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Automatic enrolment: policy considerations
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Automatic Enrollment : An Option for Ireland ?

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Some Problems

- Current pension systems are widely seen as failing in a number of ways.
- DB schemes have been replaced with DC schemes with far lower employer contributions and risk shifting to employees.
- Lower contributions coupled with low stock market returns in many countries and low (negative) interest rates on Government bonds, will make future accumulated lump sums lower, and have increase the cost of annuities.
- Pension coverage fell from 51.9% to 47.6% of the labour force between Q1 2005 and Q2 2015.
- Coverage fell the most in sectors with the lowest level of pay; relatively high rates of employee turnover and seasonal employment.

Table (1)
Members of DB and DC schemes in Ireland

Year	DC Active members	DB Active members (subject to funding standard	Deferred members
2016[1]	299782	111397	415300
2015[1]	281629	121995	430518
2014[1]	263261	137357	414207
2010	259232	222072	
2005	234814	239127	

Why Automatic Enrollment

- First discussed in a Green Paper in 2007 (D S F A, 2007, p. 125).
- In 2010, an AE scheme was proposed.
- Why?
- Economists argue that “individuals deciding whether (and how much) to save in a pension may have problems with ‘self-control’ and may procrastinate over this decision” Cribb and Emerson, 2016.
- There are other arguments .
- For example , D S FA, (2010, p. 30) stated:-
- It would overcome “inertia”;
- Increase transparency;
- Reduce inequities in pension provision;
- Increase affordability by allowing breaks in contributions and withdrawals for a house deposit.

The 2010 AE scheme

- Employee would contribute 4%, the employer 2% and the State 2%.
- AE would only apply to a band of earnings between €352 and €995 per week.
- The OECD (2013) singled out the New Zealand AE as being of particular relevance for Ireland (OECD, 2013, p. 128).
- A Universal Retirement Savings Group was established in February 2015 to introduce a universal retirement savings scheme based on the principles of individualisation of risk in market based solutions.
- The then Minister for Social Protection h stated(Dail Debates 2th January, 2017):
- “I have made pension reform a priority for my term as Minister for Social Protection. This includes an intention to develop a new supplementary retirement savings system for those workers without adequate savings for retirement”.

What can we learn from the UK AE scheme ?

- AE in Uk aims to increase the number of individuals “saving more in a work place pension”,(Dept of Work and pensions, 2015, p. 26).
- Although voluntary for employees there are considerable enforcement powers exercised by TPE for employers,:
- the need to provide access to a scheme,
- manage a scheme and provide information to employees, etc.

- In future all employers will be required by law to provide a workplace pension).

- **Contributions levels were set at total of 2% to April, 2018**, 5% to April 2019 and 8% from April 2019 on, with employer contributions at 1, 2 and 3% respectively.
- Note employer contribution levels are the inverse of current DB and DC schemes

