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Who pays the piper?
An international comparison of employer and employee contributions to DC pensions

This report has been commissioned by NOW: Pensions

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Executive summary

This report commissioned by NOW: Pensions explores different factors related to, and country experiences of, employer/employee contribution balances. The UK scenario is compared to countries that have nationwide automatic enrolment schemes (Italy and New Zealand) and other countries where Defined Contribution (DC) schemes operate outside of automatic enrolment (Japan and Denmark). This is a cross-section of regions (Europe, Australasia and Asia) including both well-known and original examples.

The impact of employer contributions on pension saving is related to the pension and welfare system as a whole

Higher pension contributions are associated with improved retirement outcomes and more adequate replacement rates.[1] Higher contributions can be achieved through matched and above minimum employer contributions, and can increase the probability of achieving a target replacement income. However, the impact of employer contributions on adequacy is related to the structure of wider pension and welfare systems. For example, in the UK, an adequate retirement income is more difficult to achieve if the state pension is increased in line with average earnings rather than triple locked, and might mean that people need to save more in private pensions to compensate.[2]

Factors that determine employer and employee contribution levels fit into societal, organisational and individual levels

There are a number of key factors related to employee and employer contributions which are relevant to different levels of analysis (see Figure 1). Framing various factors at these different levels can help with understanding both the implementation and outcomes of policies.[3]

Factors within the societal level are related to the government and the structure of a pension and welfare system. There is an overlap in employee and employer factors at the societal level. Economic conditions and recession are included at this level. In Italy, for example, it is harder for employees to afford contributions after two recessions.

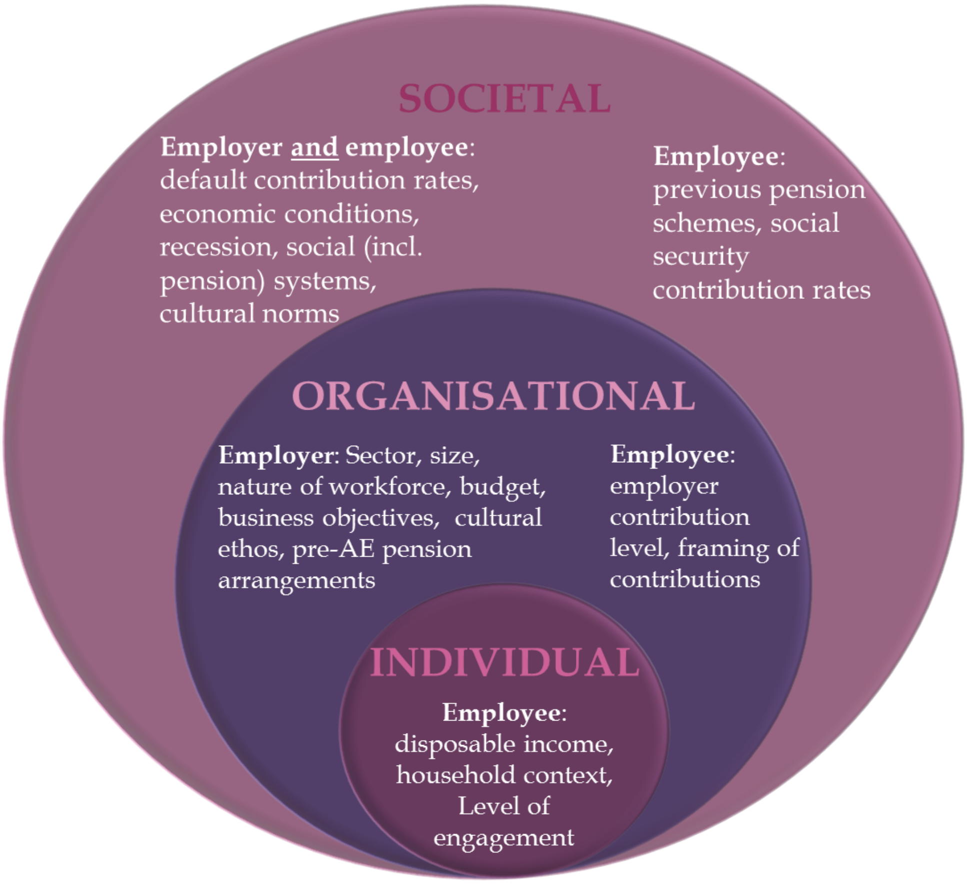
Sector, industry and workforce factors are included within the organisational level. An example of employer related factors within this level can be seen in Denmark where there are a number of different pension arrangements for varying collective agreements. These account for differences in workforce characteristics by sector. In terms of factors impacting employees, in Japan the maximum contributions that can be made by employees is bound by the level of

[1] PLSA (2016)
[2] PPI (2013)
[3] Caldwell and Mays (2012)

employer contributions. Employee contributions cannot exceed that of employers.

There are also factors within the individual level. These factors relate to personal income and financial situations as well as family and household circumstances. These can be addressed through various behavioural techniques.

Figure 1: Employee and employer pension contributions – the three levels



There are a number of potential options in terms of the current automatic enrolment contribution balance

There are a number of different options in terms of potential next steps for developing automatic enrolment policy in the UK.

- Minimum employer contributions could be raised. In Denmark, ATP workplace pension contributions were raised. Not all employers are adverse to a change in the contribution balance that would result in higher employer contributions. Rebalancing contributions could make for a more even contribution ratio which could in turn encourage a greater proportion of employees to save towards retirement.
- However, with this option, the costs would be spread out unevenly across employees. The cost of higher employer contributions would be more for higher earners than staff on lower salaries.

- Employers could view contributions as an opportunity associated with benefits and less as a cost. Higher employer contributions can be embedded in broader organisational approaches. Support could be made available to employers so that they recognise the potential for increased contributions to strengthen their brand, affirm their ethos, strengthen their objectives and attract and retain staff. These are all qualities framed under the Pension Quality Mark's highest standard of excellence. This quality mark is available to UK employers to demonstrate the pension benefits that they offer.[4]
- It could be more acceptable to both employers and employees if changes to the contribution balance are introduced at different times to wider policy changes.

  Employees: Research from individuals that opted out of KiwiSaver in New Zealand, shows that numerous changes before, during and after a policy is rolled-out could affect some people's trust in the system.

