Addressing gaps in pension coverage

Lessons from the UK's automatic enrolment programme

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Session outline

- Brief introduction to the UK auto enrolment system and Nest
- Impact of auto enrolment – opt-out and participation rates
- Resilience in the face of the pandemic (and cost of living)
- Challenges with the universal auto enrolment model
- Excluded groups – the self-employed, and what can be done about them
- Future policy debates – coverage and adequacy

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Brief introduction to the UK system

High-level architecture

- Pillar 0 – means-tested minimum income guarantee, additional means-tested benefits such as housing benefit
- Pillar 1 – flat-rate State Pension paid on the basis of years contributing to the National Insurance system (paying NI or certain recognised activities) – maximum c£9300 per year
- Pillar 2/3:
  - Historically, non-compulsory employer-sponsored provision: mix of Defined Benefit (DB) and Defined Contribution (DC) (trending to the latter), wide variation in generosity, coverage
  - Since 2012:
    - mandatory automatic enrolment of eligible workers into a qualifying workplace pension scheme*
    - Individuals have the right to opt out
    - Where individuals remain in, minimum contribution of 8% of a band of earnings, of which *at least* 3% from employer
    - Employee contributions boosted by basic-rate tax relief – so in effect, most common contribution pattern is 3/4/1

*NB Nest is 'a qualifying workplace pension scheme' – there is no obligation to use Nest, but Nest has a statutory public service obligation to accept any employer/member coming to us under the employer automatic enrolment obligations.

Brief introduction to the UK system

Automatic enrolment requirements

› Mandate to automatically enrol eligible workers applies to all UK employers of any size – including, e.g. parents employing a nanny

› Worker eligibility is complicated:

Eligible Jobholder

- Aged 22 to SPA
- Earnings £10,000 or greater
- Must be automatically enrolled
- Employer must contribute
- Minimum contributions apply
- Can Opt-out

Non-eligible Jobholder

- Aged 16 to 21 or
- Aged SPA to 75 or
- Earnings between Lower earnings threshold and £10,000
- Can Opt-in
- Employer must contribute
- Minimum contributions apply
- Can Opt-out

Entitled Worker

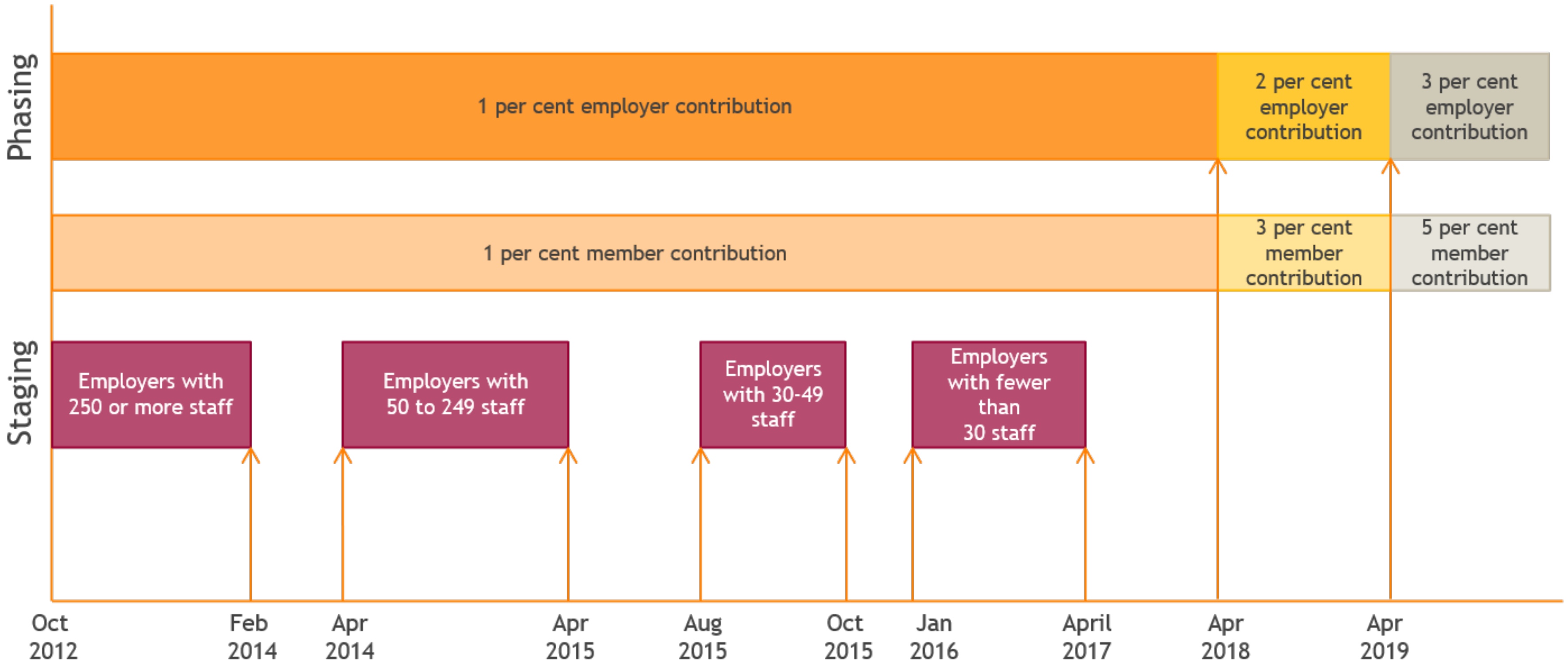
- Earnings less than the lower earnings threshold
- Can ask to join
- Employer doesn't have to contribute
- No minimum contributions
- Can not Opt-out

NB Income criteria are applied per pay period (usually weekly, four-weekly or monthly) so individuals can dip in and out of eligibility