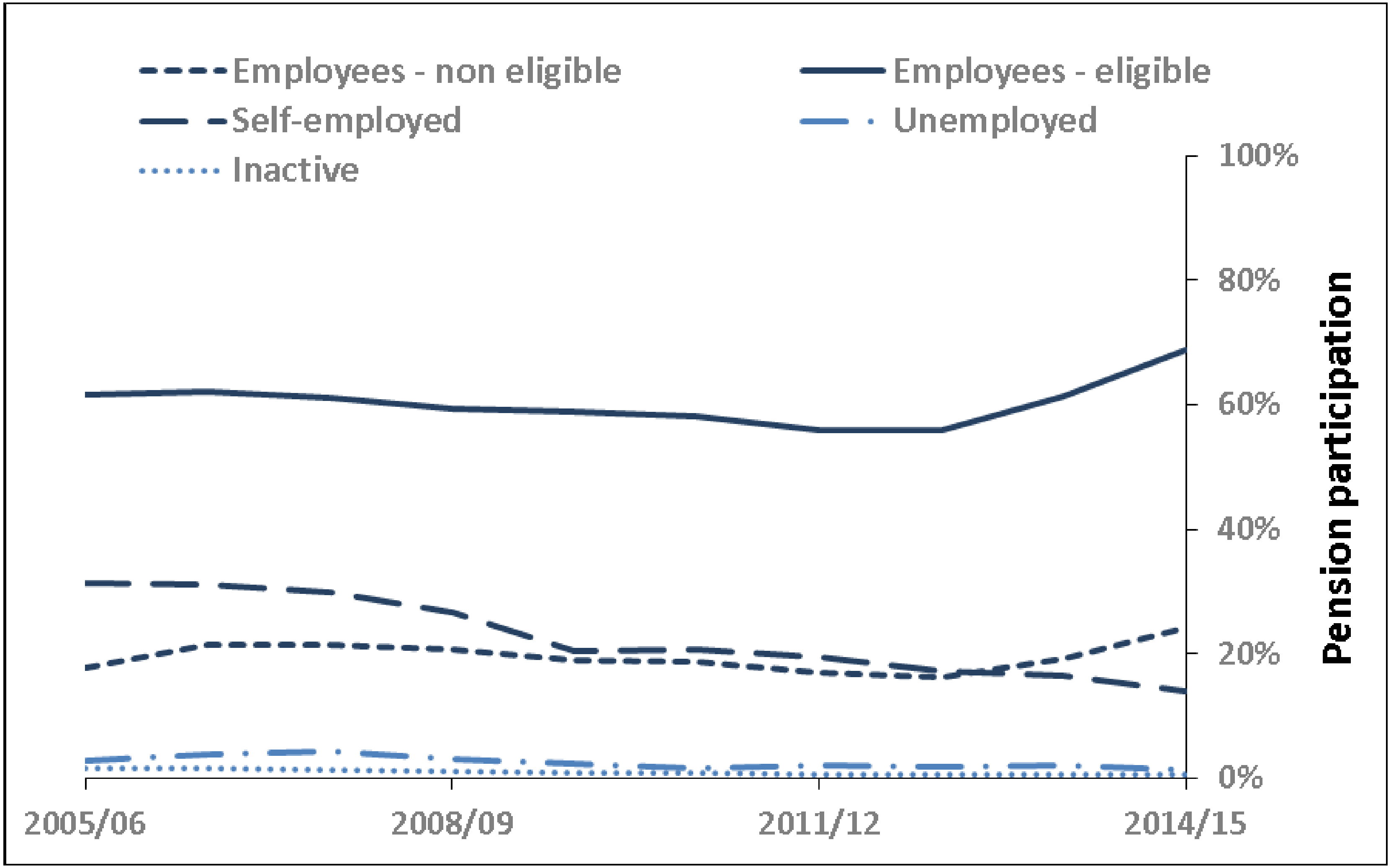
Table (2)
Trends in pension coverage in the UK

- Between 2004 and 2012 workplace pension participation decreased from 63 % of eligible employees (11.9 million) to 55% (7.8 million), and subsequently increased to 78% (13.9 million) in 2014 (Table 1).

  In particular members in AE schemes have increased.

	2005	2012	2013	2014	2015	2016	March 2017	Projected
Membership of occupational pension schemes in UK		27.6	27.9	30.4[1]	33.5[1]	39.2[1]		
Per cent members of Occupational schemes[2]	62	55				78		
Active members		7.8	8.1	10.2	11.1	13.5[2]		
Automatic Enrollment nos.			1	3	5.2	6.87	7.7	9.0

So what's not to like ?
Chart shows declining coverage amongst self-employed



Self employment is higher in Ireland than the UK and much high than for example in Denmark

- A rising level of self employment may partly reflect ‘levelling down’. Those working for Uber, Deliveroo, etc do not have pension entitlements and our own Ryanair.

