerful positive indicator by a considerable margin than both mortgage arrears and student loans combined are negative ones.
- These findings suggest that the Government's policy of autoenrollment into mandatory contributions is the right decision. However it also confirms the danger of delaying implementation for smaller firms where employees are least likely to be covered, and are the most in need of saving.

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CII Introduction: 2012 will be landmark year for a lot of things, most notably the rollout of the first phase of auto-enrollment reforms to the UK pensions system. By about 2018, it is expected that all employees in the UK will be auto-enrolled into their employer pension scheme, and the firm will be expected to be required to contribute 4% of the employee's earnings into the scheme.¹ How much of a difference will this make to people's saving habits? Behavioural economic theory tells us that the psychology of auto-enrollment might actually work. But will some people actively chose to de-enroll because of their finances, such as their income being too low, or that their partner is saving, or if they are in mortgage arrears? James Lloyd of the Strategic Society Centre and Tim Fassam from the Prudential summarise the results of their extensive survey research that casts light on these issues.²

Pensions are rarely out of the press and a regular topic for political debate. We all know that people aren't saving enough and many aren't saving at all.

The UK's pension reforms, which are set to come on stream in October 2012, represent some of the boldest and most radical policy measures to drive up pension saving rates to be found in any country. Yet we actually know surprisingly little about what drives pension saving behaviour. Although various studies have been undertaken, particularly in the US, research has tended to focus on specific groups and schemes, and the impact of particular factors.

Unlike some other studies, the findings of this report are based on a huge sample, over 25,000 employed people, making this by far the most robust study of pension saving ever undertaken in the UK.

Prudential has worked with the Strategic Society Centre (a leading think-tank) and the Institute of Economic and Social Research (ISER) at the University

¹ The phasing will be by size of employer and extent of contributions. Size of employer will start in Oct 2012 for firms with over 250 staff; to April 2017 for employees of firms of less than 30 staff. The extent of employee/employer contributions from 1% each Oct 2012; to 3% employee and 4% employer by Oct 2017. Employees must be aged 22–state pension age, and earning above the state personal allowance (£7,475 in 2011/12). See [Written Ministerial Statement on Changes to the Autoenrollment Timetable](#), 25 Jan 2012. See also: [CII Policy Briefing, Pensions Act 2011](#), Dec 2011.

² This thinkpiece is based on a report entitled *Who Saves for Retirement?* by James Lloyd (Strategic Society Centre), and Mark Bryan, Birgitta Rabe and Mark Taylor (Institute for Social & Economic Research, University of Essex), Dec 2011. Details on accessing the full report are available at the end of this article.

of Essex to analyse this issue. The fascinating results are set out in *Who Saves for Retirement?* – a study on exactly who chooses to save in a pension and, most importantly, why.

The study uses data from the first wave of the Wealth and Asset Survey (WAS), a vast longitudinal household survey spearheaded by the Office of National Statistics, which asks detailed questions about individual's finances and attitudes. Unlike some other studies, the findings of *Who Saves for Retirement?* are therefore based on a huge sample – over 25,000 employed people – making this by far the most robust study of pension saving behaviour ever undertaken in the UK.

About the Wealth & Assets Survey (WAS)

The Wealth & Assets Survey is a longitudinal survey launched in 2006 to address gaps in knowledge about the asset position and savings of households in Great Britain.

Only the first wave, collected July 2006–June 2008, is currently available but it already provides a detailed snapshot of the distribution of assets, debts and savings among British households, together with details of retirement saving and other financial Planning.

WAS interviewed approximately 55,000 individuals in 32,000 private households, with interviews with all adults aged 16+ in each household (excluding those aged 16–18 in full-time education). The survey had two questionnaires:

- (1) **a household questionnaire:** answered by the household reference person, usually the head of household or the spouse, which collected details of household structure and demographics, as well as household-level finances like mortgage arrangements; and
- (2) **an individual questionnaire:** answered by each adult, which collected economic and employment information, plus details of personal finances and behaviour.

