ROYAL LONDON POLICY PAPER 13

A three point manifesto for pensions

ABOUT ROYAL LONDON POLICY PAPERS

The Royal London Policy Paper series was established in 2016 to provide commentary, analysis and thought-leadership in areas relevant to Royal London Group and its customers. As the UK's largest mutual provider of life, pensions and protection our aim is to serve our members and promote consumer-focused policy. Through these policy papers we aim to cover a range of topics and hope that they will stimulate debate and help to improve the process of policy formation and regulation. We would welcome feedback on the contents of this report which can be sent to Steve Webb, Director of Policy at Royal London at steve.webb@royallondon.com

Royal London Policy Papers published to date are:

1. The "Living Together Penalty"
2. The "Death of Retirement"
3. Pensions Tax Relief: Radical reform or daylight robbery?
4. Britain's "Forgotten Army": The Collapse in pension membership among the self-employed – and what to do about it.
5. Pensions Dashboards around the World
6. The 'Downsizing Delusion': why relying exclusively on your home to fund your retirement may end in tears
7. Renters at Risk
8. Pensions Tax Relief: 'Time to end the salami slicing'
9. The Mothers Missing out on Millions
10. The Curse of Long Term Cash
11. The 'Mirage' of Flexible Retirement
12. Will harassed 'baby boomers' rescue Generation Rent?
13. A three point manifesto for pensions

The Policy Papers are available to download from http://royallondon.com/policy-papers

A THREE POINT MANIFESTO FOR PENSIONS

Executive Summary

The new government faces two key challenges on pension policy:

- To support existing pensioners in a fair and sustainable way;
- To ensure that today's workers, both employed and self-employed, build up a decent pension to complement the state pension they will receive in retirement

In this 'manifesto' we set out three key areas where the new government needs to take action and make recommendations for reform.

A) The State Pension and the 'triple lock'

Since 2010, the state pension has been increased each year by the highest of the growth in prices, wages or a floor of 2.5% - the so-called 'triple lock'. This policy has resulted in a significant uplift to the rate of the state pension and has contributed to the fall in pensioner poverty. But it has come at a cost. It is estimated that the cost of state pensions is now around £6 billion per year higher than if the pension had been linked only to the growth in earnings.

Whilst the cost of the triple lock in the next few years is likely to be low, mainly because inflation and wage growth are now close to 2.5%, the Office for Budget Responsibility has estimated that retaining the triple lock in the very long-term would add around 1% of GDP to the cost of state pension spending.

On the other hand, pensioner poverty has not been eliminated. Roughly half of all pensioners are too poor to pay income tax, and nearly two million claim means-tested top-ups simply to meet daily living costs[1]. So what should an incoming government do to ensure that the pension system is affordable in the long-term whilst supporting those pensioners, and particularly older pensioners, who are living on more modest means.

In this paper we advocate a 'middle way' on the triple lock. We suggest that all pensioners who reached pension age before 6th April 2016, and who are therefore dependant on the old system of a basic pension of around £120 per week plus any earnings-related state pension, should continue to receive the triple lock. But newer pensioners – those who reached pension age since that date – would instead see the new state pension rate of just under £160 per week linked only to average earnings.

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/591734/dwp-quarterly-stats-summary-february-2017.pdf

We note that the newly retired tend to be substantially better off than older pensioners and this policy would therefore broadly target those most in need. As we show in this report, the average newly retired pensioner is around £100 per week better off than those who are aged 75 or over.

This policy would not save much in the early years, but would save around £500m per year by 2021/22 and nearly £3 billion per year by 2027/28. We believe that this strikes the right balance between long-term fiscal sustainability and ensuring dignity and security for today's pensioners.

B) The self-employed

Whilst pension coverage amongst employed earners has risen sharply since the advent of automatic enrolment in 2012, coverage amongst the self-employed has continued to fall. According to the DWP, only around 1 in 7 self-employed people contributed into a pension last year. Without urgent action, millions of self-employed people face a choice between working on long past normal retirement ages or seeing a sharp fall in their standard of living when they retire.

We therefore advocate a system of 'automatic enrolment' for the self-employed. Whilst the self-employed do not have an employer to fulfil this duty, millions of self-employed people file an annual tax return and pay income tax and National Insurance to HM Revenue and Customs. We believe that the Government should use this process to provide a strong 'nudge' to the self-employed, effectively requiring them to contribute to a pension by default unless they actively opt out. Without a measure of this sort, this longstanding problem will continue to get worse. We do not believe that simply running awareness campaigns or offering modest savings incentives would match the scale of the problem.