Brief introduction to the UK system

Implementation approach

- Obligations on employers were ‘staged’ by employer size over a five-year period from 2012
- Minimum contribution levels were ‘phased’ in, using principle of auto-escalation to smooth employer and employee level impacts
- Re-enrolment is mandatory every three years where employee remains at same firm (in practice, re-enrolment is dominated by job-change)



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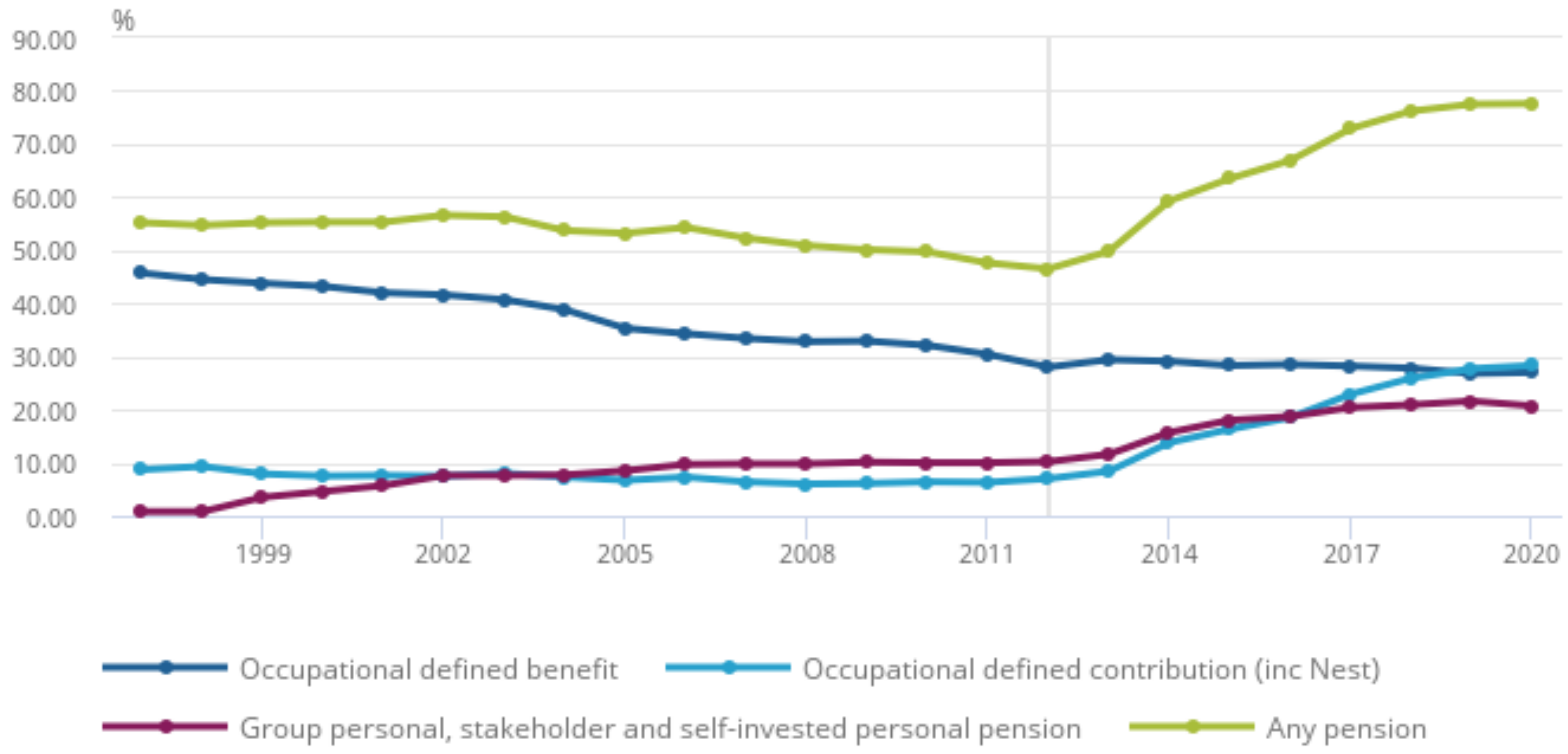
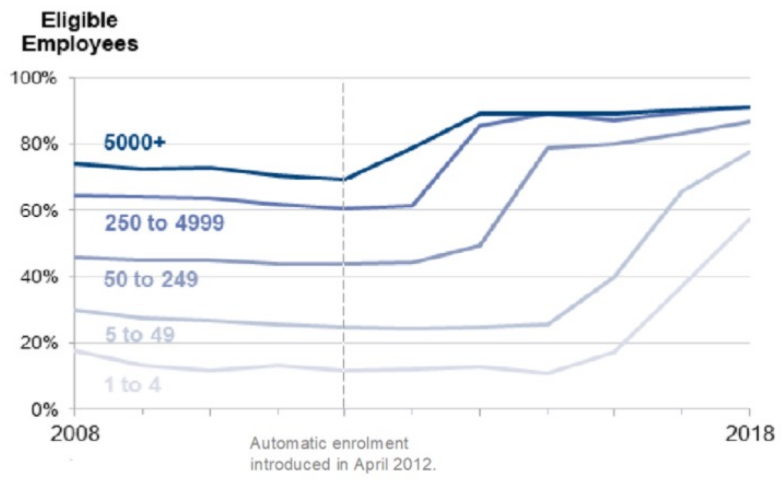
The impact of auto enrolment – overall