In this article, we will set out what the research tells us about who saves, what it tells us about the factors that drive that behaviour and discuss what this means for current pensions policy.

Who Saves

So what does the pension saving landscape look like? Many are concerned that too few are saving for

retirement and the research suggests that this is a legitimate concern with 45% of employees currently not saving at all. Among those who do save into a pension, around 86% are saving into just an occupational pension, 10% into a private pension and 4% into both. These figures are relatively consistent between men and women with one exception – twice as many men just save into a personal pension.

Looking at the data in more detail there is some evidence of a substitution effect between occupational and personal pensions. Having access to an occupational scheme makes someone 10% less likely to save into a personal pension. This is not unexpected as many choose a personal pension specifically because they do not have access to a scheme via their employer.

With so many using workplace schemes to save, eligibility for an occupational scheme is a key issue and it varies widely between different industries and employers. While 80–90% of those employed in public administration, education or by large firms are eligible, only 40% of those employed in retail or in firms with fewer than 25 employees are.

Contrary to popularly held belief that those who do not save will be covered by their partner's pension, in three quarters of households where the main income earner does not save, the partner also does not.

A key finding of the research was pension saving behaviour within households. In recent years, some have suggested that low pension saving among some workers may not be a problem if one half of a couple are choosing not to save because they will be covered by a partner's pension. However, this research reveals a more worrying picture. Partners tend to make similar saving decisions. In fact in three quarters of households where the head of the household doesn't save, the partner also does not save.

It will come as no surprise that saving tendencies increase with wealth. What may come as a surprise is that the link is not as strong as you may think. While the highest rate of saving occurs amongst those earning over £30,000 (around 70%), over 1 in 10 of those earning less than £5000 choose to save and 1 in

5 of those earning less than £10,000. In many cases, these individuals are likely to be women working part-time.

While the highest rate of saving occurs among those earning over £30,000, over 1 in 10 of those earning less than £5000 chose to save, and 1 in 5 of those earning less than £5,000.

Another interesting finding relates to the interaction between pension saving and having other liquid assets. About 30% of those with no liquid savings still choose to save into a pension and this increases to 60% for those with liquid savings above £2500. However, beyond this £2500 threshold, the correlation between liquid saving and pension saving appears weak. In other words, it appears that individuals only require quite a low level of liquid, 'buffer' savings before they engage in pension saving. This has implications for recent debates about how much individuals prefer liquid saving to illiquid pension saving, and whether rules on pension saving should be redrawn to allow greater flexibility. It appears that relatively low levels of liquid savings are not really a barrier to pension saving.

What drives saving?

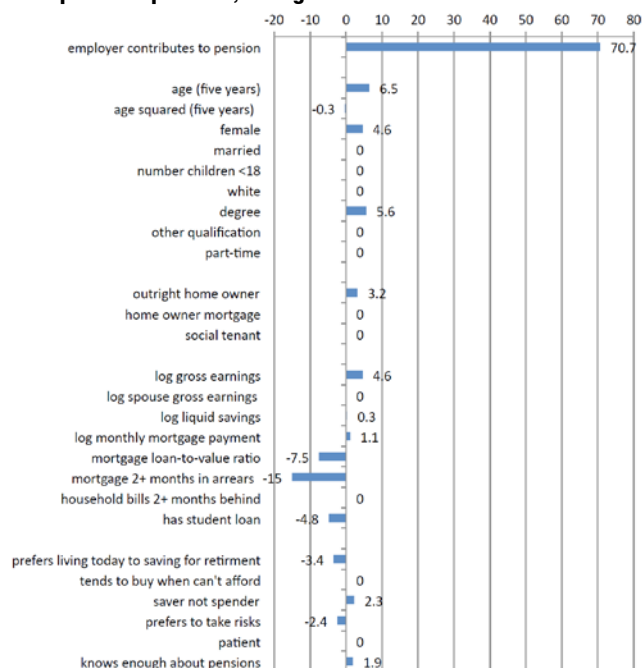
With such a large sample and broad range of variables to analyse, the real opportunity presented by *Who Saves for Retirement?* was to undertake a large regression analysis to explore in detail the factors that drive pension saving.

