

Mandating Autoenrollment: The NEST Plan in the UK

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The Problem

- One of the main problems in pension policy is one of inclusion.
- In voluntary pension systems, rarely are more than 50 percent of the work force included in a pension.
- In the UK in 2012, 42 percent of the private sector workforce participated in a pension.

The solution

- There are three possible approaches to dealing with this problem of raising employer-provided pension coverage.
- Non-tax incentives attempt to increase coverage by adding features to pension plans that are designed to make the plans more appealing.
- Tax incentives and other financial incentives attempt to increase coverage by financial incentives.
- Autoenrollment attempts to increase coverage by changing the default so that workers automatically participate in a pension plan.
- Some recent evidence suggests that autoenrollment may be the most effective approach.

The Problem with the solution

- Automatic enrollment is generally more difficult to administer for small firms than for larger firms.
- Small firms lack employee benefits specialists who can handle autoenrollment by the firm establishing its own pension plan.
- In addition, because small firms tend to have lower-wage employees, they are not attractive clients to insurance companies or to other providers of autoenrollment pensions.
- For this reason, some autoenrollment programs exempt the smallest employers.

Distribution of firms by firm size, UK and US

<u>Table 1 - Number of Firms in the U.K. and U.S. by Employment Size of Firm</u>				
<u>No. of Firms by Employment Size of Firm</u>	<u>U.K.¹</u>		<u>U.S.²</u>	
	<u>Firms</u>	<u>Percent</u>	<u>Firms</u>	<u>Percent</u>
-	(000s)	-	(000s)	-
<u>All Firms</u>	<u>5,389</u>	-	<u>29,664</u>	-
<u>Nonemployer Firms</u>	<u>4,077^a</u>	-	<u>23,836</u>	-
<u>All Employers</u>	<u>1,311</u>	<u>100.0%</u>	<u>5,061</u>	<u>100.0%</u>
<u>1 to 9</u>	<u>1,068</u>	<u>81.5%</u>	<u>3,858</u>	<u>76.2%</u>
<u>10 to 49</u>	<u>203</u>	<u>15.5%</u>	<u>978</u>	<u>19.3%</u>
<u>50 to 249</u>	<u>32</u>	<u>2.4%</u>	<u>85</u>	<u>1.7%</u>
<u>250 or more</u>	<u>8</u>	<u>0.6%</u>	<u>139</u>	<u>2.7%</u>

Small Country Problem

- The table for the UK and the US suggests that in smaller countries a relatively large part of the workforce works in small companies.
- Thus, the problem of the difficulties of small employers in complying may be relatively large in Ireland.
- Data for Ireland show that 92.3% of employers have 1-9 employees, compared to 81.5% in the UK and 76.2% in the US.
- This strengthens the argument for a programme like NEST in the UK, which I will discuss next.

UK

- The United Kingdom autoenrollment covers all employers, even those with one employee.
- The pension participation rate for those with low earnings (between £10,000 and £20,000 a year) rose from 35 percent in 2012 to 65 percent in 2015 due to the phase in of autoenrollment.

Pension Participation Rates

- Overall, the pension participation rate in the private sector has risen from 42 percent in 2012 to 70 percent in 2015.
- By gender, the participation rates in 2015 were 70 percent for women and 69 percent for men, women having overcome a 3 percentage point gap due to auto enrollment.

Small employers in the UK

- The United Kingdom has recognized the problem facing small firms in meeting the mandatory autoenrollment requirement.
- 35% of employers reported that pension providers they contacted were unwilling to enroll all of their employees, presumably because of the low-wages and small account balances of some employees not making it profitable for the pension providers.

NEST

- To address this problem, the UK has established the NEST pension plan.
- NEST stands for National Employment Savings Trust.
- NEST is an independent pension plan established by the UK government. It is a nonprofit, multiemployer pension fund.
- NEST is designed to provide a simple way for small employers to meet their autoenrollment requirement.

Market Failure

- The justification for establishing a government-run pension plan is a market failure.
- The market failure is the failure of the private sector to provide pensions to employees in small firms with low wages.

Policy success

- As of April 2014, less than two years after starting, NEST had more than one million participants
- rising to 1.8 million in 2015,
- 3.2 million members as of March 2016, more than 3.5 million members as of September 2016.
- Roughly half of autoenrolled workers in the UK are in NEST.

Unfair competition

- Because of the high percentage of autoenrolled pension participants who are members of NEST, some pension providers have criticized that NEST is unfair government competition.
- NEST does not charge employers fees, while its two main competitors do charge employers fees.

Employer Requirement

- The small employer must send to NEST every month the required contributions for each employee who has been autoenrolled.
- Among workers meeting the minimum and maximum age requirements (22 and 65), 42 percent of workers at employers with 1 to 4 employees do not meet the minimum earnings requirement (£10,000 a year) to be covered by the autoenrollment requirement.

Opt Out and Default

- Employees who have been autoenrolled have the option to opt out.
- Those who do not opt out are placed in the default investment, but they can make an active choice of another investment option.
- The default investment is a target date plan that is based on they age at which they can start receiving state pension benefits (social security).
- 99% of members are in the default fund.

Coverage is not the only thing that counts

- This arrangement appears to be an effective way of increasing pension coverage.
- However, some evidence indicates that among employers that already have generous pension plans there is a tendency to reduce contributions to the government mandated level.
- While increasing coverage is important, providing adequate benefits is also important.
- The full effect on contribution rates will not be known until 2019 when contribution rates are fully phased in.

Contributions

- When fully phased in by 2019, contributions will be:
 - four percent of pay for employees,
 - three percent of pay for employers for participating employees, and
 - one percent of pay government subsidy,
 - making a total contribution of eight percent of pay.

Contribution base

- Between lower and upper earnings limits of £5,824 (\$6,990) and £43,000 (\$51,600) for the 2016-2017 tax year.
- Starting in April 2017, there is no maximum limit on annual contributions, but a limit of a £1 million account balance applies.

Fees

- NEST charges no fees to employers.
- It charges the same fees to all participants, no matter how small or large their account balance.
- It also charges the same fees for all of its investment options.
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Fee structure

- The NEST fees are 0.3 percent (30 basis points) of assets plus a charge of 1.8 percent of contributions (a load fee).
- The charge on contributions is made on all contributions, including those by employers and the government.
- This two-part fee structure is more complex than the usual structure in the U.S. that charges only based on assets in the participant's account.
- The two-part structure makes it difficult for most people to compare its fees to the fees of service providers who charge only based on assets.

Fee level

- The NEST fees are roughly equivalent to a flat fee of 50 basis points a year.
- It is expected that over time, as asset balances grow, the fee will decrease.

Conclusions

- The United Kingdom is in the process of phasing in mandatory autoenrollment for all employees.
- Because some small employers have mostly workers with low wages, these employers are not attractive to pension providers for autoenrollment because managing the small account balances is not profitable.
- For this reason, the UK government has established a nonprofit pension fund called NEST—National Employment Savings Trust.

Conclusions 2

- Roughly half of the employees autoenrolled are members of NEST.
- This is a larger percentage than was expected, and raises concerns of unfair competition with the private sector.
- The full story of autoenrollment won't be known until at least 2019, when the full 8 percent contribution rate takes effect.

