The impact of automatic enrolment in Italy, New Zealand and the USA

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Connecting policy with the personal: UK pension reforms and individual financial decision making

The ESRC is funding a 3 year PhD studentship in a collaboration between Manchester University and the PPI. The study will examine employee responses to recent pension reforms in the UK. The research will inform our understanding of real-life financial decision making in an increasingly individualised system where people are expected to take high levels of responsibility for their own financial welfare in later life. This collaboration offers exceptional insight into how the work of researchers feeds into policymaking and policy impact, including how evidence is utilised by key actors such as Members of Parliament, government officials and other stakeholders.

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PPI Briefing Notes clarify topical issues in pensions policy.

Key findings

The experiences of the three countries reviewed in this Briefing Note offer important considerations for automatic enrolment into workplace pensions in the UK:

- In Italy, there were significant regional variations in the impact of auto-enrolment, attributed to a peer group effect, where employees who were already engaged with workplace initiatives were also more successfully engaged with pension participation.
- In New Zealand, auto-enrolment resulted in much greater participation in workplace pension saving, although there is a tendency for savers to stick to minimum levels of contribution.
- In the USA, research suggests that benefits of additional participation may not always outweigh the costs of anchoring to lower contribution levels and conservative funds following auto-enrolment.

Table 1: International case studies of automatic enrolment

Country	When adopted	Scale of adoption	Scale of participation
Italy	2007	Quasi-national (private sector only)	In 2013, 21.4% of employed people, or 18.8% of total workforce
New Zealand	2007	National	In 2016, 2.6m members; 75% of population aged 18-64
USA	1990s onwards	Company-specific	Up to 86% participation found within organisations, 2001-2004

Introduction

This Briefing Note will examine what is known about the experience of automatic enrolment for pensions in Italy, New Zealand and the USA. Auto-enrolment has been implemented on a national scale in New Zealand and quasi-national in Italy, while in the USA it has been implemented by a number of companies to support saving into 401(k) plans, a type of retirement savings plan which is sponsored by the employer. This note summarises existing research on these national cases to determine what may be learned for the future of auto-enrolment in the UK.

Auto-enrolment in the UK obliges employers to enrol workers automatically into a qualifying pension scheme. Employees are able to opt out from the scheme at any point, but they will be re-enrolled every three years. Eligibility for the policy covers all employees aged between 22 and the State Pension age and earning over £10,000 per year. The aim of the policy is to encourage more private pension saving by increasing the number of savers and the value of savings, in order to reduce the burden of funding for state pensions in the long term.

Automatic enrolment in the UK was phased in from October 2012, starting with large and then medium sized businesses. Smaller organisations (those with fewer than 50 employees) were phased in from 2016. By 31st July 2016, 206,137 large, medium and small employers had completed the auto-enrolment process. This represented 6.5 million eligible workers who were newly enrolled.

The UK policy set a value of total minimum contributions for auto-enrolment at 8% of earnings, comprised of 4% employee contribution, 3% employer contribution and 1% government tax relief on the contributions. This is being phased in by 2019. Until then, total contributions are 2% of earnings until April 2018, increasing to 5% until April 2019, before rising to the full 8%.

The next sections will consider three examples where auto-enrolment has been used from in Italy, New Zealand and the USA, as shown in Chart 1.

Italy

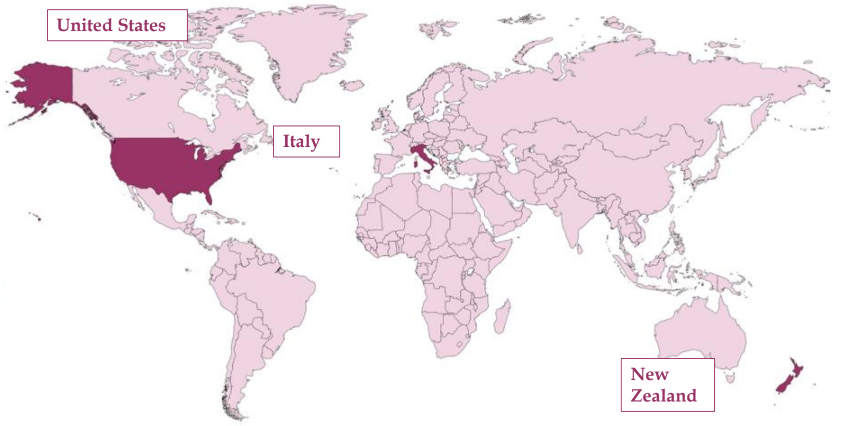
In Italy, automatic enrolment of private sector employees into a supplementary, Defined Contribution workplace pension was introduced in 2007.[1,2,3] This was driven by an ageing population, the slowing down of economic growth, and government budget restrictions. The new legislation also made changes to link the State Pension to economic growth and life expectancy.[1] The auto-enrolment policy gave workers six months to decide whether to transfer their severance pay money, called Trattimento di Fine Rapporto (TFR) worth about 7% of before-tax salary, to a supplementary pension fund.[3] Alternatively, the money could be retained as a cash payment upon severance of employment.