C) Employees

We very much welcome the fact that automatic enrolment is set to bring around ten million additional workers into pension saving. But the average amounts being contributed are currently insufficient to generate a decent income in retirement. Previous research by Royal London has shown that those who contributed only the statutory minimum contributions under automatic enrolment could face working well into their 70s or beyond if they want the sort of pension enjoyed by previous generations.

In 2019 the minimum contribution under automatic enrolment will be 8% of a band of 'qualifying earnings' starting at £5,876 per year. We believe that this contribution rate is far too low.

Building on the lessons of automatic enrolment, we propose that as a default, contribution rates should rise each year to coincide with workers' pay rises. This could be done gradually – perhaps at 0.5% per year – but would happen automatically unless the worker opted out. The process would continue until contribution rates were in the 12-14% rate which we estimate should generate a much more realistic pension pot for today's workers. Without such an initiative we believe that the success of the automatic enrolment programme to date could be undermined.

1. State pension uprating

a) Uprating policy - background

From 1980 to 2010 the annual increase in the basic state pension was generally linked to the increase in prices as measured by the Retail Prices Index (RPI). On occasion there would be discretionary above-inflation increases, most notably the £5 per week increase in April 2001 the year after the notorious 75p increase in a year when the RPI was particularly low. But overall the policy of price indexation meant that the basic state pension formed a declining percentage of the national average wage.

Since 2010 the Coalition Government and now the Conservative Government has applied the 'triple lock' policy. This is to increase the basic state pension each year by the highest of three numbers:

- The growth in prices, measured (since 2011) by the consumer prices index (CPI);
- The growth in average earnings;
- A floor of 2.5%

The third element of the triple lock – the 2.5% floor – had an impact on the upratings in April 2013, April 2015 and April 2017, as in each of those years both price inflation and wage inflation were below 2.5%.

b) The impact of the triple lock on individuals – an anomaly

The UK state pension system was radically reformed in April 2016. Prior to 6th April, those reaching state pension age received a 'basic' state pension – currently £122.30 per week – if they had made 30 years of National Insurance Contributions (NICs), and a second, earnings-related, state pension variously known as SERPS or the 'second state pension'. The size of this pension depends on their contribution history and on whether they were members of a private pension arrangement which 'contracted out' of this part of the state scheme.

For those who have reached pension age since 6th April 2016 there are no longer two tiers of pension provision but instead a 'single tier' pension payable at £159.55 for those with 35 years of full rate contributions. There is a one-off deduction from this figure for those with a past history of 'contracting out'.

One anomaly in the way in which the triple lock applies is that the guarantee applies only in respect of the basic state pension for pre April 2016 pensioners but in respect of the full flat rate pension for new pensioners[2]. The policy is therefore more generous to the newly-retired which is somewhat perverse given that on average this group tends to be better off (see below).

This anomaly is summarised in Table 1 which compares two pensioners – one who retired pre April 2016 and has a pension made up of a basic pension of £122.30 and a state second pension of £37.25, and another

[2] Any SERPS or state second pension is uprated only in line with the CPI.

who retired post April 2016 and simply receives the full flat rate of £159.55. Purely for purposes of illustration we assume that CPI is in line with the Bank of England's target of 2.0% and that the triple lock 'bites' by generating an increase of 2.5%.

Table 1. Triple Lock anomaly – two pensioners on the same income receive different annual increases

1. Pre-April 2016 pensioner	Uprated by?	Cash value of uprating
Basic state pension (£122.30)	Triple lock (2.5%)	£3.06
Second state pension (£37.25)	CPI (2.0%)	£0.75
TOTAL (£159.55)		**£3.81**
2. Post-April 2016 pensioner		
New state pension (£159.55)	Triple lock (2.5%)	**£3.99**

As the table shows, these two pensioners who have identical total state pensions are getting a different amount of uprating. The difference on these assumptions and over one year is modest (just 18p per week) but over time the gap could grow considerably and there is no logical reason why the new pensioner should receive more favourable treatment.

c) The cost of the triple lock – short-term

The Government Actuary's Department has estimated that the impact of the triple lock added around £6 billion per year to spending on state pensions compared with indexation in line with average earnings which is the statutory minimum requirement[3]. It could be argued that this figure overstates the true cost of the triple lock since it would have been politically difficult for any government to have adhered rigidly to indexation by average earnings at times when price inflation was higher. So, for example, in 2012, wage inflation was 2.7% whilst price inflation was 5.2%. Even without the triple lock policy it seems reasonable to think that the government would have struggled to increase pensions by just 2.7% in that year. Politically, something like a 'double lock' – the higher of prices or earnings – may be the least that could be delivered. Nonetheless, the cost of the triple lock was significant over the course of the last Parliament.