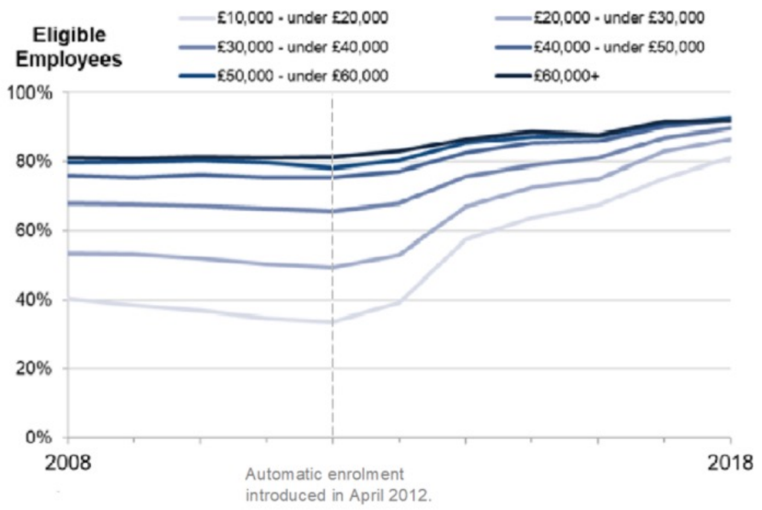
Proportion of employees with workplace pensions by type of pension, UK, 1997-2020

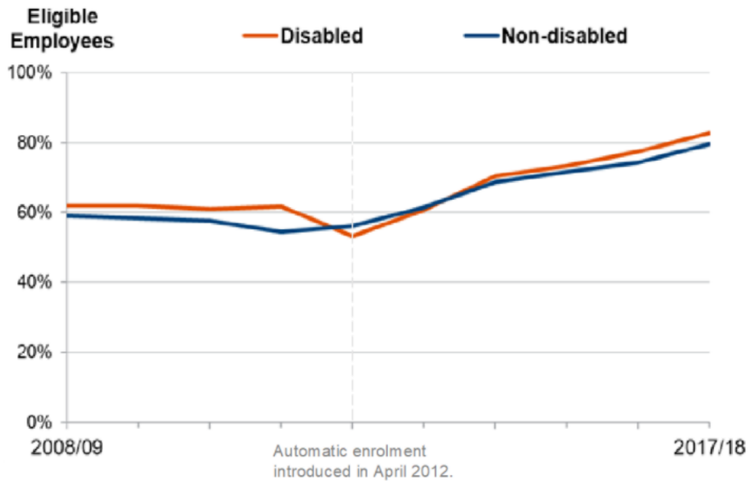


Source: Office for National Statistics – Annual Survey of Hours and Earnings

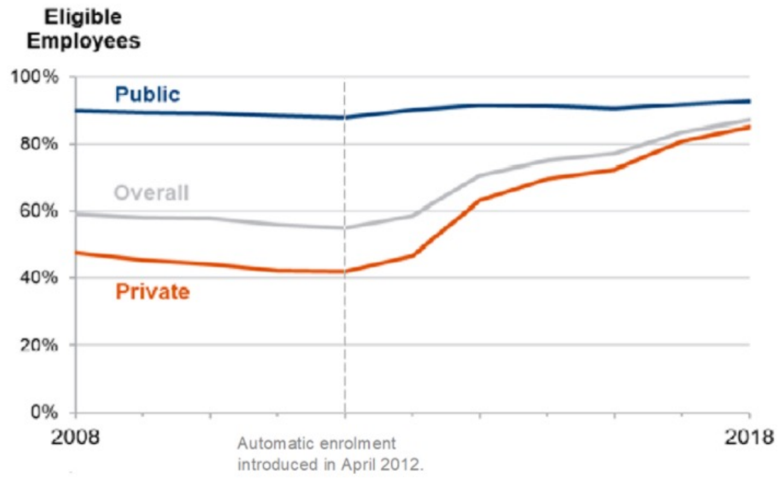
Impact of auto enrolment – ‘other demographics’

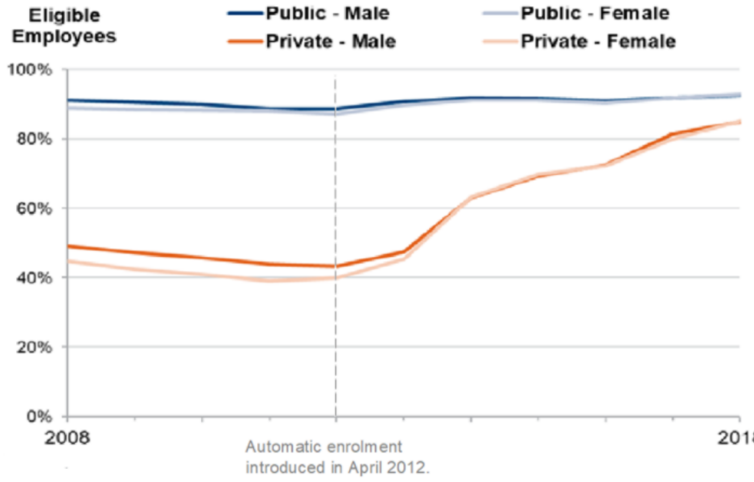


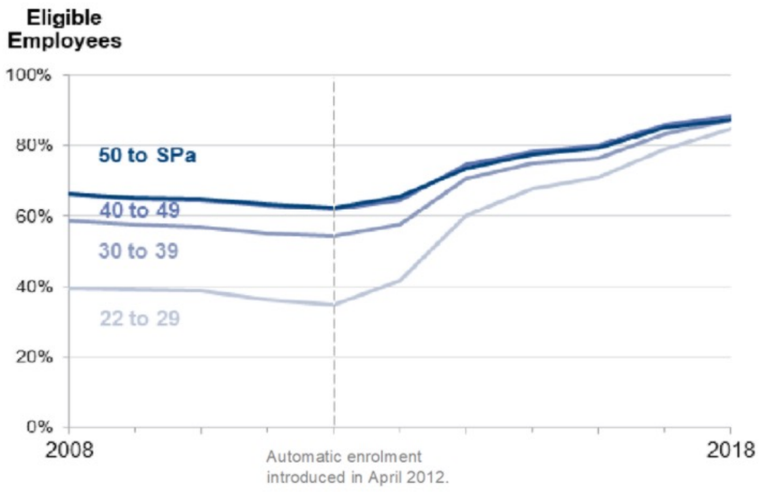




Source: Modelled analysis derived from the FRS, UK, 2008/09 to 2017/18.