Regression analysis allows us to look at the impact of a particular factor while controlling for all other factors; to look at the difference one change would make between two otherwise identical individuals. This allows us to pick out particular features and attitudes that drive pension saving. This is expressed as a change in the percentage probability that an individual will save into a pension. The large sample and range of variables available for analysis meant that *Who Saves for Retirement?* was able to directly compare the effect of different factors.

Let's start with some basic demographics. Whilst the amounts saved are likely to differ, it turns out that

women are 4.6 percentage points more likely to save for a pension when eligible for an occupational scheme. Although rates of pension saving are lower among minority ethnic groups, when all other factors are controlled for, being white does not make someone more likely to save into an occupational pension.

Figure 1: Factors affecting whether people save into an occupational pension, if eligible



Source: Who Saves for Retirement? (Dec 2011), p.59. Probit regression. Columns show % change in likelihood of joining an occupational pension, if offered. 9732 observations.

Education also has an effect, with degree holders seeing a 5.6 percentage points higher probability than those with no qualifications, even after controlling for the effect of income.

It does not appear that individuals hold off pension saving until they get on the property ladder. The point that housing tenure does seem to make a difference is owning without a mortgage.

In recent years, there has been great speculation as to the role that rising house prices will have on pension saving. In terms of tenure, those owning a home with a mortgage are no more likely to save into an occupational pension than private renters. So, it does not appear that individuals hold off pension saving until they get on the property ladder. The point that tenure does seem to make a difference is owning without a mortgage: these individuals are significantly

more likely to save into both an occupational or personal pension.

What about housing costs more broadly? Unsurprisingly, being in mortgage arrears is associated with a 15 percentage point lower probability of saving into a pension. But among the majority, a 10 percentage point increase in the size of mortgage repayments is actually associated with a 0.1 percentage point increase in pension take-up. So, it does not appear that mortgage repayments ‘crowd out’ pension contributions.

Box 2: Key Findings for Personal Pensions

- **Earnings:** higher earnings are associated with a higher probability of personal pension saving. A 10% increase in earnings is associated with a 0.2 percentage points increase in the probability of saving.
- **Spousal earnings:** however, spouse’s income once again has no effect on pension saving;
- **Liquid savings:** once more, liquid savings have a marginally positive effect on personal pension saving;
- **Mortgage expenditure:** unlike occupational pension saving, the level of mortgage repayments does not appear to affect personal pension saving;
- **Mortgage loan-to-value ratio (LTV):** there is also no association between LTV and personal pension saving;
- **Mortgage arrears:** being in mortgage arrears does not affect the probability of saving.
- **Household bills in arrears:** unlike for occupational pension saving, being arrears with household bills is associated with lower participation in personal pensions.
- **Student loan:** we do not find any effect of having a student loan the probability of saving to a personal pension.

Do individuals with low levels of equity in their home prioritize repayments over pension saving? Regression analysis found that a 10 percentage point increase in mortgage loan-to-value ratio is associated with a 0.75 percentage point decrease in pension take-up, after controlling for all other factors. This is a pretty modest effect, but nevertheless highlights that households

may substitute pension contributions with mortgage repayments.

So, if housing and pension saving appear remarkably distinct from each other in household financial decisions, what was the biggest revelation regarding pension saving and personal finances? One finding stood out: even after controlling for the effect of earnings, savings, gender and age, individuals with a student loan are 4.8 percentage points less likely to save into a pension than those without such a loan. This is a strong effect, and worrying given the growing percentage of the population with a student loan.

The WAS contains some very rich questions on financial attitudes. The picture that emerged from regression analysis was complex. Being patient and over-spending don't seem to have an effect on pension saving. But attitudes to the future, attitudes to saving and knowledge about pensions can combine for an effect of 7.6 percentage points.