  Employers: In terms of the UK, if the income threshold and lower band of earnings is removed, and the eligible age is lowered to younger than 22, this could leave employers with more to budget for in terms of their Automatic Enrolment duties. It might be difficult for employers to budget for higher minimum employer contributions at the same time as bearing the administrative costs of enrolling newly eligible employees. With this option, the costs for employers would be spread out evenly and not vary between high and low earning employees.

Increasing employer contributions can be an opportunity to engage savers in pension saving

A comprehensive programme of engagement and financial education involves backing from employers and other stakeholders. Information about different options available can lead to employees being better informed. This in turn can help people to make decisions that lead to outcomes that better meet their needs. Employers can be a source of financial information for employees and can signpost to other parties with relevant information.

Employers can raise staff awareness of pension contributions by increasing their contributions and using engagement methods via multiple channels. Highlighting an increase in employer contributions can help consolidate the importance of planning for retirement. In other words, an opportunity for a higher employer match could be a "teachable" moment.[5] This is a time point when people are more open to reprioritising their personal finance approaches.

[4] PQM (2017)
[5] PPI (2017d)

A contribution balance that is made up of employer, employee, and government contributions represents a multi-stakeholder approach to pension saving

All three parties face various fiscal barriers. Policies are most effective when they are phased, consistent, and include recognition of the financial constraints faced by the three parties. Furthermore, the most successful policies incorporate recognition of financial constraints and allow contributions to increase gradually for those under increased financial constraints.

Introduction

NOW: Pensions commissioned the Pensions Policy Institute (PPI) to produce this report. The research presented here is an exploration of different factors related to, and country experiences of, employer/employee contribution balances. This report is intended to feed into the 2017 Automatic Enrolment Review. In this report, the UK scenario is compared to countries that have nationwide automatic enrolment schemes (Italy and New Zealand). It is also compared with other country environments where Defined Contribution (DC) schemes operate outside of automatic enrolment (Japan and Denmark). This is a cross-section of countries from across the globe (Europe, Australasia and Asia) including classic as well as lesser known examples.

With a move towards DC schemes, pension outcomes will be explicitly dependent on, amongst other factors, the value of contributions made for the majority of savers. Under automatic enrolment, employers are obligated to automatically enrol workers into a qualifying pension scheme. Those individuals who do not participate, or contribute only at minimum levels, risk having a less-than-adequate income to live on when they reach retirement.[6]

The main focus of the 2017 Automatic Enrolment Review is to look at the existing coverage of the policy and consider the needs of those not currently eligible for automatic enrolment.[7] It is therefore timely to examine these aspects of the UK scenario in relation to other country approaches. This research is an evaluation and review of existing material and is designed to help improve the discussion and debate on automatic enrolment.

The research presented in this report addresses the following research questions:

- Chapter one: How does the UK automatic enrolment contribution pattern compare to other nationwide automatic enrolment schemes?
- Chapter two: How does the UK automatic enrolment contribution pattern compare to those of other DC based countries?
- Chapter three: How does the automatic enrolment contribution pattern compare with other UK schemes? How do employers budget for contributions?
- Chapter four: What are the behavioural factors around possible changes to the contribution balance?

[6] PPI (2017a)
[7] Harrington (2016)

Chapter one: How does the UK automatic enrolment contribution pattern compare to other nationwide automatic enrolment schemes?

This chapter provides a background to automatic enrolment policy in the UK and compares the UK contribution pattern to those in Italy and New Zealand. These are two countries where automatic enrolment is organised at the national level, as it is in the UK.[8]

Factors that determine employer and employee contribution rates fit into three different levels

A number of factors that influence employer and employee contributions fit within three different levels (Figure 1). Contribution rates and balances are affected by decision makers from each level and it is necessary to recognise all three for successful policy design. These three levels of analysis make up the framework used in the research presented here. They are referred to throughout this report. The three levels are societal, organisational and individual (Figure 1). These levels can also be referred to as being at the macro (societal), meso (organisational) and micro (individual) levels. Framing various factors according to these different levels can help with understanding both the implementation and outcomes of policies.[9]

Figure 1: Employee and employer pension contributions – the three levels

[8] OECD (2014)
[9] Caldwell and Mays (2012)

Factors within the societal level are related to the government and the structure of a pension and welfare system. There is an overlap in employee and employer factors at the societal level. Sector and workforce factors are included within the organisational level. Factors within the individual level relate to personal and household circumstances.

Automatic enrolment was introduced in the UK to overcome barriers to saving

AE was introduced to make it easier for people to save more for retirement and to overcome barriers for saving. The policy entails eligible employees aged between 22 and state pension age being automatically enrolled into a workplace pension scheme. By 2019, employers must pay at least a minimum contribution of 3% of band earnings for employees earning £10,000 per annum or more in one job that do not opt-out. Employees pay at least 4% of band earnings. Employers can elect to pay the full statutory minimum contribution (or more) in which case employee contributions are not required. The Government contributes up to a further 1% or more through tax relief.

The Pensions Commission recommended an overall combined pension contribution of 8%. This is based on research that indicates that the minimum level of replacement income that a median earner will need is 45% of their working income in retirement. The 8% contribution rate is intended to help people to reach this 45% replacement level. However, many people will need a higher percentage of working income in order to replicate working life living standards.

The way in which this combined contribution relates to actual outcomes in line with a total replacement rate of 45% is dependent on a number of factors. These include the indexation mechanism used for the State Pension and returns on investment, for example. Furthermore, most people will want to achieve a replacement rate above 45%. One way to do this would be through additional contributions.[10] For example, if automatic enrolment contributions were doubled to 16% of band earnings, a median earner contributing for their working life would be closer to achieving a replacement rate of 65%.[11]

Outline of pension systems

An outline of the pension systems of the three countries with automatic enrolment discussed in this chapter is presented in Table 1. The introduction of automatic enrolment in 2007 in Italy was driven by an ageing population (societal), the slowing down of economic growth, and government budget

[10] DWP (2006)
[11] Pensions Commission (2005)

constraints. In New Zealand, there was a very underdeveloped market for pension saving before the introduction of automatic enrolment.[12]

Table 1: Outline of country pension systems

Country	State Pension	Private Pensions
UK[13]	• Contributory State Pension	• Workplace (voluntary) pension plan • Personal (voluntary) retirement savings
Italy[14]	• *Assegno sociale*: means-tested benefit	• Trattamento di fine rapport: Workplace pension plan • Voluntary pension plan
New Zealand[15]	• Near-universal flat-rate public pension for residents of more than 10 years	• KiwiSaver: Quasi-mandatory workplace pension • Workplace (voluntary) pension plan

Employer contributions are worth more to employee pension pots in Italy and New Zealand than they are in the UK:

- UK: 3% band earnings
- Italy: 6.9% gross earnings
- New Zealand: 3% band earnings.