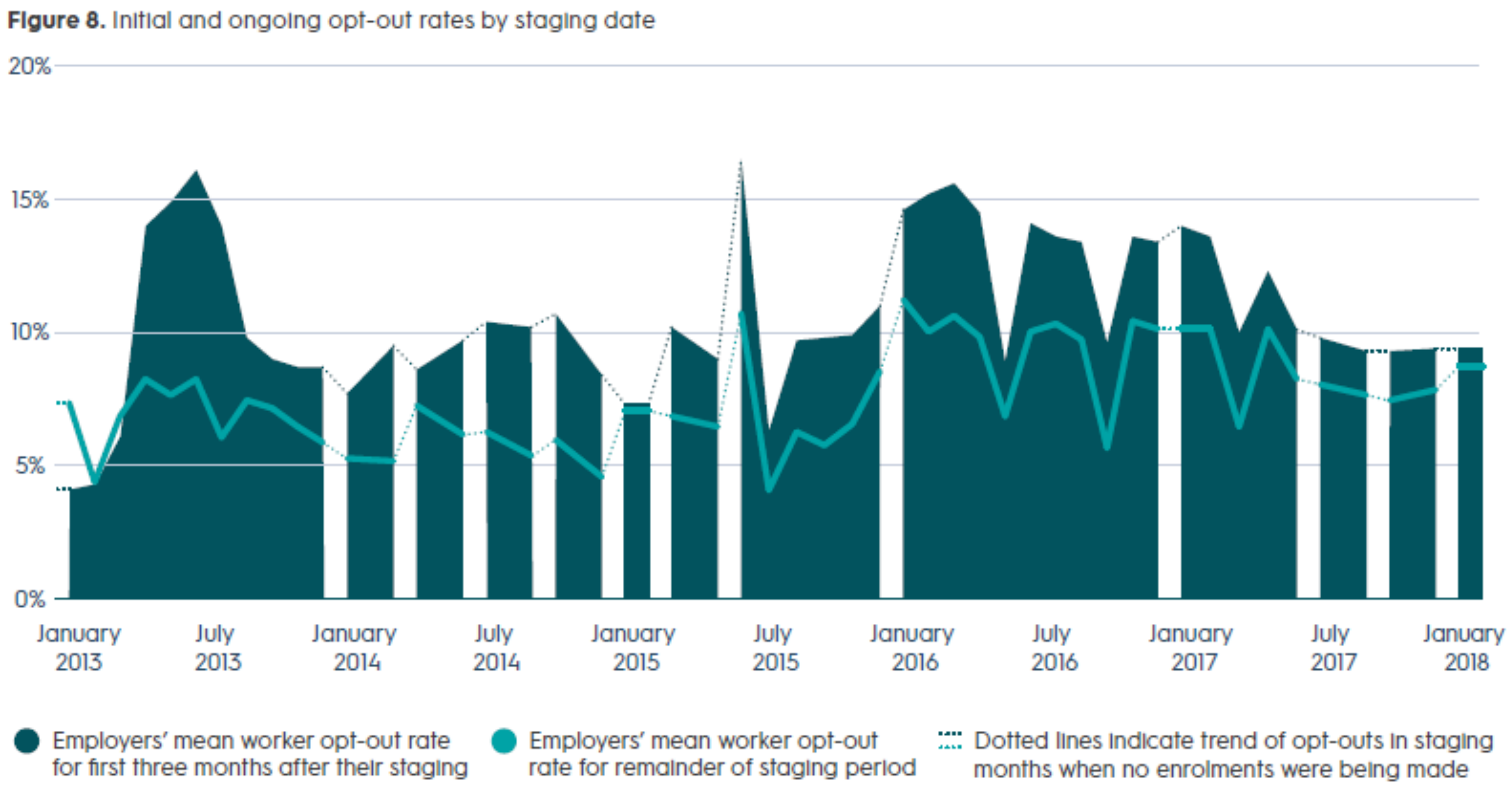


Source: DWP estimates derived from the ONS ASHE, GB, 2008 - 2018

Impact of auto enrolment

Opt-out rates (Nest)

Opt-out rates during implementation – existing and new employees



Source: Nest Insight – Retirement saving in the UK 2021

Impact of auto enrolment

Contribution rates (Nest)

- Minimum contribution rules framed as ‘at least 8% of a band of earnings, of which at least 3% must come from the employer’
- Band of earnings is currently £6,240 - £50,000
- Most employers using Nest contribute at the minimum rates – limited data on broader employer base but likely that higher contribution rates are more common outside of Nest

Table 11 Relationship between member and employer contribution rates, by percentage of employers

	Percentage of employers					
	Member contribution rate*					
Employer contribution rate	0%	More than 0% up to 5%	5%	More than 5% up to 8%	More than 8%	Total
Less than 3%	0.0%	0.2%	2.1%	0.4%	0.1%	**2.7%**
3%	0.0%	0.5%	76.0%	6.5%	1.7%	**84.7%**
More than 3% up to 5%	0.0%	0.7%	2.3%	4.4%	0.4%	**7.8%**
More than 5% up to 8%	0.6%	0.4%	0.5%	0.5%	0.3%	**2.4%**
More than 8%	0.5%	0.1%	0.9%	0.2%	0.6%	**2.4%**
Total	**1.2%**	**1.9%**	**81.9%**	**12.0%**	**3.0%**	**100.0%**

* Member contribution includes tax relief.