Looking ahead, the cost of the triple lock over the course of a Parliament running from 2017 to 2022 is likely to be relatively modest. This is because the rate of growth of wages and prices is now close to 2.5%, and price inflation appears to be on an upward trend. Even without the third element of the triple lock, it is hard to think that state pensions would go up by much less than 2.5% per year over the next five years in any case.

[3] This paper was published and then withdrawn but a copy can be viewed at: http://paullewismoney.blogspot.co.uk/2015/10/gad-on-triple-lock.html

The OBR assumes that in the medium term, the triple lock adds around 0.34% to the pension uprating each year compared with the statutory requirement to uprate in line with the growth in average earnings[4]. If we assume that this is correct for the next five years, Table 2 gives a simple estimate of the 'cost' of the triple lock during the next Parliament. It is based on total expenditure in 2017/18 on the basic state pension and the 'new state pension' of around £76.4 billion.

Table 2. Short-term cost of triple lock – based on OBR assumption of additional 0.3% per year uprating[5]

	Addition to uprating arising from triple lock	Additional public spending
2018/19	0.34%	£0.26 bn
2019/20	0.68%	£0.52 bn
2020/21	1.02%	£0.78 bn
2021/22	1.36%	£1.04 bn
2022/23	1.70%	£1.30 bn

This simple table suggests that retaining the triple would add a little over £1 billion per year to spending on the basic state pension and new state pension by the end of 2017-22 Parliament, against a baseline spending figure in 2017/18 of just over £76 billion.

d) The cost of the triple lock – long-term

The bigger concern that has been expressed about the triple lock is the cost of persevering with the policy over a period of decades. The compounding effect of higher annual indexation, reinforced by the growing size of the pensioner population, means that the triple lock would add significantly to the share of national income taken up by state pension spending.

The OBR, in its 'Fiscal Sustainability' report published in January 2017, estimated that over a fifty-year period, the consistent application of the triple lock was increase state pension expenditure by just under 1% of national income. This would be in addition to the other upward pressures on public spending on public service pensions, the NHS and social care resulting from an ageing population. Table 3 shows how the share of spending on different items is set to grow based on current policies.

[4] Source: OBR Fiscal Sustainability Report January 2017, Para 21, Page 7.
[5] *Note: This simplified analysis ignores the 'compounding' effect of the additional 0.3% per year, and also the slowly changing mix between people receiving the old basic pension and the new state pension. Neither of these assumptions makes a significant difference in the short-term*

Table 3. Public spending as a share of GDP, selected items, in 2021/22 to 2066/67

	2021/22	2066/67
State Pensions	5.0%	7.1%
Health	6.9%	12.6%
Social Care	1.1%	2.0%
TOTAL	**13.0%**	**21.7%**

Source: OBR Fiscal Sustainability Report, January 2017

Whilst the biggest spending pressure clearly comes from health rather than from pensions, health spending is likely to be 'demand-led' and more difficult to control than state pension spending which is a matter of judgment for the government of the day. The desire to avoid significant long-term commitments on state pension spending is therefore likely to be considerable.

One reason to be concerned about the future cost of state pensions would be because the state pension system is run on a 'pay-as-you-go' basis – today's pensions are paid from money raised from today's taxpayers. A rising bill for an ageing population translates into a rising tax bill on the working population, and there may be concerns about the intergenerational equity of continued increases in the tax burden on those of working age.

However, even setting aside intergenerational concerns, there may be an argument that within the total amount to be spent on the older population, older people themselves may prefer a different balance. Given a choice between slightly larger annual increases in the state pension or a better funded system of health or social care, it may be that many pensioners – and perhaps particularly older pensioners – would opt for the latter over the former.

e) What do we know about pensioner incomes?

Given concerns about the potential long-term cost of the triple lock, one option would be to scrap the policy forthwith. One argument for this is that pensioners as a group have significantly improved their position relative to the working age population since the triple lock policy was introduced and therefore have no need of further assistance. Proponents of this view would cite the latest 'Households Below Average Income' statistics published by the Department for Work and Pensions and shown in Figure 1 below.