Year	Ireland	UK	Germany	Denmark	New Zealand
2015	17.6	14.9	10.8	8.7	14.8
2014	17.4	15.4	11.0	8.9	15.3
2013	17.1	14.5	11.2	9.0	15.4
2012	16.7	14.6	11.6	9.1	16.6
2011	16.6	13.9	11.7	9.1	16.7
2010	17.1	13.9	11.6	9.1	16.2
2005	17.7	12.9	12.4	8.9	16.4
2000	18.8	12.3	11.0	9.1	18.5

What about the effect on Contribution Rates in the UK ?

- DC contribution rates in the UK fell from 9.7% in 2012 to 4.2% in 2016.
- DC Contributions in Ireland are inadequate but higher than those reported for the UK
- Employers contributions to DC schemes amounted to 7% (IBEC 2017.
- An IAPF survey of 6430 in 2015 schemes reported total contributions of 11.1% with employer contributions of 5.7%.
- Query: will AE contributions increase as AE rates increase, or will there be 'levelling down' ?. An alternative is that there could be an increased number leaving AE schemes.

	2012	2013	2014	2015	2016
Average contribution to DC schemes[1]	9.7 (6.6%)	9.1 (6.1%)	4.7 % (2.9%)	4% (2.5%)	4.2% (3.2%)
Average contribution to DB schemes%[1]	20.1 (15.2)	20.6 (5.2)	20.9 (15.8)	21.2% (16.2)	22.7% (16.9)
Amount saved per 'eligible saver" [2]	£7000	£6957	£6653	£5774	£5419

Governance - member charges

- Evaluation reports by the DWP (2014, p. 30, 2015, p. 75) state :-
- “The large number of savers being automatically enrolled into DC schemes means that the standards of governance and administration of these arrangements is very important for savers’ outcomes”.
- A charge cap (defined as “annual ongoing member charges”, of 0.75% for default funds was introduced in trust based schemes (DWP, 2015, p. 81).
- From April 2016 a ban on “Active Member Discounts”;
- Ban on consultancy charges – that is members paying for advice to employers;
- Ban on member borne commission payments members paying for advice they have not freely chosen DWP, 2015, p. 83).
- We should note that there will inevitably be other charges relating to portfolio balance decisions, reinvesting dividends and member contributions, etc..
- Pension charges are particularly important for small dormant sums

Governance – Employer costs DWP Evaluation Reports

DWP 2013 p. 86	"As a general rule, when asked to give an approximate figure for the total financial cost of implementing automatic enrolment (not including employer contributions), employers estimated this to be in six or seven figures"
DWP 2014, p. 29	"Qualitative research with employers who staged between January 2014 and July 2014 found that they rarely incurred substantial ad hoc costs as a result of implementing automatic enrolment, with the average implementation cost being between £200 and £700. Many of these employers were comfortable with the administrative costs of implementation, as they had tended to be low".
DWP 2015, p. 28	Median costs of implementing AE were £500. There were 60,000 participating firms; "implementation cost vary substantially by employer size (p. 28), so that average costs will be higher. The main costs were "communicating reforms" and "ongoing administration". Note In 2015 1.4 million small businesses will be required to implement AE. If median and average costs per firm are lower, for example, amounted to £150 per annum, implies costs of implementing and maintaining AE would amount to £219 million (1.5% of projected AE savings of £15 billion).
DWP 2016, p. 52	Large-scale surveys of employers and small and micro employers to be commissioned.
Pensions Regulator, 2017, p 13	"Around a fifth (17-21%) of employers paid for external support to help them comply with their ongoing duties- the median monthly cost varied from £42 for micro employers, £100 for small employers to £175 for medium employers Majority of employers estimated time used to be less than two hours per month in terms of compliance. This would indicate that average employer costs in terms of employee time is likely to be in excess of £200 per annum.