A rounding tolerance of ±0.05% has been applied to all contribution bands, so for example 3% contribution rate covers contribution rates in the band 2.95% to 3.05%.

Source: Nest Insight – Retirement saving in the UK 2021

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Resilience in the face of the pandemic

Figure 1: Monthly opt-out rates

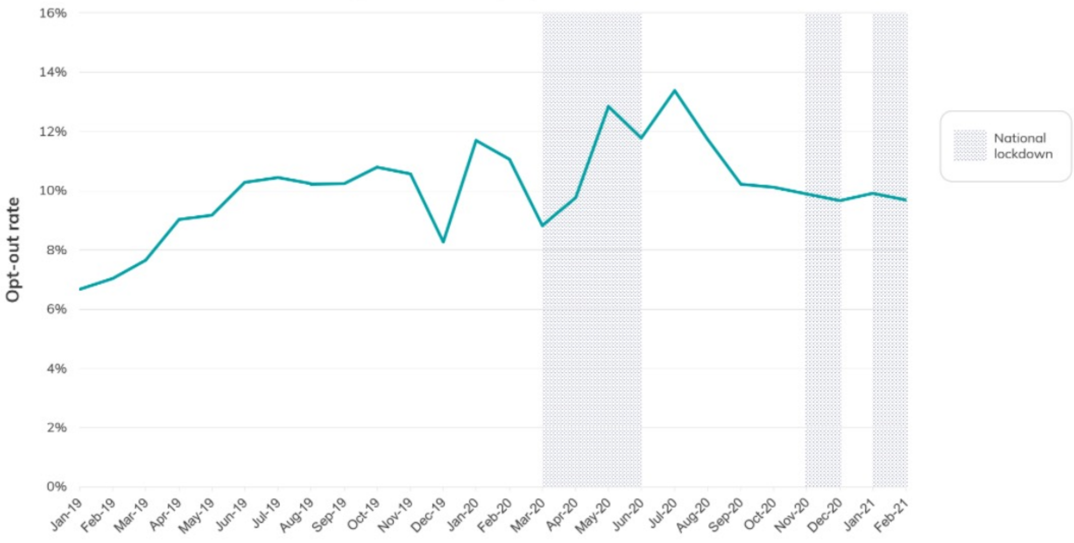


Figure 2: Monthly cessation rates

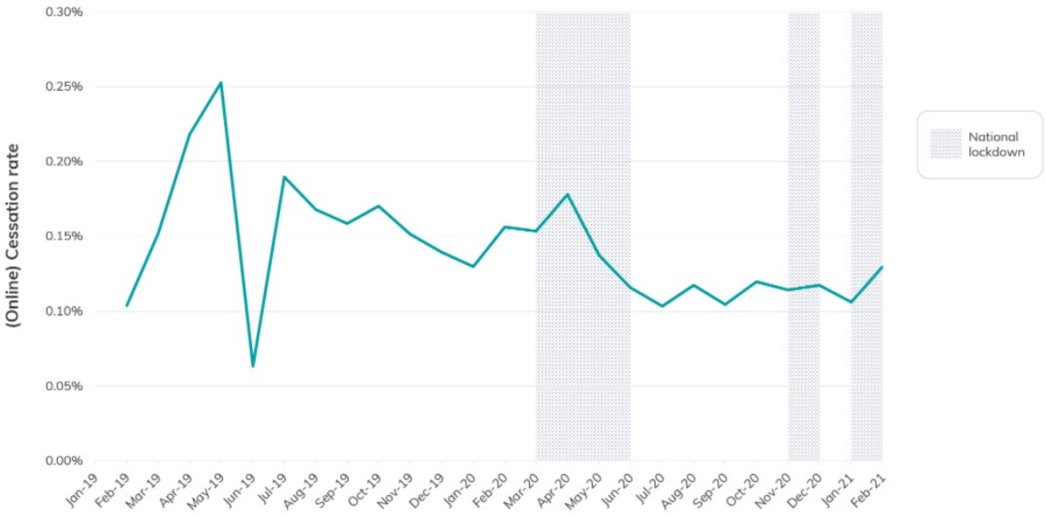


Figure 3E: Monthly withdrawals (aged over 55)