Figure 1. Average (median) net household disposable income (after housing costs) in 2015/16 prices

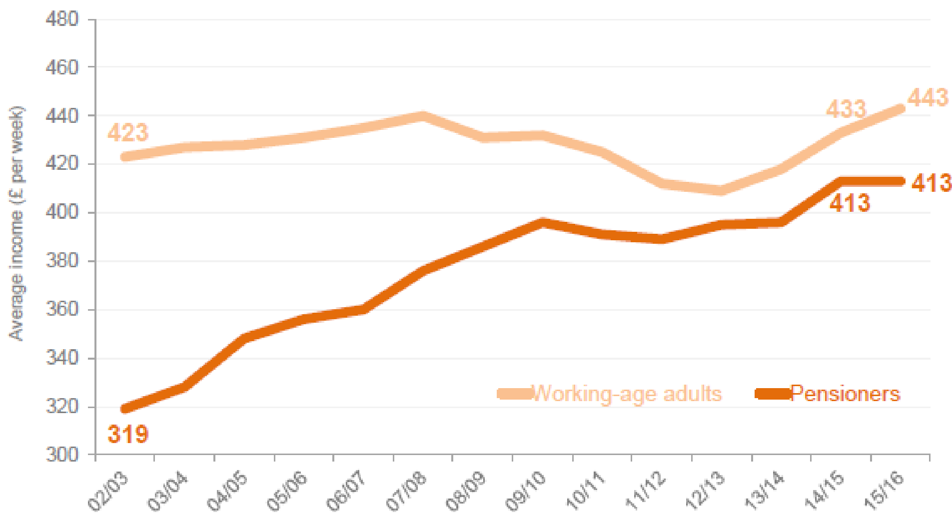
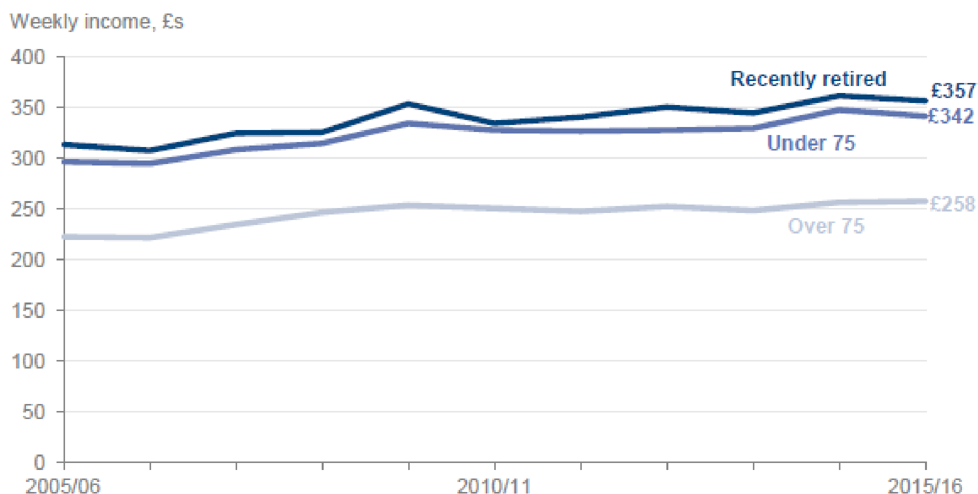


Figure 1 shows average incomes for working age adults and pensioners based on income after housing costs have been paid. Whereas in the early part of this century pensioners were more than £100 per week behind those of working age, the gap had shrunk to just £30 per week by 2015/16. On this basis, the case for regarding pensioners as a generally needy group is much weaker than once it was.

However, figures published on the same day in the 'Pensioners Income Series' also provide a reminder that pensioners are far from being a uniform group. There are big differences between men and women and, of particular interest to us, between younger and older pensioners.

Figure 2 shows trends in the last decade in the weekly income of the recently retired (those within five years of state pension age), the under 75s and the over 75s.

Figure 2. Average (median) weekly income of pensioners (after housing costs) in 2015/16 prices



What is striking about this chart is the persistent gap in living standards between younger and older pensioners. Whilst both have seen real increases in their standard of living, the gap between the newly retired and the over 75s is substantial and has, if anything, increased in recent years. The average income of a newly retired pensioner is almost exactly £100 per week higher than that of someone aged over 75. This suggests that generalisations about the 'end of pensioner poverty' may be somewhat premature.

f) Policy options – a middle way on the triple lock

We have observed a number of issues raised by the triple lock policy:

- In the short-term the cost of the policy is relatively modest, mainly because of the rise in inflation, but if the policy was applied consistently over a period of decades it would add significantly to the rising costs of an ageing population;

- The triple lock has helped to improve the relative position of pensioners, but there are big differences within the pensioner population, with older pensioners having substantially lower average incomes than the recently-retired;

- There is a particular anomaly which means that newly-retired pensioners on the new state pension (those who reached pension age after April 2016) get bigger increases under the policy than all other pensioners;