Key features of automatic enrolment: Italy[16]

Italy

- Introduced across the private sector in 2007
- Target population: all private sector employees and all first time employees thereafter
- Opt out: Within six months following automatic enrolment
- Employer contribution rate (6.91%)
- Employee contributions are voluntary

[12] PPI (2017a)
[13] PPI (2016b)
[14] OECD (2008), (2015a)
[15] OECD (2008), (2015a)
[16] PPI (2017b)

Key features of automatic enrolment: New Zealand[17]

New Zealand

- Introduced nationally in 2007
- Target population: New employees aged 18 – 64
- Opt out: Anytime between 2 - 8 weeks following automatic enrolment
- Employer contribution rate (3%)
- Employee contribution rate (3%)

Automatic enrolment in Italy

Automatic enrolment was introduced for new private sector employees in Italy in 2007. Employees have three options available to them. These are:

1) apply to opt-out within six months and keep the money already contributed as severance pay, or
2) explicitly agree to transfer the money to a pension fund, or
3) tacitly agree for the money to be transferred to a pension fund by not taking any action at all.[18]

Employee/employer contribution balance

Employer contributions are set at a universal rate of 6.9% of gross earnings. Employee contributions are voluntary. However, labour contracts covering most employees provide for an additional employer contribution. This is usually in the range of 1-1.5% of gross wages conditional on a higher matching employee contribution.[19] Where employees do not make a contribution, the 6.9% employer contribution is still paid into the pension fund.

[17] PPI (2017b)
[18] PPI (2017b)
[19] OECD (2014)

Raising expected voluntary contributions for employees may not work if employees are under financial pressure from high taxation and low wage growth

There is a considerable difference between the cost of labour and net wages in Italy. This is partly related to income tax and welfare contributions. Employers' and employees' combined compulsory social security contribution rates are 33% of gross wages.[20] This is broken down into 23.8% paid by employers and 9.2% by employees.[21] Furthermore, disposable income for the average Italian employee is low compared to other Organisation for Economic Co-operation and Development (OECD) countries. Average household net disposable income fell by around 9% in the period between 2009 and 2013.[22] In the context of these conditions, it may not be affordable for many workers to allocate additional resources to pensions.[23] This could make it particularly difficult for employees to contribute at a higher rate in order to benefit from a 1-1.5% increase in employer pension contribution.

Poor economic performance of pension funds might hinder the success of policies aimed at raising employer contributions

The financial and economic crisis has made things more difficult since 2008, and Italy also experienced a second recession in 2011 - 2012.[24] The economic difficulties have made further employee contributions less affordable for both potential scheme members and for smaller organisations.[25] This is likely to have played a role in limiting participation and impacting contributions.[26] Furthermore, with confidence in pension plans investing in financial markets being hampered, the crisis has increased risk aversion.[27] Where individuals are risk averse, they avoid making decisions that risk losing them money.[28]

Automatic enrolment in New Zealand

KiwiSaver, was introduced in New Zealand in 2007. When starting a new job, employees aged between 18 to 64 years are automatically enrolled by their employers into a qualifying scheme. They then have eight weeks to opt-out. Existing employees not covered by automatic enrolment can also voluntarily opt-in and join the KiwiSaver plan.[29]

[20] Rinaldi (2011)
[21] OECD (2015a)
[22] OECD (2016a)
[23] Rinaldi (2011)
[24] OECD (2016b)
[25] Rinaldi (2011)
[26] PPI (2017b)
[27] Rinaldi (2011)
[28] PPI (2017c)
[29] OECD (2014)

Employee/employer contribution balance

Employees must pay in a minimum contribution of 3% of gross salary. This is different to the UK where contributions are based on band earnings. Employers in New Zealand make contributions of at least 3% of salary to the scheme on behalf of their employees.[30] Employees can choose to contribute either 3%, 4% or 8% of gross pay. If no amount is chosen, the default rate of 3% contribution applies.[31] KiwiSaver makes it accessible for individuals to make additional contributions if they wish to. They can make regular contributions or irregular payments and this does not bear any impact on employer's legal responsibilities or impact tax incentives.

The New Zealand government pays an annual member tax credit to eligible members. This works out to be 50 cents for every dollar of member contribution, up to a maximum payment of $521.43 annually. In order for members to qualify for the maximum payment, they must contribute $1,042.86 annually.[32]

Opt-out rates have declined in the context of changing contribution rates thus highlighting the role of inertia in increasing workplace pension saving

Both the minimum employee and employer contributions were reduced from 4% to 2% of earnings from April 2009. In April 2013, the minimum employee and employer contribution rates changed again, increasing from 2% to 3%.[33] It is reasonable to expect that when contribution rates are increased, opt-out rates may increase. This is due to concerns about the affordability of contributions.

There has been a decline in the percentage of individuals who opted out of KiwiSaver. This is a consistent trend since the introduction of the policy. When minimum employee and employer contribution rates increased from 2% to 3%, the percentage of individuals that opted out and remained out declined. The rates declined from 23.1% (2013) and 20.9% (2014).[34] Whilst the change in contribution rate did not adversely affect opt-out rates, it is possible that in the longer term they could affect attitudes to the scheme in a wider sense and pension saving more broadly.

Changes to the contribution balance could potentially lead to higher opt-outs in the long term and also affect some people's trust in the system

Changes to minimum contribution rates may not always effect opt-out rates immediately. Numerous changes before, during and after a scheme is fully rolled-out could affect people's trust in the system.[35] 28% of respondents from a survey conducted to explore views towards the scheme related their non-membership of KiwiSaver to uncertainty about the scheme structure and a belief

[30] OECD (2014)
[31] Inland Revenue New Zealand (2017a)
[32] Inland Revenue New Zealand (2017b)
[33] OECD (2014)
[34] OECD (2014), p.158
[35] PPI (2017b)

that further changes were likely in the future. Other reasons for KiwiSaver non-membership include lack of affordability, or having other pension arrangements.[36] This is in the context of default contribution levels having changed twice since the KiwiSaver scheme was introduced along with other changes being made to the wider scheme. This is a lesson for the UK in terms of the potential impact of making multiple changes to automatic enrolment policy.