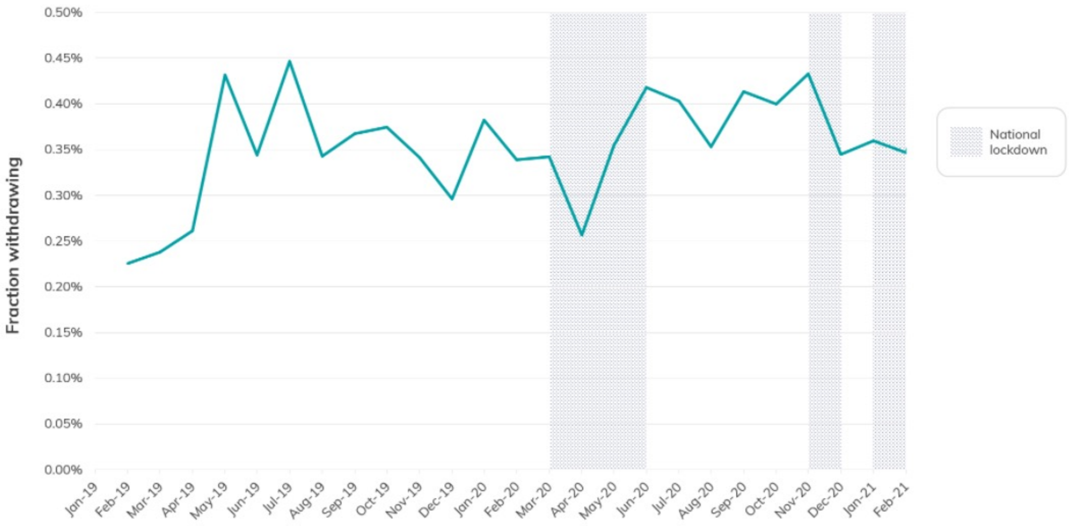
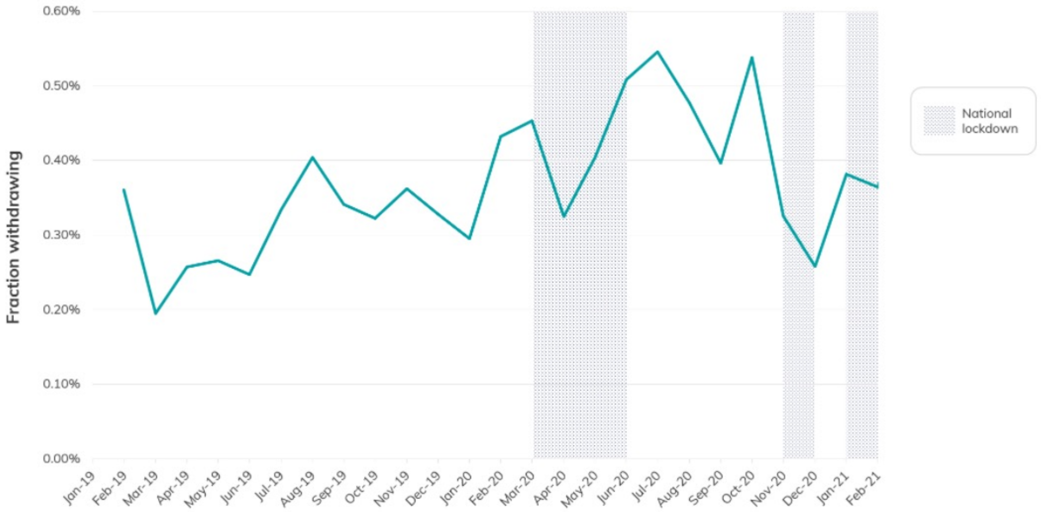


Figure 3F: Monthly withdrawals (aged 55)



› AE behaviours appear very resilient in the face of financial resilience challenges

› Also held true through increases to minimum contributions…

› … and so far, in response to the cost of living crisis

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Challenges with the universal auto enrolment model

Power of inertia – a double-edged sword?

- Evidence suggests that people highly likely to remain opted in and to continue contributing in the face of a range of external pressures
  - Research around auto enrolment suggests many possible reasons for this but one of those is that you are harnessing inertia in favour of saving

- That inertia follows through into downstream behaviours:
  - 31% of Nest's members have activated their online accounts
  - c99% remain in the default investment option
  - c1% of members making any sort of voluntary additional contributions
  - Too early to say how active people are around decumulation decisions but some evidence of inertia here too

- Overall, people who are automatically enrolled are relatively unlikely to take any active steps to ensure that their retirement saving strategies are sufficient/appropriate – some risk of anchoring to a government 'standard', and of insufficient outcomes/frustration as people become more aware

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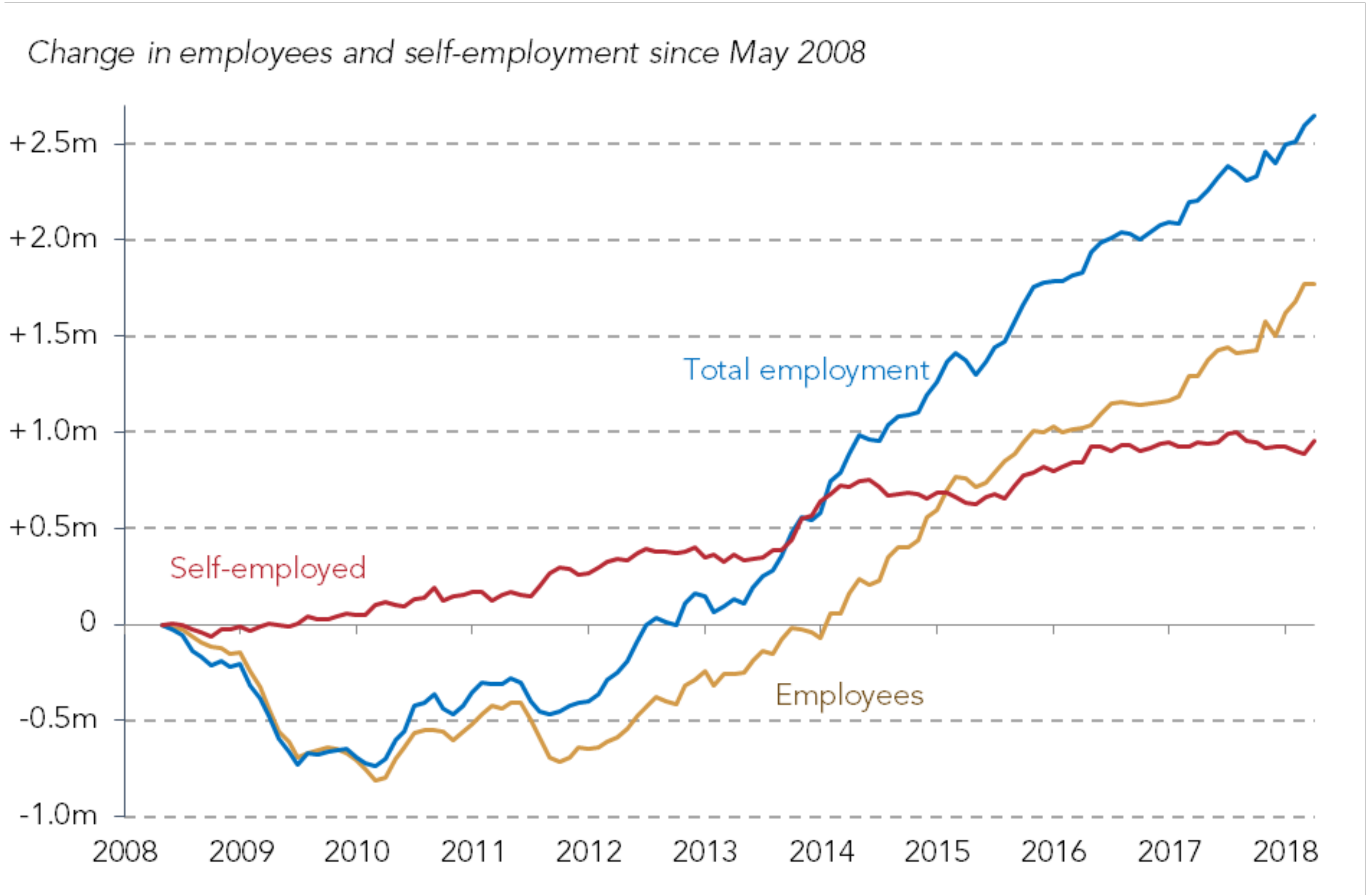
The self-employed

