Summary

- Fewer than 20 per cent of self-employed workers are saving into pensions – the inverse of employees.
- While we think of the self-employed as a cohesive, homogenous cohort, needs are more specialised and individualised.
- Further reform is needed, particularly around auto-enrolment in pensions or a reduction in penalty fees for those with LISAs.

The sum of many small parts

As the number of self-employed continues to rise, what changes are required to better assist them in their retirement saving?

Much of the conversation around pensions focuses on the bigger picture – the funds, the assets under management, the legislation, the actions of the government – but too often all the industry's talk lacks speaking about those it works for on an individual basis. Even when talking about pension holders, the discourse focuses on groups and demographics, the sum of their parts rather than the individual pieces (people) themselves.

This tone is highlighted by its opposition: The role of pensions savings in the habits of the self-employed population.

According to HMRC, the number of self-employed people in the UK making pension contributions rose from 350,000 to 360,000 between 2022 and 2024. Over the same period of time, the amount of contributions paid by that cohort only rose from £2.3 billion to £2.7 billion.

And there still remains a huge discrepancy between those paying into a pension while self-employed compared to those doing so as an employee. Figures from the Institute for Fiscal Studies (IFS) indicate that 80 per cent of self-employed people are not paying into a pension – the opposite of salaried employees, of which 80 per cent are paying into a pension.

The proportion has been on a downward trajectory for some time, since other figures from the IFS indicate that just over 25 years ago, in 1998, 48 per cent of the self-employed paid into a pension. The proportion has since fallen by roughly 30 percentage points, or just over 60 per cent.

There are many reasons for this, says St. James's Place head of advice, Claire Trott. "The self-employed have long faced barriers when it comes to pensions," she says, "and recent changes to allowances risk making it even harder. Early in their careers, many prioritise reinvesting profits back into their businesses, which means pension saving is often delayed. "By the time they can afford to contribute more, they can find themselves constrained by annual allowance limits and only limited carry-forward options."

She adds: "Awareness is another hurdle. Incentives to save only work if people understand the benefits of pensions, yet education alone is rarely enough. For many, the reluctance to lock away large sums reflects the reality of irregular earnings – a poor year in business can quickly change financial priorities."

Nest Insight managing director, Will Sandbrook, points to further factors.

He says: "It's also important to consider the changing nature of self-employment, and the growth of the self-employed workforce in recent years. A significant proportion of the growth in (UK) labour-market participation over the past 20 years is driven by the growth in self-employment, even after a slight fall-back after the Covid-19 pandemic; that growth includes the 'gig economy', which didn't exist in the same way 20 years ago."

He adds: "This points to a large new cohort of self-employed people, who may be less likely to save through a pension, than previous cohorts of self-employed people. Meanwhile, this could be part of a cohort effect, where an older generation of self-employed people – who were likely to have a pension – are retiring."

How the self-employed save for retirement

There is no one-size-fits-all solution for retirement planning, especially in the cases of those who work for themselves.

One of the big myths, says AJ Bell pensions and savings expert, Charlene Young, is that a big lump sum is needed from the outset to build a pension pot. It is much better, she says, to save a little but to do it often, allowing for the magic of compounding. "It's those small numbers," she adds, "that you may miss a little less on a day-to-day basis."

There is also the argument that many pension arrangements are not ideal for the self-employed because they lack both flexibility and the contributions that would otherwise be matched by an employer.

The IFS senior research economist, Laurence O'Brien, says that the level of wealth held by the self-employed roughly aligns with others working in the private sector (public sector DB pensions are a much-different beast). This, he says, will often be held in other places such as property, meaning that it will not be counted towards pensions savings.

"There are reasons to be concerned about their pensions savings," he says, "but there are also some nuances there about how they can be saving in other things."

The Pensions Policy Institute head of modelling, Tim Pike, raises another point. "When we think about retirement incomes," he says, "the state pension also plays a part. Even in the bottom half of retirement incomes, there is still a dominance by the state pension. It's only when you get to the top half of the distribution that most of the money comes from private savings. So, when you talk about those with low savings, their most-effective way of saving for retirement is making sure that they are qualified for the state pension."

Helping the self-employed save for retirement

One vehicle that many self-employed do opt for has been a Lifetime ISA (LISA). These push holders to save for a house or for later life. They allow someone to save £4,000 a year until the age of 50, with the government adding another 25 per cent, to a maximum of £1,000, a year.

So far, the UK government has come out broadly in favour of LISAs. In June 2024, the Treasury Committee said that the product was working well for self-employed workers but needed changes so that it could be treated much the same as other retirement products.

"80 per cent of self-employed people are not paying into a pension – the opposite of salaried employees, of which 80 per cent are paying into a pension"

One change in the LISA setup that many advocated for was a reduction of the penalty for early withdrawal. Currently 25 per cent, some felt that this should be reduced by a fifth to 20 per cent to encourage more to save into these products.

"I don't like the level of the penalty," says Young. "It's far too high. I look at it from a consumer point of view, and I think that it's ripe for reform. That would be great to help people put money into their pensions over the long term."

Other changes have been mooted. Hargreaves Lansdown head of retirement analysis, Helen Morrissey, says the firm has been calling on the government to increase the age at which someone can open a LISA. Currently, this tops out at 40, with contributions finishing at 50.

"This can help the self-employed as many people decide to go self-employed later in life," she says, "and as it currently stands, they would not be able to make use of this product. Pushing it out past 40 and enabling them to open and pay into a LISA until the age of 55 would give them an extra option when it comes to saving for retirement. Analysis from our Savings and Resilience Barometer estimates that 1.2 million households with a basic-rate-tax-paying, self-employed earner could benefit from the proposed changes."

There was also wide advocacy for a form of intervention around self-assessment. A common solution suggested was that a portion of a self-employed worker's income could be shaved off during the preparation of a tax return and invested within a chosen vehicle. The system would not be mandatory but would operate on an 'opt-out' basis.

"It comes with the heaviest of nudges," says Pike. "There's that liquid savings account that gets you that immediate protection against income volatility. People can save to a target level in there, then it could be moved into a pension pot."

Work in this direction has been undertaken for some time by Nest, says Sandbrook.

He says: "Our research to date has shown that saving defaults, which work similarly to automatic enrolment for employed workers, hold promise in supporting more self-employed to save for retirement. These defaults do not restrict choice or reduce autonomy – self-employed people can still choose not to save, for example by ticking a box – but they harness our inertia and tendency to stick with the pre-selected option. We therefore focus now on how such defaults can be implemented in practice."

Written by Peter Carvill, a freelance journalist