The employee has effectively three options: they could apply to opt-out of the transfer within the six month period (and thus keep the money as severance pay), they could explicitly agree to the transfer of the money to a pension fund by completing a form, or they could do nothing, which was considered as a form of tacit agreement for the money to be transferred to a pension fund, known as 'silenzio assenso'.[4] The auto-enrolment mechanism was introduced permanently for new private sector employees, who would have 6 months after joining a new firm to take action.[4]

The auto-enrolment measure has had a small impact on private pension savings. Just 67,000 employees were auto-enrolled by the end of the first year of operation.[2] At the end of 2010, 5.3 million workers or about 23% of the workforce had been auto-enrolled into a workplace pension fund.[5] In 2013, this had fallen back to 21.4% of employed people, or 18.8% of the total workforce.[6]

While the financial crisis has likely played a role in limiting participation, it has also been suggested that the scheme was hindered by problems in implementation such as communication and awareness.[2] There are wide regional variations in participation ranging from 46% in some regions, down to 17% in others.[6] It is believed that where employees already had a strong base of communication and engagement in the workplace, auto-enrolment was more successful, whereas auto-enrolment made little impact where employees were not already engaged.[1,2]

Chart 1: This note uses evidence from the pension systems of Italy, New Zealand and the United States to draw conclusions about the potential impact of automatic enrolment into workplace pensions



This peer group effect has also been considered in research in the USA.[7] Duflo and Saez (2002) demonstrate the importance of peer effects in a study of employee participation data from a large university, as individual levels of participation and contribution were found to vary with overall group levels.[7] This was considered to occur through employee interaction with others who share characteristics such as age, gender, or tenure which were recorded through the study, but the authors highlight that there could be other latent variables that encourage such interaction, such as the propensity to save, which was not measured. This offers important considerations for the UK implementation of auto-enrolment. While it is recognised that people make decisions about pension with others in mind, there has been little research on the extent to which peer group behaviour affects pension saving in the UK.[8,9]

New Zealand

Before the introduction of auto-enrolment in New Zealand, there was a very underdeveloped market for pension saving.[10] In contrast to Italy's experience, the auto-enrolment programme has been effective in getting more people participating in pension saving.[10,11]

KiwiSaver was introduced in July 2007 offering a total and flexible solution for pensions saving, meaning that anyone can join at any time, and any amount can be contributed. The auto-enrolment element of the KiwiSaver scheme takes place when starting a new job, where the employee has eight weeks to opt out.[10,11] Employees must pay in a minimum of 3% of before-tax salary, and this is the default level of contributions. Employers are obliged to pay at least 3% of salary as contributions to the scheme where their employees are members. The scheme's eligible plans were chosen from existing offerings from private companies, and employers who already offered a workplace pension could apply to convert it to a KiwiSaver scheme.[10,11] By June 2016 it had 2.6 million members.[12] This represented over 75% of the population aged 18–65 years, compared to just 15% of the population who were saving in a private pension scheme before the introduction of KiwiSaver.[13,14]
A large number of employees and employers have continued to make contributions at minimum levels, even a number of years after the implementation.[10] While there is a concern that minimum levels of contributions may not offer an adequate outcome, contributions levels have been kept low to encourage more participation.[13,14]

This is an important consideration for the implementation of auto-enrolment in the UK. Data so far has suggested that individuals and employers are to some extent being anchored to the current minimum contribution levels, as median contribution rates have decreased towards the minimum levels since the introduction of auto-enrolment.[15] The KiwiSaver case represents a policy trade-off where the focus has been on achieving higher levels of participation rather than improving the amounts saved. The UK policy has also favoured participation in the initial rollout, and it is unclear whether more people will opt-out as the minimum contribution levels rise to the full levels mandated by the policy by 2019.[15] Yet it is also unclear whether the full minimum levels mandated will be enough to provide for adequate pension outcomes in the long-term.[15]

The USA

There has been more academic research on automatic enrolment in the USA where schemes have been implemented on a company-specific basis. Since the late 90s, the US federal government has encouraged the use of behavioural tools such as auto-enrolment which harness inertia in order to boost savings, for example, by issuing guidance for employers on how to implement these tools.[16] However, as this section will show, research findings are unclear as to whether there is a long-term benefit from the use of auto-enrolment in the USA.