The research presented in this chapter offers important considerations for the future of automatic enrolment in the UK. There are a number of different options available in terms of making changes to the contribution balance. These are as follows:

- Minimum automatic enrolment contributions could be based on a percentage of gross salary. Employer contributions in both Italy and New Zealand are calculated as a percentage of gross salary. An option for the UK if the government wishes to raise contribution levels, is to continue with the current contribution rates as percentages, but to use gross salary instead of band earnings as qualifying income. This would increase value of the contributions without a change to the contribution balance.

- Employers could offer a higher match on the condition of higher contributions from employees. This is evident in many employers in Italy. Some employers are offering above minimum levels of contribution. However, whether employees are able to themselves increase their contributions to qualify for the higher employer contributions is conditional on wider economic conditions and levels of disposable income. This is related to a multi-stakeholder approach where pension saving is framed as a shared responsibility. Furthermore, a higher match could be an increased incentive for employees.

- Employee and employer contribution rates can be changed at the same time. In New Zealand, changes were made to both employee and employer contributions at the same time. This is the structure that has been followed with regards to phasing in the policy in the UK. It might be possible to continue in this manner in terms of changes to the policy going forward. This may be a less attractive option, however, if opt-out rates increase with minimum employee contributions going up under the current policy.

[36] Finsia (2011)

Chapter two: How does the UK automatic enrolment contribution pattern compare to those of other DC based countries?

In chapter one, the UK was compared to countries where automatic enrolment is organised at the national level. Comparing the UK contribution pattern to countries that have Defined Contribution (DC) schemes other than automatic enrolment gives an alternative perspective and highlights different lessons. The research presented in this chapter includes a brief outline of employee and employer contributions in different countries and a more detailed discussion of DC schemes in Japan and Denmark.

The Danish pension system is included as it was considered the best pension system by the Melbourne Mercer Global Index for the period 2012 – 2016. There is value in comparing Japan (Asia) with Denmark (Europe) as their pension systems operate in vastly different economic, social and cultural contexts. There is pressure on Japan to take action to mitigate the financial pressures related to having the highest old age dependency ratio of all the countries in the index.[37]

Employer/employee contribution rates vary by country

Different employee and employer contributions for six Organisation for Economic Co-operation and Development (OECD) countries are presented in Table 2 below. These rates are percentages and relate to mandatory private pension contribution rates for average workers as at 2014. France is an example of a country where employers match employees. Employer contributions exceed that of employees in Israel, Mexico, Sweden and Switzerland. When contribution levels have reached 8% in the UK, the minimum employer contribution will be 3%. The average employer contribution is higher in five of the seven countries than in the UK.

Table 2: Comparison of different employer/employee contribution rates for average workers in six OECD countries[38]

	Employee	Employer	Share of burden
France	3.0	3.0	50%
Chile	11.2	1.1	9%
Iceland	4.0	8.0	67%
Israel	5.5	12.0	69%
Mexico	1.1	5.1	82%
Sweden	Voluntary	4.5	-
Switzerland	7.7	10.4	57%

[37] Melbourne Mercer (2016)
[38] OECD (2015b), p.177

DC plans in Japan[39]

The pension system in Japan is composed of three tiers (Table 3) and the framing and structure of the matching contributions is of interest.

Table 3: Outline of the Japanese pension system[40]

Japanese Pension System		
State Pensions	Tier one	• Flat rate basic pension equal to 16% of average worker earnings[41]
	Tier two	• Income-related Employees' Pension Insurance
Private Pensions	Tier three	• Workplace (voluntary) DC • Workplace (voluntary) DB

Matching contributions are central to the structuring of workplace pensions
The DC market is small in Japan and growing with the number of plans approved by the government increasing constantly since 2001. Most workplace DC schemes in Japan have been introduced after, and are secondary to, pre-existing Defined Benefit (DB) schemes. In 2011, 4,013 plans covering 16,000 employers had been approved. From 2012, a new system of matching contributions, including upper limits, were implemented as part of voluntary DC workplace plans.

In the UK, matching contributions are framed as employer matching of employee contributions. This is in contrast to Japan, where matching contributions refer to employee contributions that are required to match those of their employer. The amount of employer contributions is fixed irrespective of its profits and must either be a fixed percentage of employees' pay or a fixed amount for every member.

Contribution limits vary by type of DC plan
Workplace and personal pension plans are the two types of DC plans in Japan. In individual type DC plans, employees can make voluntary contributions. The contribution limit for these plans is ¥23,000 a month. In line with the matching structure set out in 2012, employees' cannot make contributions that exceed those made by their employer. This policy relates to societal (macro) level factors associated with contributions.

There are two different contribution limits:

1) Where employers have an employee pension fund or DB plan alongside their DC plan, contributions to individual accounts are limited to ¥25,500 (£177.57) a month.
2) Where there is no other fund or DB plan, there is a higher limit of ¥51,000 (£355.14) a month.

[39] Takayama (2013)
[40] OECD (2008)
[41] 2014 figures

Tax relief can be attractive for contributing employees

In Japan, tax relief from contributions is intended to make workplace DC plans more attractive. Employee contributions are deducted from each employee's salary, and are tax deductible at the contribution stage. Earnings from investment are not taxed if they remain in the plan. Japanese scheme contributions are limited in order to avoid excessive tax relief and over saving. The combined total of the employee and employer contributions must not surpass the upper limit of ¥51,000 for tax relief.

Limiting the level employees can pay to those chosen by employers can disadvantage some scheme members

The design of the contribution balance in the UK is such that matching employer contributions can be an incentive for employees to join and contribute to their pension plans. The structure of the scheme in Japan is opposite to this. This is because employees are only permitted to pay in to their plan to the extent that their employer is willing to contribute.