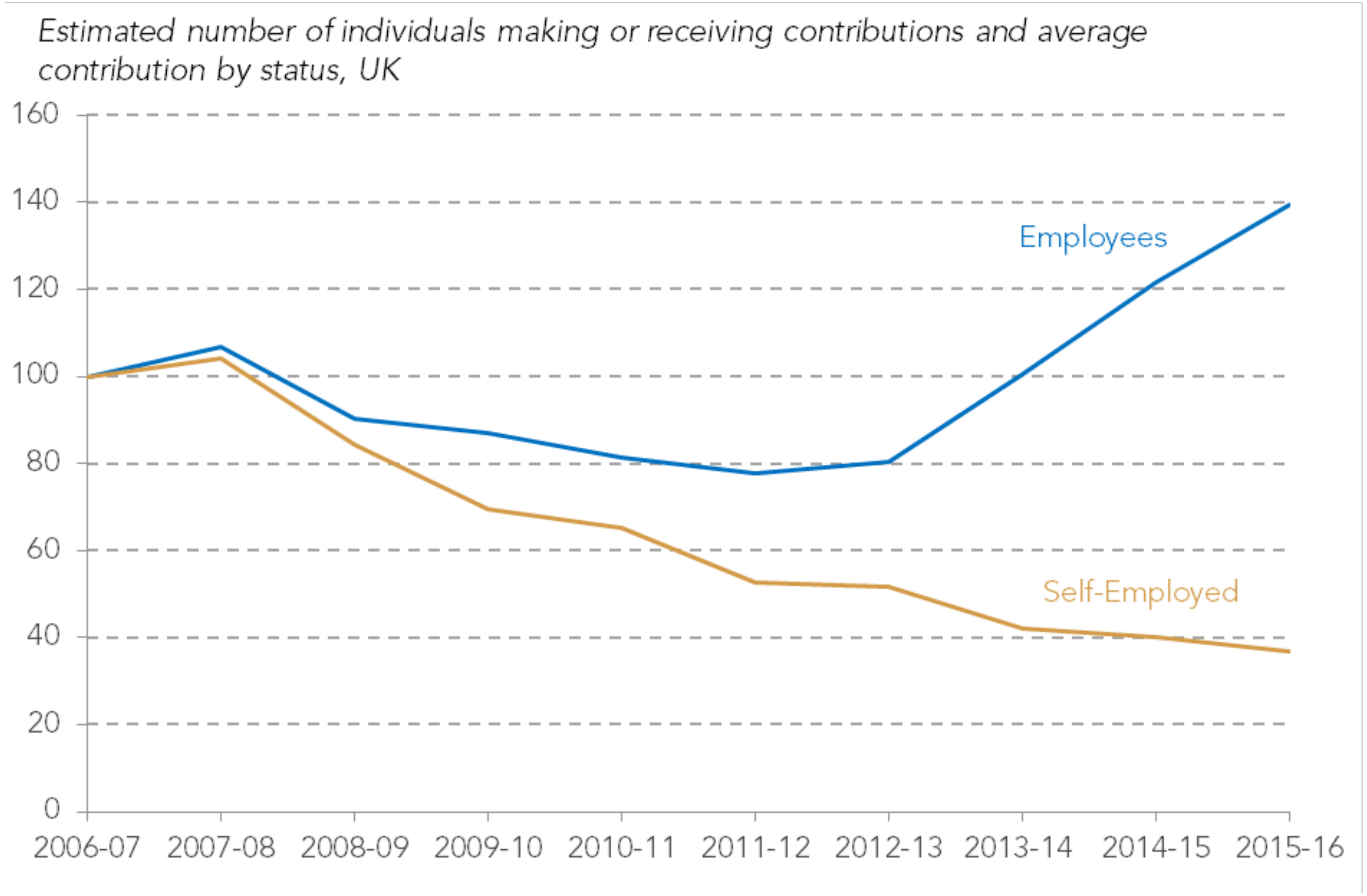
Self-employment was growing rapidly (at least pre-pandemic)



Source: Resolution Foundation

The self-employed

Active participation in formal pension saving in long-term decline



Source: Resolution Foundation

The self-employed

What do we know about the self-employed and pensions?

later life

50% are not confident about how they will fund their retirement

35% are put off thinking about pensions because it makes them feel nervous

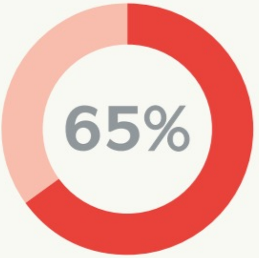
Only **24%** say they currently contribute to a pension