So, is there a way to tackle the potential long-term unsustainability of the triple lock whilst recognising the needs of current older and poorer pensioners? We believe that there is. Our proposal is:

- To retain the 'triple lock' policy for those who reached state pension age before 6th April 2016 – namely those receiving the old basic state pension and
- To revert to earnings indexation for the newly retired recipients of the new state pension;

There are a number of attractions to this policy:

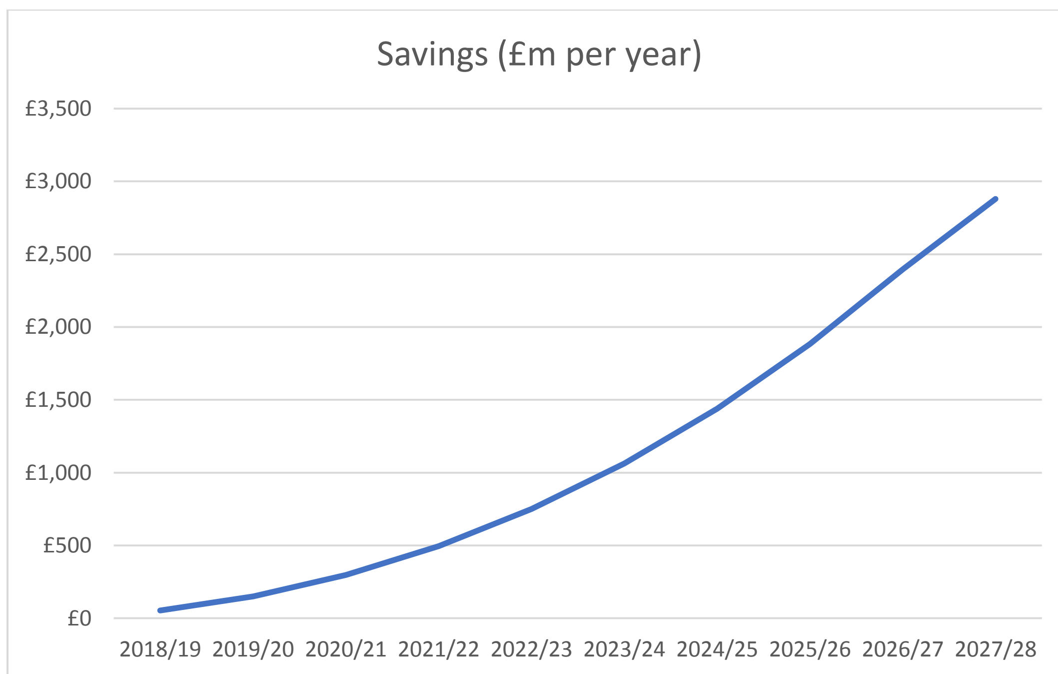
a) The cost of the triple lock is immediately capped and declines every year as the balance between newly-retired and older pensioners shifts;
b) The money spent on the triple lock is diverted away from the generally better-off newly-retired and focused on the generally poorer older pensioners;
c) The savings from this shift build up gradually over time and are therefore greater in the medium term when the pressures on public spending from an ageing population are likely to be more intense;
d) This would largely resolve the anomaly whereby older pensioners get lower indexation under the triple lock than newer pensioners; under this policy, older pensioners would get a mix of triple lock indexation of their basic state pension and CPI indexation of their additional state pension, whilst

newer pensioners would get earnings indexation of their full flat rate pension; this is a fairer balance than the current system.

g) Exchequer Impact

The savings to the taxpayer would be modest in the early years because the majority of pensioners would still be covered by the triple lock. But with every passing year the savings would grow, as shown in Figure 3. This chart is based on the assumption that the impact of the triple lock is that annual increases in the new state pension are 0.34% higher than with the link to earnings.

Figure 3. Annual savings from 'Middle Way' approach to the triple lock



As the chart shows, savings from this policy are initially very modest as the vast majority of pensioners in the early years are still covered by the triple lock. However, by 2021/22 annual savings are running at around £500m, and by 2027/28 the saving is a little short of £3 billion.

2. Coverage of automatic enrolment

a) Employees

Since the start of automatic enrolment into workplace pensions in 2012 more than seven and a half million workers have so far been enrolled into a pension by their employer. By the time all firms have reached their staging date an estimated ten million will have been enrolled. However, there are millions of workers in Britain who are not covered by automatic enrolment and who may have low levels of pension provision.