Where employers pays less than the contribution limit, the maximum contribution from the employee must decrease accordingly. These variations in contribution by employer relate to organisational (meso) level factors associated with contribution balances. Employees whose employers choose to pay low levels of contributions will be disadvantaged. Contributions will vary among employees of different organisations with the same salary.

The framing of employer matching is related to the wider cultural beliefs

Matching employer contributions are not framed as an employee benefit in Japan in the same way they are in the UK or the other country examples explored in this report. In the UK, matching contributions are framed as employer matching of employee contributions. In Japan, matching contributions refer to employee contributions that are required to match those of their employer. Employee contributions must not exceed that of employers.

These facets of the structuring of employer matching reflect wider Japanese organisational culture. Japanese firms have been found to be based on paternalism with an emphasis on respect towards authority.[42] Employees not being permitted to contribute more than employers is an example of this.

Defined Contribution plans in Denmark

The Danish pension system is made up of three tiers and is outlined in Table 4 below. One key difference between Denmark and Japan is that the former has a compulsory private pension component that makes up the second tier of the system.

[42] Sedgwick (2007)

Table 4: Outline of the Danish pension system[43]

Danish Pension System		
State Pension	Tier one	• Basic State Pension equal to 17% of average earnings
Private Pensions	Tier two	• Compulsory workplace pension (ATP)
	Tier three	• Workplace schemes

Employers pay two-thirds of the contributions in both the second tier ATP and third tier of workplace pension schemes

Workplace pension schemes were introduced by collective agreement by different employer associations and unions. More than 90% of these schemes are DC schemes. They are compulsory for all firms covered by the agreement. The average total contribution rate (including employer and employee) for these plans is 15% of income. As with the ATP, two 3rds of total contributions are paid by employers, with one 3rd paid by employees.[44]

ATP labour-market pension

The ATP is a National Insurance scheme based on individual contribution records. It covers all wage earners and nearly all recipients of welfare benefits. ATP membership is voluntary for the self-employed. ATP covers almost the entire population and comes close to absolute universality. ATP provides a lifelong pension from the age of 65, and works in a similar way to a guaranteed deferred annuity.

The contribution is not a percentage of income, instead it is a fixed amount that varies only according to the number of hours worked.[45] In terms of the contribution balance, two-thirds of contributions are paid by employers and one-third by employees. In 2016, this was broken down as DKK 1,136 employee contribution (£131.06) and DKK 2,272 (£262.11) employer contribution for the year.[46][47]

Increasing employee/employer contribution costs at the same time distributes the burden on both and could make increases more acceptable

In 2009, the overall ATP contribution was increased by around 10%.[48] The contribution was again increased in 2016 where it was adjusted from DKK 3,240 (£373.79) to DKK 3,408 (£393.17) (approximately a 5% increase).[49] Some public sector collective agreements operate with particularly low ATP contributions. A process was launched in 2008 to help ensure that public sector employees would eventually receive the same ATP pension as employees in the private labour

[43] OECD (2015b)
[44] Wilmington Insight (2017)
[45] OECD (2015b)
[46] Danish Krone (DKK)
[47] ATP (2015)
[48] OECD (2015b)
[49] OECD (2015b), ATP (2015)

market. The switch to a higher contribution rate that took place at the beginning of 2016 is part of this wider process that is due to conclude in 2018. The broader rationale of this increase was to protect against a reduction in the purchasing power of future pensioners associated with lower contributions.[50]

Contribution rate policy can be set in a way that reflects the different labour market behaviour of different groups

Danish workplace DC pension schemes, agreed between social partners through collective agreements, cover around 90% of the employed workforce. Total contributions range between 12% and 18%. Lower rates mostly apply to lower income and lower education groups and higher rates generally apply to higher income and higher education groups.

The rationale given for this difference is related to labour market entry. It is common for more highly educated workers to enter the labour market later than their less educated counterparts. Therefore, the higher contribution rate has been seen to help make up for missed contributions and is linked to obtaining a standard replacement rate.[51]

It is evident that employers contribute more to employee pensions in Denmark than in the UK in terms of the ratio of the contribution balance. Despite total contributions varying between sectors, the ratio remains at two thirds employer contribution and one third employee contribution.

There are a number of different key lessons that the UK learn from other DC based countries

- Limiting employee contribution rates to the same as employer contributions can result in inequalities in pension saving. As different employers will contribute different amounts, the employee matching maximum contributions will vary between employers. This can result in inequalities in opportunities for pension saving. This is due to a different level of permissible contributions among employees of different firms within the same sector and salary band.

- Employee and employer contribution rates can be changed at the same time. Denmark is similar to the New Zealand example in chapter one, where changes were made to both employee and employer contributions at the same time. The rationale given for these changes includes:
  - An improved chance of financial security for employees in retirement.
  - Reducing the gap between public and private sector pensions.

[50] ATP (2015)
[51] OECD (2015b)

- Contribution rates could be set to vary by sector and workforce characteristics. In Denmark, different contribution rates are applied to employees with varying educational histories that work in different sectors. This is based on sub-sectional differences in the perceived needs of different employees. Specifically, it relates to higher vs. lower contributions required for adequate replacement rates.

Chapter three: How does the UK automatic enrolment contribution pattern compare with other UK schemes?

Employers have decisions to make around determining appropriate employer and employee contribution levels. Specifically, they consider whether to set rates at the legal minimum or to contribute above these levels.[52] Contribution rates in the UK vary according to key employer characteristics. This relates to organisational (meso) level factors associated with contribution levels. Examples of these include:

- Size of the organisation
- Profile of workers
- Pre-legislation pension provision.