Employer Response – Levelling down

- Key question: What will happen to contributions as required rates increase ?
- This will depend on employer response – levelling down
- DWP (2016) states strategies to absorb increased costs include (p. 76) "lower wage increases" as well as "changes to the existing pension scheme"
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DWP 2015 Report, p. 71	"Levelling down strategies include changes to existing pension schemes or contribution rates (15% of employers)" Data also seems to show that the larger the employer the more likely levelling down was to take place (Evaluation, 2015, p. 71).
DWP 2015 Report, p. 70	"... .. a fairly consistent level of levelling down over time. From 2007 to 2012 around 6 per cent of workers had their employer contributions, or other outcomes reduced. This rose slightly to 8 per cent of workers between 2013 and 2014.
DWP 2016 Report, p. 70	Levelling down strategies rose "to 9 per cent of eligible savers in 2015. The largest change was observed in the proportion of eligible savers with DB schemes in both years which fell from 62 per cent in 2010 to 48 per cent in 2015".

Enployee Response to increased rates – opt out

DWP 2012 and 2013 Report p. 68	“The main reason given was financial constraints, particularly the affordability of contributing to a pension set against other priorities”.
DWP 2014 Report p. 27	“The proportion of employees who had opted out of, or left, a scheme after being automatically enrolled was between nine and ten per cent” (source:- Employers’ Pension Provision Survey 2013.
DWP 2014 Report p. 28	“DWP qualitative research with 50 employers showed an average opt out rate of 12 per cent, with the opt out rate for most individual employers ranging between five and 15 per cent”.

Other Evidence

- Using panel data for 181,000 firms in the UK, Cribb and Emmerson, report that AE has led to a large increases in both participation rates and in total contributions to workplace pensions (2016, p. 4).
- More controversially they find that AE “increased the total contribution rate to a workplace pension (expressed as a percentage of total earnings) by 1.05 percentage points, compared with a pre-reform average of 7%”.
- This is a much higher contribution rate to DC pensions than that reported by the ONS.
- Cribb and Emmerson also cite mixed evidence on the effect of AE on leveling down (p. 7-8), but conclude that there is no evidence that the introduction of AE led to a reduction in employer contributions to those already enrolled (p. 30).