There is general agreement in research literature that auto-enrolment increases participation. In a study of a large Fortune 500 company over a two-year period, Madrian and Shea (2001) found that participation in 401(k) saving rose from 49% to 86% with the introduction of auto-enrolment.[17] This has been echoed in other research, for example, Choi et al (2004) examined auto-enrolment in three large companies using data from two large surveys, a Vanguard report and Profit Sharing/401(k) Council of America survey.[18] The authors found that auto-enrolment had a significant impact on participation, with rates increasing to over 85% from a base of less than 50%.[18] In both studies, the authors pointed out that without auto-enrolment, participation rates would tend to increase with tenure, which means auto-enrolment may bring forward participation by getting people saving earlier than they would have otherwise.[17,18,19] Choi et al (2004) also found that where auto-enrolment was in place, participation was still up to thirty-four percentage points higher after thirty-six months of tenure.[18] It remains to be seen if this effect continues with longer tenure.
However, there is also evidence that auto-enrolment creates procrastination within the participation process. As in New Zealand, studies have identified a tendency for auto-enrolment

participants to stick to defaults on contribution levels and fund allocations.[18,19] Choi et al (2004) found that 65-87% of participants stick to the default for both contribution level and fund allocation. The defaults were chosen by the three employers studied and they tended to be conservative at either 2% or 3%. The research found that the trend to stick to the default declines slowly over time, but after four years, at least 45% of participants are still on a default rate of contribution.[18,19] This has been described as passive decision making as employees seek to take the "path of least resistance" due to self-control issues, procrastination or inertia.[19] It has also been suggested the tendency to stick to the default may be driven by participants seeing defaults as recommendations or advice, although this has not been proven through research.[17,18,19]

The research from the USA suggests that the gains from additional participation following the auto-enrolment of a group may be offset by losses from anchoring to lower contribution levels and conservative funds once in the scheme.[17] The impact of this at an individual level is unclear. Some participation is better than none, yet if anchoring reduces amounts of contribution in the long-term, certain individuals may lose out through being auto-enrolled.

One method for overcoming anchoring to minimal contribution levels is the Save More Tomorrow scheme, which was designed by Richard Thaler and Schlomo Benartzi.[20] The scheme encourages employees to save more by committing them to increasing contributions on their future pay rises. Thaler and Benartzi found that savings increase significantly over time where the scheme is in place: by the fourth pay rise, SMarT participants were contributing on average 13.6% compared to 8.8% for a group who did not participate in the scheme.[20]

The research from the US provides further evidence that there might be a trade-off between additional participation and anchoring to lower contribution levels following auto-enrolment in the UK. The Save More Tomorrow scheme was considered by the Pensions Commission in their recommendation to implement auto-enrolment, although it has not been endorsed as part of the auto-enrolment policy.

Summary

The examples of automatic enrolment into pensions from Italy, New Zealand and the USA which have been reviewed in this Briefing Note offer the following conclusions:

- In Italy, there were significant regional variations in the impact of auto-enrolment, attributed to a peer group effect, where employees who were already engaged with workplace initiative were also more
- successfully engaged with pension participation.
- In New Zealand, auto-enrolment resulted in much greater participation in workplace pension saving, although there is a tendency for savers to stick to minimum levels of contribution.
- In the USA, research suggests that benefits of additional participation may not always outweigh the costs of anchoring to lower contribution levels and conservative funds following auto-enrolment.

These conclusions are salient for the UK. There is already evidence of some participants sticking to minimum contribution levels after auto-enrolment.[7] It is not yet clear if this cost might outweigh overall benefits of increasing participating gained from auto-enrolment, as has been suggested in the USA examples. The role of peer groups as suggested by the experience in Italy has not been examined in the UK, but we might anticipate a similar effect.

Overall, these conclusions reinforce the necessity of understanding how and why individuals have responded to auto-enrolment in the UK, a theme which will be explored throughout this PhD series.

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