So after all that did we find a 'silver bullet'? A factor that had an impact far exceeding any other on whether individuals save into pension? In fact, one variable did stand out above all others: the availability of employer pension contributions.

You can have multiple characteristics which reduce the probability that you save (such as having a student loan) and still be more likely to save into a pension if you have employer contributions.

Indeed, employer contributions make an eligible employee a startling 70 percentage points more likely to save in a pension. This means that you can have multiple characteristics which reduce the probability that you save (such as being male, having a student loan and being in mortgage arrears) and still be more likely than not to save into a pension if you have employer contributions. This is an incredibly strong effect of an order that is rarely found in regression analysis.

Of course, it would have been highly surprising if employer contributions were not associated with increased pension saving. However, there has been little previous research to suggest that the association

between employer contributions and pension saving is so dominant as it is, nor based on such thorough analysis of the saving behaviour of over 25,000 workers. Employer contributions have by far the largest impact on participation pension saving compared to other relevant factors such as income and job-type.

What does this mean?

First – and most importantly – it suggests that the government's pension reforms, which will see workers automatically enrolled into workplace schemes with employer contributions available, are likely to be a success. The research shows that the biggest single determinant of pension saving is eligibility for a workplace scheme. Simply by making pensions available through every workplace we are likely to see a significant increase in the number choosing to save.

There is nothing else in the policymaker's arsenal that is anywhere near as effective at getting individuals to save as ensuring eligibility for workplace pensions with employer contributions.

This effect is more powerful, even startling, when combined with an employer contribution. As this is exactly what we will be rolling out from next year, we can afford to be confident. And the prevalence of pension saving identified in *Who Saves for Retirement?* among those with low-earnings, low-savings and working part-time again reinforces that pension saving is for everyone, and is not a 'minority sport' for higher income households.

Second, the importance of small businesses being part of the reforms has been made very clear, and the implications of recent government decisions to partially delay implementation of reforms. The research shows that only 4 out of 10 people who work in firms employing fewer than 25 staff are eligible for a workplace pension. As about 30% of the workforce work in a firm of this size, a huge proportion of those who could have benefited most from these reforms could be excluded.

So while we understand the thinking behind the decision to delay automatic enrolment by one year for small firms, it is important that in time those

employees have access to good quality occupational pension. Put simply, there is nothing else in the policymaker's arsenal compared to ensuring eligibility for workplace pensions with employer contributions that is anywhere near as effective at getting into individuals into pension saving. So, as much as taking on greater responsibilities for offering pensions may be a burden for some smaller employers, if the UK workforce is ever to save adequately for retirement, this is simply an unavoidable step.

Third, the powerful effect that 'matching contributions' from someone else on whether someone saves into an occupational pension raises questions again regarding ongoing debates about whether tax-relief on contributions should be 'repackaged' by the government as 'government contributions'. Not all individuals understand tax-relief on their pension contributions, but the availability of cash contributions from a third-party appears to have a very strong effect.

The government may be 'missing a trick' if it does not make the most of how it presents tax-relief.

Fourth, we need to ensure effective communication. Not all who are eligible for a workplace pension may realise it, and not all appreciate the significance of employer contributions. That is why we support the Government's communications campaign with various stakeholders to boost awareness of auto-enrolment in partnership. Our advice is that employer contributions feature prominently!

Who Saves for Retirement? by James Lloyd, Strategic Society Centre, Mark Bryan Birgitta Rabe and Mark Taylor (Institute for Social & Economic Research, University of Essex), December 2011. The full report can be accessed from the Strategic Society Centre website: www.strategicsociety.org.uk/book/who-saves-retirement.html

If you have any questions or comments about this Thinkpiece, and/or would like to be added to a mailing list to receive new articles by email, please contact us: thinkpiece@cii.co.uk or on: +44 (0)20 7417 4783.



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