Amongst employees, the Pensions Regulator has published figures up to March 2017 on the numbers who have been enrolled, those who were already in a pension, and those not within scope. These are summarised in the following table:

Table 4. Coverage of automatic enrolment as at March 2017

Total employees at firms who have reached their date for automatic enrolment *Of which:*	**24,779,000**
- Already in a qualifying scheme[6]	10,381,000
- Newly automatically enrolled	7,657,000
- All other workers	6,741,000

Source: the Pensions Regulator, Automatic Enrolment Declaration of Compliance Report, March 2017

As Table 4 shows, over 10 million workers at these workplaces were already in pension schemes that met the requisite standards and more than 7 million have been enrolled as part of the programme. However, there are still 6.7 million workers who have not been included. The main exclusions will be:

- Those earning under the automatic enrolment trigger threshold of £10,000 per year;
- Those aged under 22 or over state pension age;

In each case these are deliberate exclusions. Younger workers were excluded to make sure that employers were not put off giving someone their first job by additional costs such as pension contributions. Older workers were excluded on the basis that many would be drawing a state pension and might have other sources of income and also because the benefits of additional saving would have little time to be felt. Lower earners were excluded partly to reduce the burdens on employers and partly because a state pension of more than £8,000 per year already provides a relatively large element of replacement income for those who persistently only earn £10,000 per year or less.

[6] Note that we have included in this category approx. 430,000 workers in workplaces running 'defined benefit or hybrid' schemes to which different rules apply.

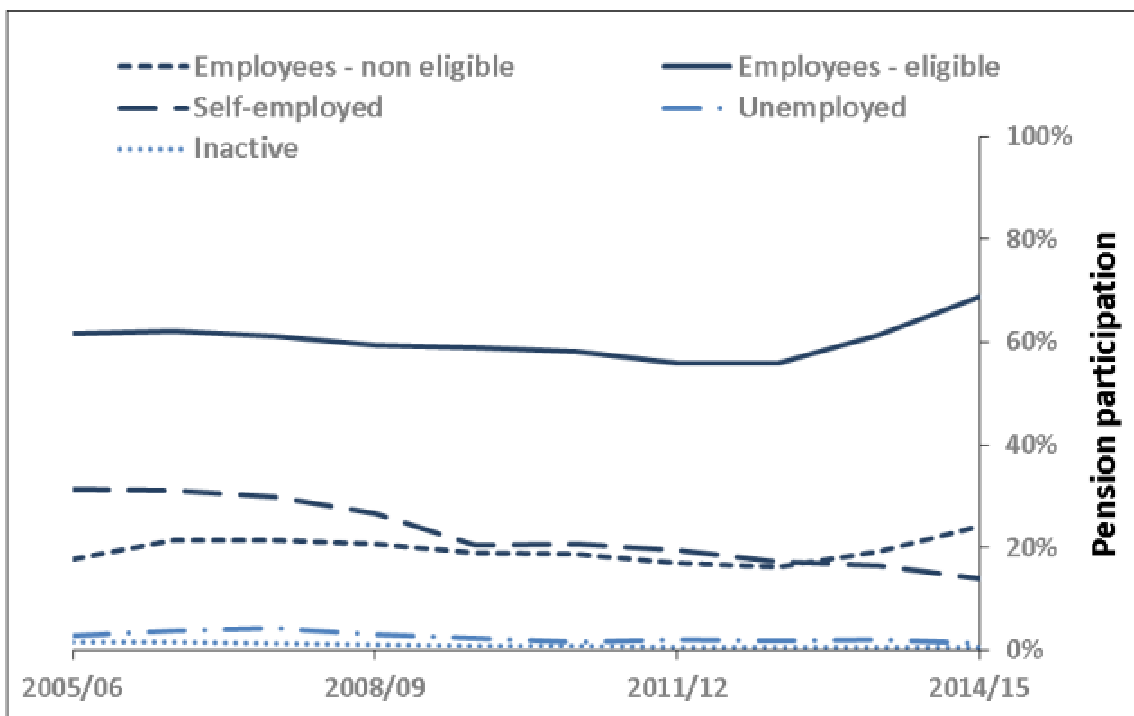
Whilst there are justifications for these exclusions, we believe that the government should look again at these rules to ensure that those employees who could benefit from a workplace pension have the chance to do so. In particular we think that there is a case for removing the age limits altogether.

b) The self-employed

There is another large group of economically active people of working age who do not fall within the scope of automatic enrolment, and this is the self-employed. Arguably, this is a more important cause for concern than low-earning employees because many of these will face a sharp fall in their standard of living on retirement unless they start to save for a pension.

Levels of pension saving among the self-employed have fallen dramatically in recent years and are now at historically low levels, as shown in Figure 4.