New Zealand AE Scheme

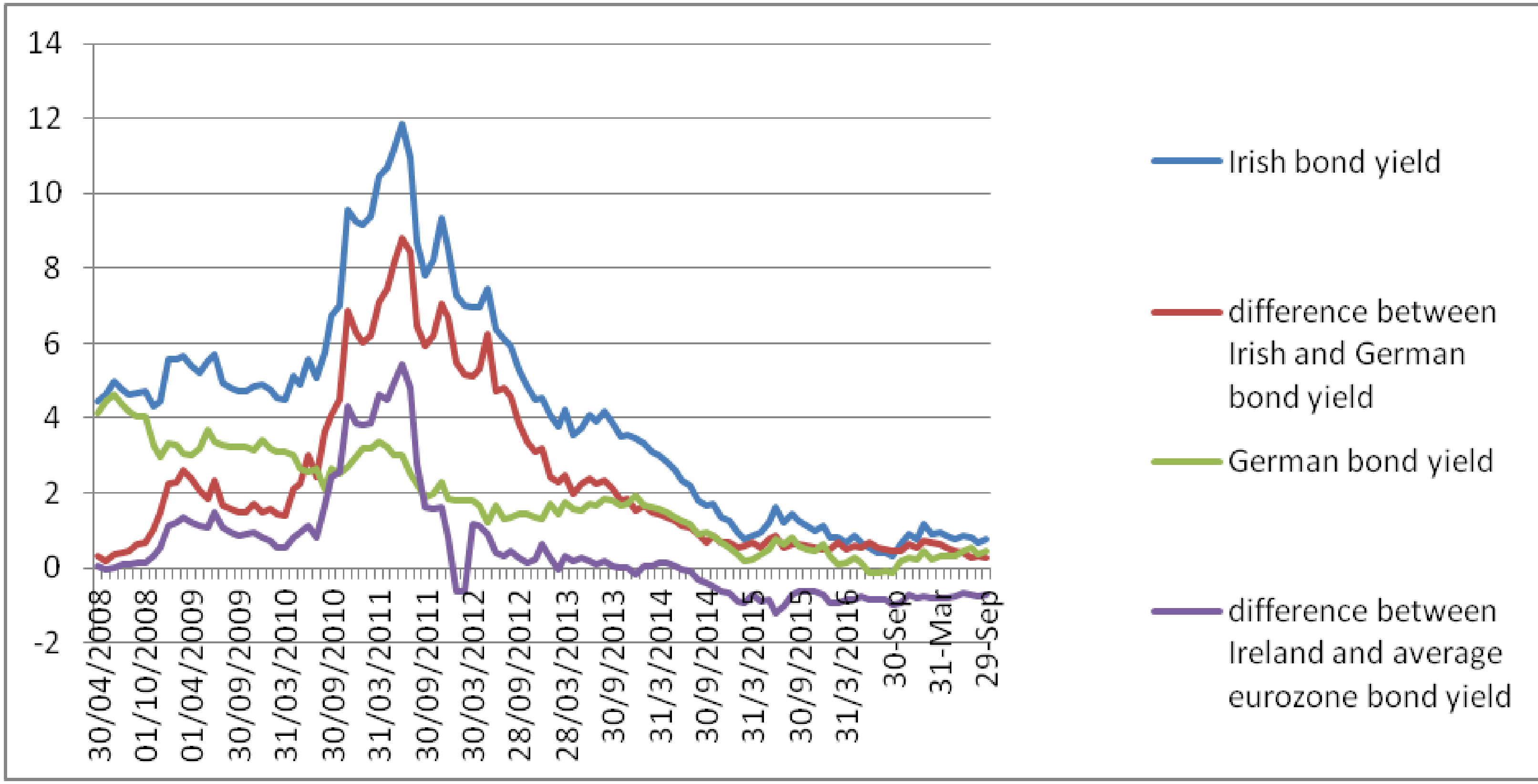
- AE scheme in NewZealand has been described "the world's first national auto-enrolment national saving scheme"
- The aim was to "to increase individuals' well-being and financial independence, particularly in retirement, and to provide retirement benefits" so that there are multiple objectives.
- Scheme is open to self –employed, (those in school above a certain age), etc.
- Partly as a result there are, low contribution rates and possibility of drawdowns to fund home ownership, and for other reasons.
- Meaningful comparison of fees is a controversial aspect of KiwiSaver .
- However there would appear to be a wide variation in TER (Total Expense Ratio) between 0.5 and 1.5%..
- The TER necessarily excludes certain trading charges, stamp duties (if any) paid on trading assets.

Total Members, Noncontributory members and Churn

- The Table below shows a substantial growth in members, but also a high proportion of those defined as ‘non-contributing’.
- The other feature is the high proportion of churn, that is those entering and leaving Kiwisavings schemes and switching schemes

	members	Not contributing[3]	Member entries[1]	Temp and per. exits[2]
March 2016	2.6	42.7	519239	454382
March 2015	2.5	42.6	725995	574038
March 2014	2.29	44.5	997923	846015
March 2013	2.09	46.0	474895	401206
March 2012	1.91	45.0	625630	504059
March 2011	1.67	44.5	587227	477105
March 2010	1.37	44.3	560685	505618