The cost of employer contributions

The cost of employer pension contributions may have risen for some employers in line with automatic enrolment duties. In terms of data from the 2015 Employers' Pension Provision Survey (EPP), 83% of staged employers reported that the cost of contributions had increased since the introduction of automatic enrolment. Small and micro employers who had staged were less likely to report facing an increase in contribution costs than medium and large employers. This could be because small and micro employers are more likely to have no eligible jobholders.[53]

Employer cost reduction exercises can degrade the overall contribution levels, either directly through lower contributions or indirectly through lower wage increases

The most common strategies used by employers who have staged already to address increased contribution costs were:

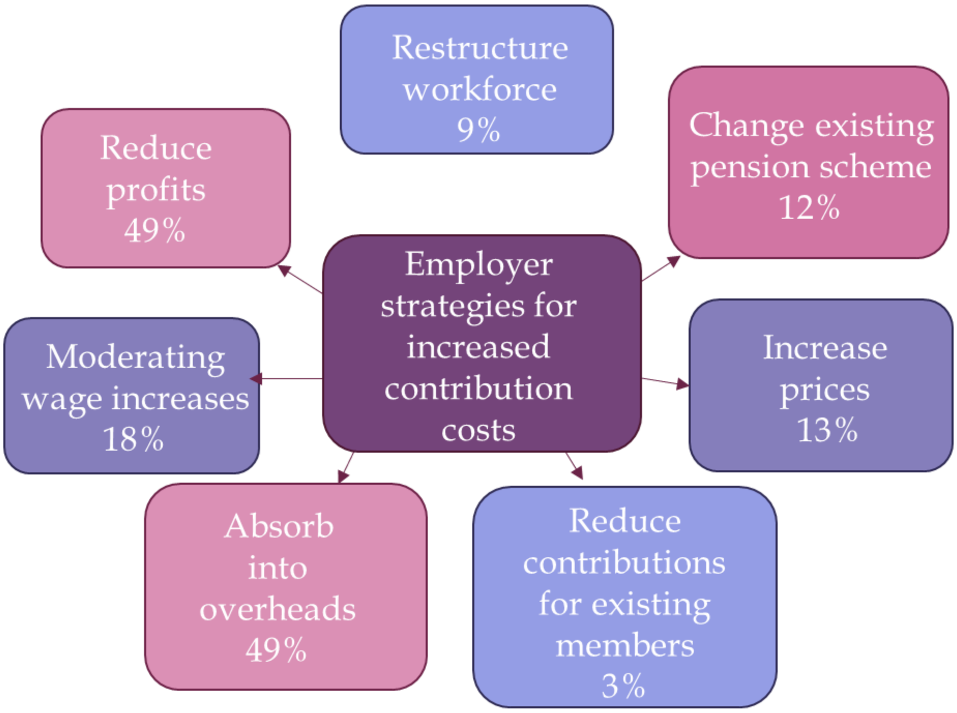
- reducing profits (49%);
- absorbing additional costs as part of other overheads (49%); and
- lower wage increases (18%).

There are also a number of other different strategies that are possible to manage increased contribution costs (Figure 2).

In terms of whether there is a fall in employer contributions, known as contribution drift, 12% of staged employers have reported that they would either amend their existing pension scheme or reduce contribution levels for existing members.[54]

[52] CIPD (2013)
[53] DWP (2015)
[54] DWP (2015)

Figure 2: Strategies used by employers to absorb increased contribution costs[55]



Despite regulation on minimum contributions, there is still wide discrepancy of employer contribution levels

The 2015 Employers' Pension Provision Survey (EPP) highlights variations in contribution patterns across different employer schemes. The majority of staged employers are phasing in contribution rate rises in line with the legislation (62%) and 85% plan to contribute at the legal minimum of 3% by the end of the phasing.[56] New, recently staged employers paying the minimum contributions level for their employees has resulted in a reduction in employer contributions per participating saver from £4,437 in 2012 and £3,560 in 2014.[57]

Employers using master trusts are more likely to contribute the legal minimum

Average employer contributions were slightly lower for the national employment savings trust (NEST) and other master trusts (2%) than for stakeholder schemes (4%) and they were slightly higher for Group Personal Pensions (GPPs)/Group Self Invested Personal Pensions (GSIPPs) (5%). This may reflect the fact that employers using NEST and other master trusts are more likely to be offering pension provision for the first time as a result of automatic enrolment, and therefore more likely to contribute the required legal minimum.[58]

[55] DWP (2016), p.65
[56] DWP (2016)
[57] DWP (2015)
[58] DWP (2016)

Majority of employers yet to stage planning to contribute at the legal minimum

Employers that had not yet staged reported planned contribution rates that were similar to those who had already staged. 14% of employees are planning to contribute above the legal minimum. In terms of employers contributing above the legal minimum, 9% of employers planned to contribute between 3 and 6% and 2% of planned to contribute more than 6%.

Larger employers likely to have multiple matching arrangements

72% of staged employers reported that they are contributing at the same rate for all employees. 18% are offering different rates to different workers where different pension schemes are running in parallel. Employers with more than 100 workers are more likely to offer different rates than smaller employees.[59] CIPD survey data shows that large firms have tended to adopt an alternative, typically less generous pension scheme for employees newly qualified for automatic enrolment. This is in comparison to matching arrangements for pre-existing pension scheme members.[60]

Employers can choose to pay full contributions

Whilst employers have a legal requirement to provide the statutory minimum employer contribution, they can choose to adopt more generous arrangements if they wish. They can, for example, choose to operate non-contributory schemes. These are where the full minimum employee and employer contributions are paid for by the employer. Non-contributory schemes can also include above minimum contributions.[61] This is similar to the situation in Italy - where employees do not make a contribution, the 6.9% employer contribution is still paid into the pension fund.

Rebalancing the ratio of employer/employee contributions for a higher employer contribution could encourage a greater proportion of employees to continue to save in their workplace pensions

A 2006 survey conducted with over 2000 UK employees explored perceptions around increases in contribution to 8% in line with current automatic enrolment policy. Results showed that 74% of respondents that intended to opt-out when rates increase to 8% would either definitely or probably remain as members of their workplace pension schemes if contributions were rebalanced. Specifically, this is if the contribution balance was split with a 5% minimum employer contribution and 3% minimum employee contribution.[62]

[59] DWP (2016)
[60] CIPD (2013)
[61] CIPD (2013)
[62] NOW: Pensions (2016)

Characteristics of employers paying above minimum contributions

Contribution levels are related to size of the employer

Larger employers are more likely to plan to contribute above the legal minimum. Those with 1,000 or more staff members were more likely to contribute between 3 and 6% following phasing than smaller employers. Employers with 20–49 workers are more likely to plan to contribute at the legal minimum.[63]

Results from a 2015 survey of 106 employers showed that 19% of employers were contributing 10% or more. Most of these employers were in the financial services sector.[64] This is backed up by qualitative data that shows employers offering above minimum employer contributions were more likely to be in the financial services and public sectors.[65]