Figure 4. Pension scheme membership amongst different economic groups 2005/06 to 2014/15



Source: Modelled analysis derived from the Family Resources Survey, UK, 2005/06 to 2014/15.

Source: DWP Automatic Enrolment evaluation report 2016, Figure 3.6

As Figure 4 shows, pension scheme membership amongst the self-employed has been well below that of the employed population for many years. Whereas membership amongst the employed has started to increase sharply because of automatic enrolment, membership amongst the self-employed has continued to fall. Strikingly, coverage is now lower amongst the self-employed than it is even amongst employees who do not come within the scope of automatic enrolment (such as those earning under £10,000 per year and those outside the relevant age limits).

These statistics for the self-employed are averages across all groups, and coverage amongst groups such as female self-employed, part-timers and low earners is particularly low. If these groups of self-employed people are ever to be able to afford to retire, we believe that urgent government action is needed to prompt them to save, drawing on the lessons of automatic enrolment.

We know that more than two million self-employed people earn enough to pay Class 4 National Insurance Contributions. The current threshold for Class 4 NICs is £8,164 per year. Just as automatic enrolment applies only to those earning more than £10,000 per year, it seems reasonable to think that we would be most concerned about the self-employed people who come within scope of Class 4 NICs, rather than those with lower profits.

In 2016 we published a Royal London policy paper – 'Britain's Forgotten Army' – on the subject of pensions and the self-employed[7]. In it, we suggested that Class 4 National Insurance Contributions might be increased from their current rate of 9% to a new rate of 12%. The self-employed would then be given a choice as to whether they wanted that additional 3% to go to the Exchequer or to be re-directed to a personal pension. This would be a similar 'nudge' to that for employed earners where their employer will be required to contribute 3% of their wage to a workplace pension. Our proposal was that the self-employed would then contribute 5% (gross of tax relief) directly into their own pension making a total contribution of 8%.

Since we came forward with this proposal, the Government has proposed a 1% increase in Class 4 NICs for 2018 and again for 2019. This was partly a revenue-raising measure and partly in recognition of the 'windfall' improvements in state pension rights enjoyed by many self-employed people as a result of the introduction of the new state pension in 2016. However, there was considerable political opposition immediately after the Budget, principally because the change was felt to be at variance with a commitment in the Conservative election manifesto not to increase income tax, National Insurance or VAT rates. As a result, the proposal was withdrawn.

It may be, therefore, that suggesting an increase in self-employed NICs would now be regarded as politically infeasible. But we believe that the basic idea of a large 'nudge' to the self-employed to get them started on pension saving remains a good one. We are therefore looking at ways in which the income tax system and/or the process of completing a self-assessment tax return by the self-employed could be turned into a behavioural 'nudge' to get the self-employed saving more. We welcome the fact that the 2017 review of automatic enrolment includes consideration of the lack of pension coverage among the self-employed and we urge the government to go beyond the usual awareness raising and publicity campaigns which are simply not powerful enough to drive the changed behaviour that we urgently need to see.

[7] Royal London Policy Paper No. 4: "Britain's Forgotten Army – the collapse in pension membership among the self-employed and what to do about it" – available at www.royallondon.com/policy-papers

3. Contribution levels under automatic enrolment

As discussed in the previous section, automatic enrolment has been hugely successful in increasing the number of employees saving into a pension. But at this stage, it has not yet succeeded in getting people saving enough into a pension to generate a decent income in retirement. Current statutory minimum contributions are just 1% from employees and 1% from employers, and these apply only to a band of 'qualifying earnings' (those in excess of £5,876) rather than to total earnings. Even when contribution levels have been phased up to their full level in April 2019, the total contribution rate will only be 8% of qualifying earnings - split 5% from the employee and 3% from the firm. For someone on the national average wage, this equates to a contribution of just over 6% of their total pay.

Compared with contribution rates into older, final-salary pensions, contribution rates under automatic enrolment are sharply lower. Analysis in the Royal London Policy Paper 'The Death of Retirement', published in February 2016, suggested that typical contribution rates into old-style 'Defined Benefit' pensions were typically around 20% of salary. There is therefore a real risk that unless action is taken, there could be a fall of up to two thirds in the amount of money going to provide for each worker's pension.

a) The impact of low contribution levels

The consequence of these low contribution rates are that workers will face an unenviable choice between retiring poor or working significantly beyond traditional retirement ages. In 'The Death of Retirement' we looked at the potential retirement age of someone who only contributed into a pension at the statutory minimum level based on a 'gold standard' retirement income of two-thirds of their pre-retirement income, and a 'silver standard' of half of their pre-retirement income. Within each of these overall targets we looked at how long you would have to work to build up a gold or silver standard pension that kept pace with inflation and provided for a pension for a surviving spouse after your death. The results are summarised in Table 5.