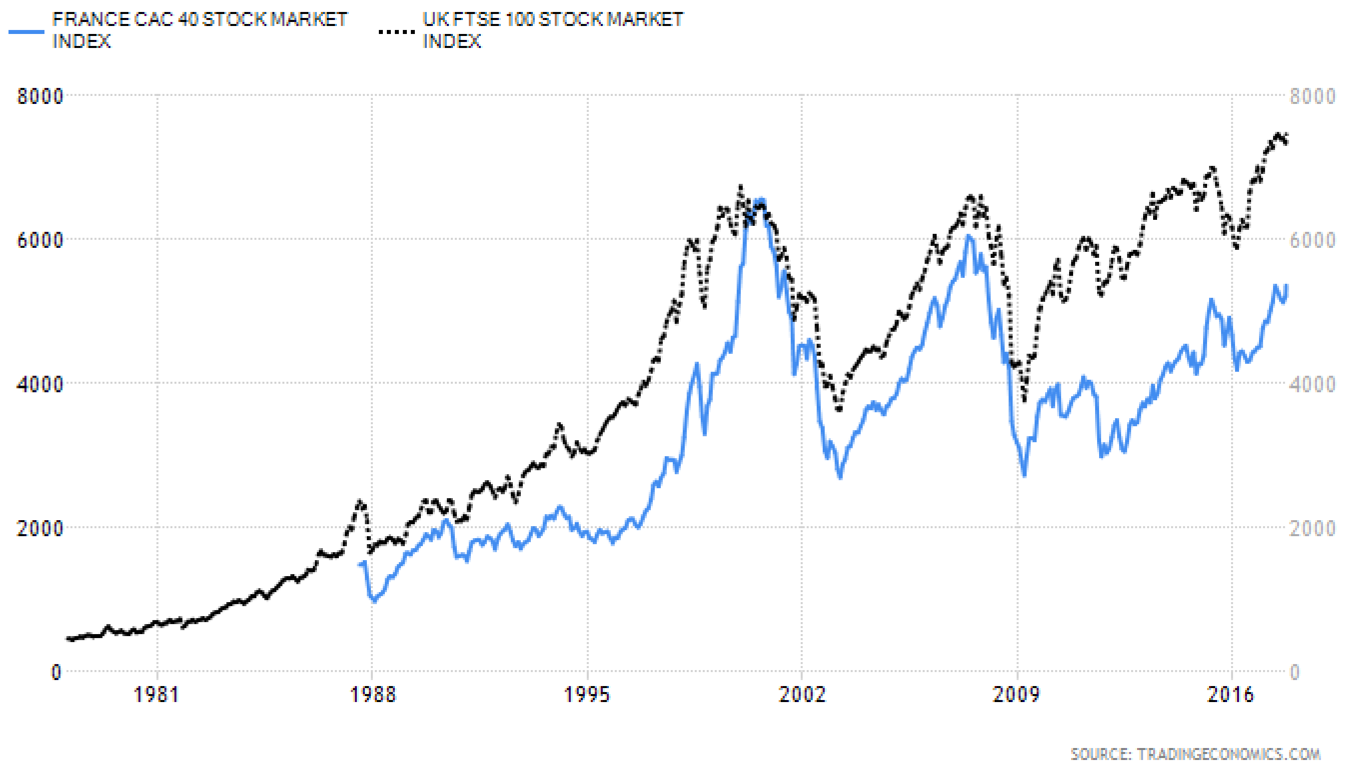
Interest rates on 10 year Government bonds April 2008 to Sept. 2017