Some employers have adapted more generous existing schemes to newly eligible employees

Some employers have extended their more generous pre-existing pension scheme to newer employers, paying above the legal minimum. One reason given for this approach is a desire for equal arrangements and not having a two-tier approach. For some employers this was aligned with:

- Broader business objectives, culture and ethos
- Approaches to recruitment and retention
- Responsibilities towards employees' wider wellbeing.[66]

One third of employers accept potential rise in minimum contributions

A 2015 survey of 477 employers conducted by the Association of Consulting Actuaries (ACA) explored views towards increases in automatic enrolment contributions. Employers were asked about their views on supporting increases to the minimum level of automatic enrolment contributions from 2020. Results showed that the majority of respondents (51%) expressed a desire for the minimum automatic enrolment employer contributions to remain at 2018 levels. However, 31% of respondents were willing to see minimum employer contributions rise to 4%.[67]

The way in which employers respond to their automatic enrolment duties reflects their wider approaches towards employee/employer relations

Factors other than cost are central to this consideration. How these considerations are evaluated depends on a number of organisational level variables including pre-legislation pension provision, size, sector, nature of

[63] DWP (2016)
[64] Punter Southall Aspire (2015)
[65] DWP (2013)
[66] CIPD (2013)
[67] ACA (2015)

workforce. The research presented in this chapter suggests that contribution levels vary according to these organisational characteristics.

It is evident that some employers are providing above minimum legal contributions. There are a number of different strategies available to employers to enable them to factor employer contributions into their budgets. If the legal minimum for employer contributions were to be raised, increasing awareness of how other organisations have been able to provide higher contributions could help. One potential option is that employer organisations could foster the sharing of case studies on how others from their sub-sector have been able to provide higher contributions. This could be a source of support for organisations, particularly as the case studies would be of firms operating in similar economic and market conditions as them.

Employers could view contributions as an opportunity associated with benefits and less as a cost.

Higher employer contributions can be embedded in broader organisational approaches. Increased contributions could strengthen employers' brand, affirm their ethos, strengthen their objectives and help attract and retain staff. These are all qualities framed under the Pension Quality Mark's highest standard of excellence. This quality mark is recognised by the HR and pensions industries as well as the Government and is available to UK employers to highlight the pension benefits that they offer.[68]

[68] PQM (2017)

Chapter four: What are the behavioural economic factors around possible changes to the contribution balance?

Along with coverage, and contribution levels, one of the three themes considered as part of the Automatic Enrolment Review 2017 is consumer engagement. Behavioural economics theory underpins different strategies used for engaging people and encouraging them to save more into their workplace pensions.[69] Incentives based on this theory are set up around the possibility that people do not necessarily behave in a rational way or as one might expect them to.[70]

Behavioural incentives are based on observed attitudes, 'mind-sets' and conduct. They are implemented with the aim of 'nudging' those behaviours towards achievement of better outcomes to the individual and society. In this case the outcome is engagement in long term saving and an increase in pension savings.[71] This chapter discusses outcomes related to changes in contribution balances and is an evaluation of behavioural economic findings on the most effective employee and employer contribution levels.

The decision to amend contribution rates within a nation-wide automatic enrolment policy is taken by government. It is a change that is implemented at the macro level. However, when designing policy at this level, the potential behavioural impact at the individual and organisational levels need to be recognised.

Employers may view legal minimums as recommendations for how best to support employees in meeting replacement rates

Some employees believe that having a workplace pension is sufficient enough to provide for retirement, regardless of contribution rates.[72] The framing effect that follows from defaults has been used to explain why some people are hesitant to amend their contribution rates. Framing effects are to do with the presentation of choices and associated actions.[73] Defaults can be perceived as representing the optimal choice. In this way, defaults are sometimes viewed as recommendations, particularly when they are set by a trusted source such as the government.[74]

[69] DWP (2017)
[70] Hardcastle (2012)
[71] Hardcastle (2012)
[72] PPI (2017c)
[73] Hardcastle (2012)
[74] PPI (2017c)

It is possible that employers also view their legal minimums as recommendations for how best to support their employees in meeting their basic retirement needs.[75] Research has shown that saving at the minimum contribution rate of 8% of band earnings may not be enough for some individuals to reach their target replacement incomes.[76] This could be an area where government and employer associations could support employers and their understanding.

Key stakeholders could highlight to employers that matching employee contributions could secure staff a better retirement whilst also having benefits for employers. This in turn could be aligned to meeting wider business objectives and fit better with overall organisational approaches to culture and talent.[77]

Changes to minimum contribution rates can be an opportunity to foster consumer engagement

An increase in employer contributions and enrolment into a good quality pension scheme to employees may only be effective if employers are able to communicate the benefits to staff. Financial education can be used to explain the link between levels of contribution and positive retirement outcomes.[78]

Offering matching employer contributions can encourage staff to review and reflect on their employee contributions. This could be a starting point for enhancing the focus that staff have on their financial wellbeing.[79] It could help employees to see a connection between various financial concerns and different stages in life.[80]

If legal minimums for employer rates were increased, there is the possibility to engage employees in their pension saving. It could be an opportunity to show employees the gap between their projected and desired replacement rates. In this case it is possible that employers incentivise saving indirectly through matched contributions and prompt employees to consider reviewing their own contributions.[81]

Different communications channels can be used to encourage reviewing of contributions and broader engagement with pensions

The Peel Ports Group raised staff awareness of pension contributions by increasing its matching contributions and using specific methods of communications. Around a third of the Group’s 1,100 employees were part of

[75] PPI (2017c)
[76] PPI (2013)
[77] CIPD (2013)
[78] Calnan (2015)
[79] Calnan (2015)
[80] SSGA & Benz Communications (2015)
[81] Calnan (2015)

its stakeholder pension plan before changes were made to the matching rates. Matching of employee pension contributions was increased from 3-6% to 3-10% from January 2014. This increase coincided with the company's automatic enrolment staging date.