Table 5. Estimated retirement ages for an average earner to receive target levels and types of pension provision

	"Gold Standard" (67% of pre-retirement	"Silver Standard" (50% of pre-retirement income)
Index-linked, with survivor benefits	77	71
Index-linked, no survivor benefits	76	71
Level pension	73	67

Source: 'The Death of Retirement', Table 1

This analysis shows that, at current contribution levels under automatic enrolment, someone wanting a 'gold standard' pension at retirement which kept pace with inflation and provided for a surviving spouse would need to work on to an age of 77. Even a gold standard pension with no inflation protection and nothing for a spouse would require working to 73. Targeting a lower 'silver standard' pension would allow the individual to retire rather earlier, but still at an age well beyond traditional retirement ages.

Our conclusion from this analysis is that a contribution rate of 8% in 2019 is simply not enough, and we need to plan how best to get people saving at more realistic levels.

b) How much is 'enough'?

The state pension is now paid at a flat rate of a little over £8,000 per year, and this will provide a substantial replacement of pre-retirement earnings for those on modest wages of £10,000 per year or less. But for those earning much more than this, an additional private pension will be needed if people are to avoid seeing their living standards slump on retirement or having to work on well past state pension age.

In Table 6 we estimate what percentage of 'qualifying earnings' would be required as a contribution rate to enable someone to stop work at 68 and achieve the specified target level and type of pension provision.

Table 6. Estimated contribution rates for an earner on the average wage to receive target levels and types of pension provision at age 68.

(% of band earnings required)	"Gold Standard" (67% of pre-retirement	"Silver Standard" (50% of pre-retirement income)
Index-linked, with survivor benefits	25.1%	13.8%
Index-linked, no survivor benefits	22.4%	12.3%
Level pension	13.8%	7.6%

Source: Death of Retirement, Table 5

The table suggests that the current rules which will require a contribution of 8% of 'qualifying' earnings by 2019 means that someone who wants to retire at 68 will only get a 'silver standard' pension (one that gives them an income at retirement of half their income in work) and with no protection against inflation or provision for a widow/widower. An equivalent pension at the gold standard level would need contribution rates of just under 14%.

Interestingly, a figure in the 13-14% range is not dissimilar to the estimate produced in 2016 by the Pensions and Lifetime Savings Association (PLSA). In their report, "Retirement income adequacy: Generation by Generation", the PLSA suggest that a target contribution rate of at least 12% would be needed to ensure that people could afford to retire at a realistic age with a decent standard of living.

c) How to get contribution rates up

The key challenge, in a system of voluntary pension saving, is how to get contribution levels up from 8% without triggering large-scale opting out. So far opt-out rates under automatic enrolment have been remarkably low, and it is estimated that around 85% of all those who will eventually be automatically enrolled will remain in pension saving. A sudden or substantial increase in contribution rates would risk undermining that achievement.

We therefore recommend that any increase in contribution rates should be gradual and that increases should be timed to coincide with pay rises. This means that those who remain in pension saving would not face a cut in their take home pay but would simply see a smaller increase than they would otherwise have seen. It seems reasonable to suppose that this will reduce opt-out rates.

Specifically, we propose to harness the inertia which has underpinned the success to date of automatic enrolment. We propose that workers would be initially automatically enrolled at a combined contribution rate of 8% but that each year, by default the contribution rate would be increased. Given relatively modest levels of pay rises it may be safest to increase the contribution rate in small steps such as 0.5% per year, but this would need to be carefully modelled. Workers would be free to opt out of this stepped increase, but if they did not do so then their contribution rate would rise. This process would continue until the contribution rate had reached a more realistic level, perhaps in the 12-14% range.

One issue with this approach would be what happens when people change jobs. If new workers with a firm were automatically enrolled at 8% then those who changed jobs frequently would never experience a sustained period of contributing at the higher rate. We therefore recommend that when employees change job their P45 should carry information about the contribution rate that they have reached and the new employer would immediately start them at that contribution rate. This would avoid them slipping back to a lower rate and would keep them at a pension contribution rate to which they had become accustomed.

d) Timing

The 8% contribution level will be reached in 2019 and we believe that urgent action is need to keep the momentum going after that date. Legislation for default increases in contributions would take time to draft and implement, and so we believe work needs to start now to put in place the necessary measures. Without this, the success of automatic enrolment in getting people started on the journey to pension saving could be undermined by a generation of workers reaching later life with inadequate pension pots and unable to afford to retire.