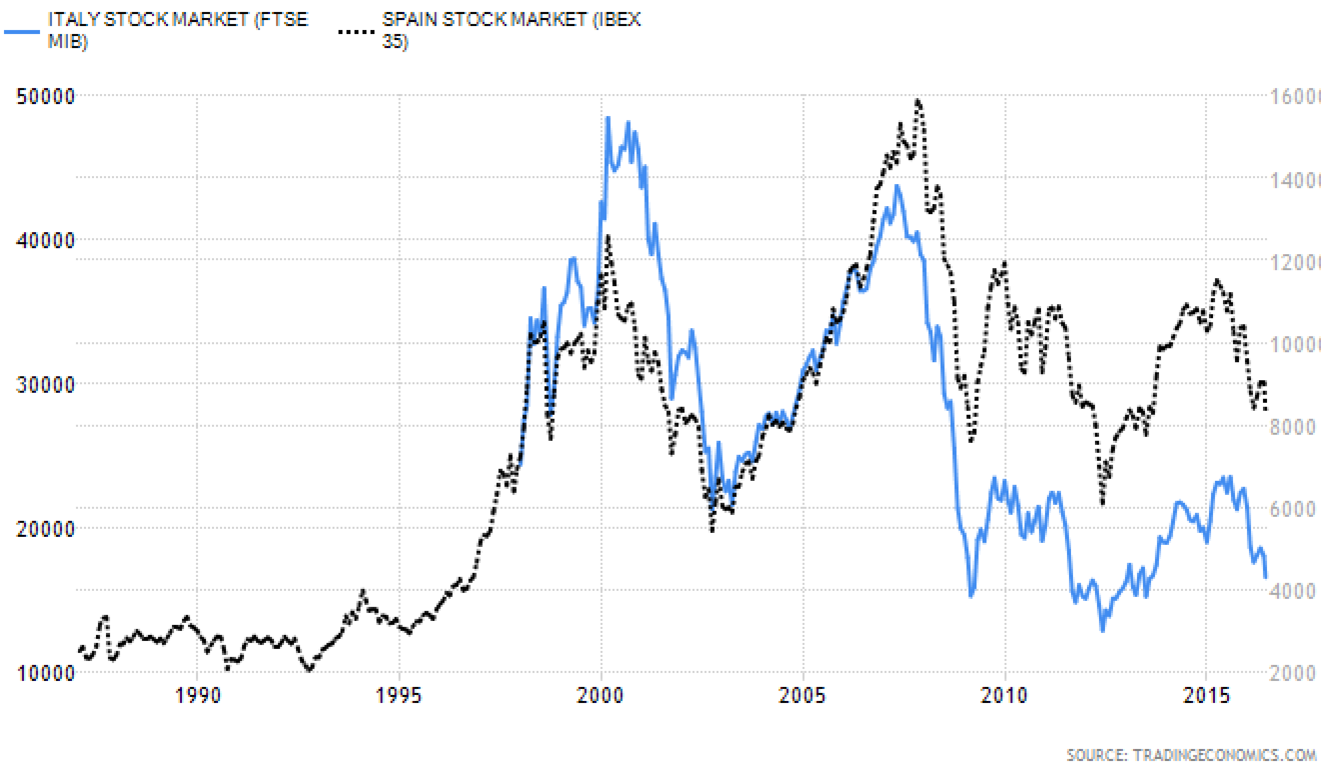
The effect of low Bond yields

- Falling/stagnant wages, low/negative returns on government bonds and historically low annuity rates, all make funded pensions systems less sustainable
- Given low rates of return it is very difficult if not impossible to accumulate sufficient funds to provide for an adequate pension income in retirement.
- For example, a 30 year old, retiring at 65 earning 50000, starting a pension now, and with a target of a pension of 50% of earnings, would need to contribute 23% of earnings per annum.
- Similar but more exaggerated movements have been in share indicies since 1998
- For example, the main Belgium, French, Italian, Netherlands, and Spanish market stock market indicies are below their peak in January 2000 .