More liquid products are preferred to pensions:

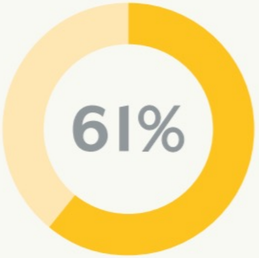
50% save into an instant access savings account (17% say they do so for retirement specifically)

37% save into a cash ISA (18% say they do so for retirement specifically)

Perceived affordability and lack of flexibility are key barriers to pension saving



of those who don't have a pension scheme say they can't currently afford to save for retirement



of those who don't have a pension say they're put off due to the lack of flexibility

A high proportion are open to help and guidance:

55% would welcome more guidance on how to best save for retirement

46% think they need encouragement to help them better plan their retirement

Source: Nest Insight research, 2019

The self-employed

Can targeted messaging help?

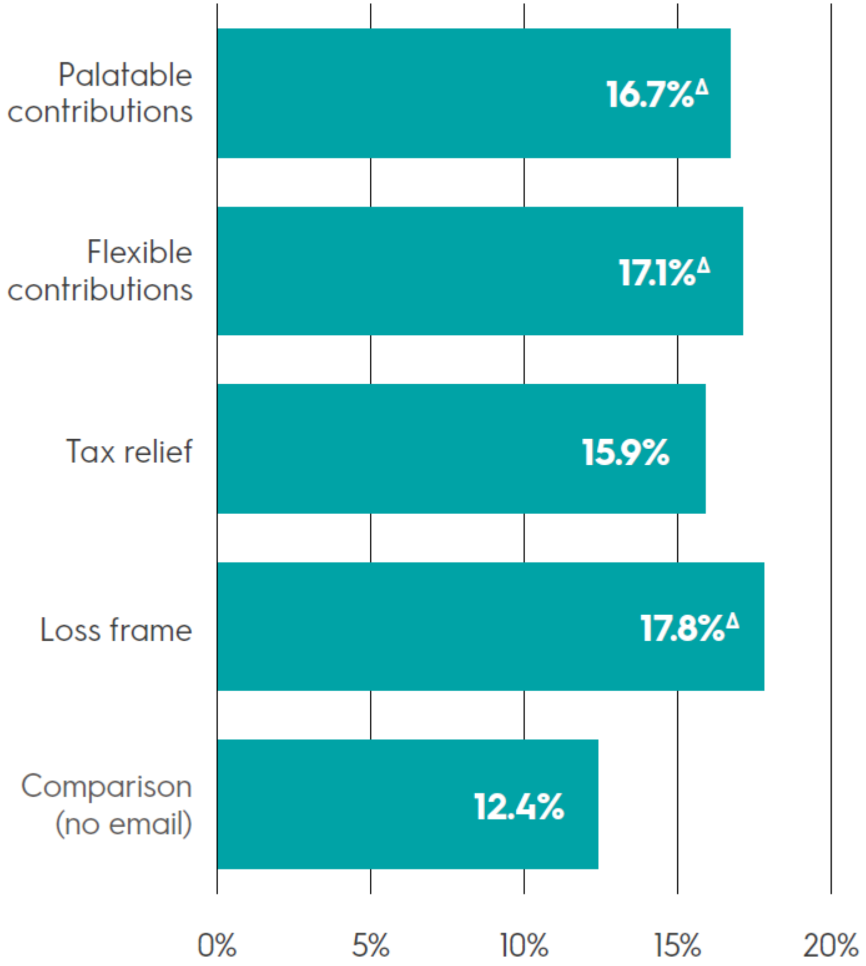
Palatable contributions: ***Could you save £2.50 a day?***

Flexible contributions: ***Flexible pension contributions for the self-employed***

Tax relief: ***A tax-free way to save for your retirement***

Loss frame: ***Don’t miss out on pension returns***

Increased contribution payment amount 3 months after opening email: self-employed Nest members making regular contributions



Source: Nest Insight - ‘Talking with self-employed people about retirement saving’ - 2020

The self-employed

What else might move the dial?

- Currently trialling various approaches using technology platforms (online pension provider, money-management app) to ‘nudge’ the self-employed:
  - Timing of messages relative to income prompts
  - Increased flexibility over contribution levels and frequency

- Trials still in progress but early indications are that impacts will be marginal

- Also a problem of scalability – heterogeneity of ways the self-employed manage money/receive income

- Current thinking is that meaningful impacts require some combination of:
  - automatic enrolment (but it’s hard to operationalise this in practice)
  - a more salient/generous financial incentive
  - different types of product

- Digitisation and increased frequency of tax reporting might be the universal touch-point for auto enrolment – plan to look at this next year

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Future policy debates

Coverage and adequacy

- ‘Excluded groups’ a major focus of the policy debate:
    - Gender pensions gap, ethnic minority pensions gap

- At least for gender, no evidence this is behavioural
    - Controlling for income only, women in Nest save slightly more and have slightly higher balances than their male counterparts*
    - Controlling for other factors (e.g. sector), there is no overall difference*

- Structural issue difficult to resolve in the private pension system?

- Interest in expanding coverage to lower-income groups (e.g. abolish the £10k income threshold)

- At the same time, open debate on whether minimum contributions under auto enrolment need to rise to improve the adequacy of retirement incomes under the system
    - Through a straightforward increase and/or by abolishing the ‘band of earnings’

- But opens up a debate about interaction with income replacement from pillar one, shorter-term financial priorities (especially with current cost-of-living issues)

* Source: Nest Insight – How the UK Saves: Effects of gender on retirement saving behaviour - 2019

Thank you

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