To highlight the increase in contribution matching, a number of different communication initiatives were introduced. These included:

- pensions briefings that highlight the importance of pension contributions,
- opportunities for discussion with a pensions professional,
- letters explaining options,
- launch of regular pensions and benefits newsletters.[82]

Higher employer matches combined with consumer engagement efforts can be a catalyst for increasing employee contributions

The previous Peel Ports pension scheme had offered a matched contribution of up to 6% of salary. This equated to a 12% employer/employee contribution in total. The scheme has been replaced with a tiered approach which is being phased in over two years. Employee contributions start at 3% and increase to 4%, and then 5% – each matched by Peel Ports. In addition, staff can contribute from 5-10%, which can be matched to a maximum of 20% combined employee-employer contribution.

Under the old pension system, only around 30% of staff took up any matching offer. With the new scheme, however, there has been a 90% take-up. Average total contributions are between 14-15%, and 30% of eligible staff are contributing the full 10% staff maximum.[83] This is one case study of a small firm. The findings from this case study may not be true with organisations with different characteristics.

KiwiSaver: An example of the micro level impact of changing contribution levels

The KiwiSaver automatic enrolment scheme was introduced in New Zealand in 2007. The scheme covers employees aged between 18 to 64 years. Since the scheme began, changes have been made to minimum contributions twice. Both the minimum employee and employer contributions were reduced from 4% to 2% of earnings from April 2009. In April 2013, the minimum employee and employer contribution rates changed again, increasing from 2% to 3%.[84]

[82] Calnan (2015)
[83] Crush (2017)
[84] OECD (2014)

Savers contribute at default rates when minimum levels change due to inertia

Inertia is a behavioural barrier related to people's tendency to avoid making difficult decisions and instead keep their behaviour unchanged.[85] 62% of people who joined KiwiSaver before 2009 continued to contribute 4% of their gross income when the level was reduced to 2%. This indicates a degree of pensions saving inertia. 80% of members who joined KiwiSaver after 2009 are contributing at the new minimum rate of 2%.[86] Inertia is central to these participation patterns and highlights the influence of default contribution rates.[87]

There may be less loss aversion amongst savers contributing at a higher pre-existing rate

Loss aversion refers to a tendency to prefer avoiding losses to acquiring gains. People are usually loss averse and worry that the choices they make could lead to regrets in later life. This can lead to avoidance of hard decisions and associated negative emotions. It is possible that there is less loss aversion amongst those that started contributing at the higher minimum amount. This is because they were already contributing at the higher rate of 4% in the first place and so will not necessarily miss the extra 2% from their income.[88]

There is a current policy discussion taking place around raising minimum contribution levels in the future using behavioural methods

Increasing employer contribution rates rather than employee contribution rates may give individuals less incentive to opt-out. Some employees have citied that the employer contribution rate is too low for the pension to adequately support their retirement. Employees citing this reason included those offered the statutory minimum (1% matched contribution), as well as individuals offered higher contribution rates (commonly between 2% and 3%). This indicates that a certain number of employees would require significantly higher employer contributions to decide to remain in a workplace pension.[89]

Policy-makers are considering taking advantage of inertia to increase contributions in the future.[90] New Zealand is an example of a country where the contribution level has been changed on more than one occasion. The changes that were made to KiwiSaver in New Zealand, however, have not involved an increase above the original minimum contribution of 4%. On the basis of other international automatic enrolment schemes, it is difficult to know then what might happen in the UK if the minimum contribution rates were increased.

[85] PPI (2017c)
[86] Rashbrooke (2013)
[87] OECD (2014)
[88] PPI (2017c)
[89] DWP (2014)
[90] PPI (2017c)

A majority of savers contribute at the minimum rates. Furthermore, where multiple changes have been made to a scheme, there can be a negative effect on trust in the wider pension system. This is an example of behavioural impact at the individual level. This is an important lesson for the UK. If changes are to be made to the contribution balance, fewer changes over a longer period rather than multiple changes over a shorter period might be more accepting to savers. Another factor for consideration for the UK is that minimum contributions are viewed as recommendations. Therefore, a new legal minimum is likely to be the rate at which the majority of employees and employers will contribute at.

Finally, changes to contribution levels can be an opportunity to prompt savers to engage in their retirement planning. There has been evidence of this being done at the organisational level when an employer changed their matching policy. If minimum contributions were changed within the UK-wide automatic enrolment policy, it could be an opportunity to implement a national pension awareness campaign at the same time as policy changes. An example of this would be the Pension3Days event in the Netherlands.[91] This is an example of potential behavioural impact at the societal level.

[91] PPI (2017e)

Appendix

NOW: Pensions

What defines DC pension scheme success?

With a worldwide shift towards Defined Contribution (DC) pensions, NOW: Pensions compares UK workplace pension contribution models from across the globe. We consider, if DC pension success is in part measured by the amount of employer and employee contributions, how does the rest of the world stack up?

UK auto enrolment legislation began in 2012 offering a non-compulsory contribution model. Contributions are currently 1% of pensionable earnings from both employer and employee. Contributions will rise in 2018 and 2019 known as 'phasing', leading to a total of 8% made up of 3% employer and 5% employee.

UK employers will be bearing just 37.5% of the burden

Automatic enrolment was introduced for new private sector employees in 2007. Italian workers can opt out within six months and keep the money as severance pay. The Italian contribution model is currently made up of employers: 6.9% with employees: voluntary. Labour contracts covering most employees provide for an additional employer's contribution in the range of 1% to 1.5% conditional on a matching employee contribution.

Italian employers will be bearing at least 84.8% of the burden

90% of the population are included in a third tier of occupational pensions apart from the state pension and compulsory labour market pension (ATP). Higher contribution rates generally apply to higher income and higher education groups (as they join the workforce later so have less time to build up a pension) but average 10% from employer and 5% from employee. Employers pay around two-thirds of the contributions in both the second and third tiers.

Danish employers bear 66.7% of the burden

KiwiSaver was introduced in New Zealand in 2007. When starting a new job, employees aged between 18 to 64 years are automatically enrolled by their employers into a qualifying scheme. They then have eight weeks to opt out. Employers in New Zealand make contributions of at least 3% of salary to the scheme on behalf of their employees. Employees can choose to contribute either the default rate of 3%, or 4% or 8% of gross pay.

New Zealand employers will be bearing at least 27% of the burden

Contribution models under DC pension schemes are evolving and changing. A contribution balance that is made up of employer, employee, and government contributions represents a multi-stakeholder approach to pension saving. The most successful policies allow contributions to increase gradually in line with stakeholder circumstances and constraints.

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