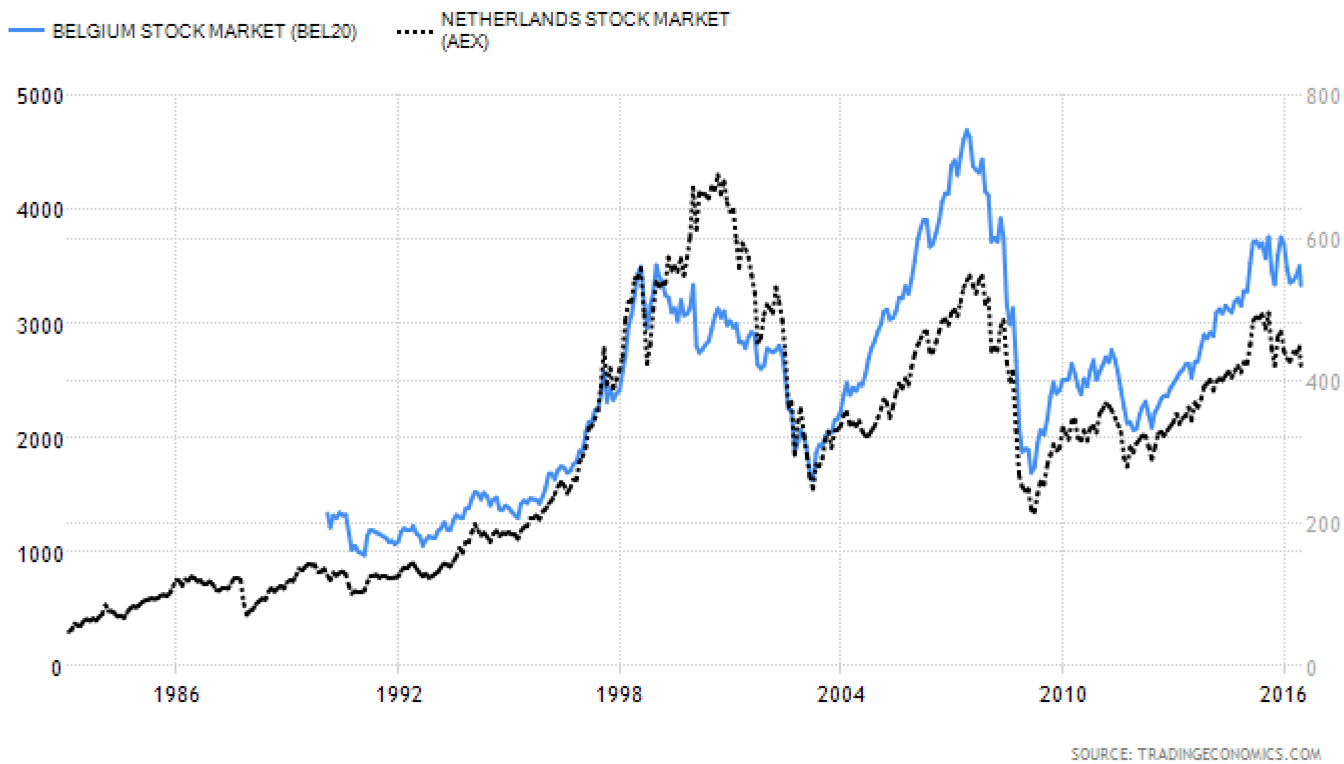
Stock Market returns have also been low and variable



Stock market returns



Stock market Returns



Conclusion

- There is a need for a supplementary second tier pension.
- There is a need to increase contributions by those currently in DC schemes.
- The issue is: is an automatic enrollment scheme the best solution and what should be the main features ?
- We would argue that a second tier pension must be universal for those without coverage and as in the New Zealand case;
- be able to
- cope with ‘contribution breaks’;
- changes in employer;
- changes in address;
- and cross border movements.
- It is unlikely that private sector providers could meet these criteria.

Conclusion

- A second component is that a second tier pension will be DC in nature that is pension payments will be a function of contributions.
- But ishould it be organised as a funded system, with associated governance issues,regulation and the need to control costs ?
- Or as a PAYG system, for example by converting all/some of USC payments into a second tier pension.
- A third issue is whether AE schemes are viable, without a greater degree of compulsion as some have argued in the New Zealand case.
- Following the New Zealand example (as recommended by the OECD) would mean a semi-public system in which the State
- would manage members,
- contribution holidays,
- changes in fund managers etc.
- Funds would be managed in the private sector,
- Perhaps a more fundamental reform would be to increase the required working retirement age in line with the requirements for the State pension.