What are the lessons from KiwiSaver for automatic enrolment in the UK?

Introduction
Following provisions legislated for in the Pensions Act 2008 (upon recommendations from the Pensions Commission that reported in 2005) employers will start to automatically enrol their qualifying employees into a workplace pension from 2012. The Government has set up the National Employment Savings Trust (NEST) as an option for employers who do not provide a qualifying occupational pension scheme or do not sponsor a group or stakeholder pension.

Automatic enrolment in workplace pensions has the potential to significantly change private pension provision. The Government has recently estimated that there could be between 5 and 8 million new savers in workplace pensions, of which between 2 to 5 million could be in NEST.[1]

The UK will be the second country in the world to introduce auto-enrolment in workplace pensions at the national level after New Zealand in 2007. This briefing note analyses New Zealand's experience with auto-enrolment and the possible implications for the UK.

Comparing policy design in the UK and New Zealand (NZ)
While there are some similarities in the UK and NZ approach of using auto-enrolment to address people's inertia and tendency not to save into a pension, there are also some significant differences in policy design (Chart 1).

Chart 1: Comparing auto-enrolment in New Zealand and the UK

	New Zealand (NZ)	UK
Savings vehicle	Multiple providers of KiwiSaver funds. Members can have only one KiwiSaver account.	Employer-sponsored schemes or Government-sponsored trustee-based scheme (NEST) . Members could have more than one pension.
Qualifying individuals for auto-enrolment	All new employees aged 18-64 or when switching jobs.	All employees aged 22-SPA with earnings above £7,475 (2011/12 terms).
Opting-out	Up to 8 weeks after being auto-enrolled.	At any time. Re-enrolled after three years.
Opting-in	Non-employed under age 18; the self-employed; employees through employer or provider.	Self-employed and people aged 16 -22 and SPA-75.
Employer contribution	At least 2% of full earnings.*	At least 3% of a band earnings from £5,715 to £38,185 (2010/11).
Member contribution	2%, 4% or 8% of full earnings for employees.* The minimum rate is used if employee does not decide. Voluntary contributions possible.	4% of band earnings, if employer contributes the 3% minimum.
Government contribution	Kick-start payment of NZD 1,000. Member Tax Credit (MTC) of 50 cents in the dollar, up to a maximum of NZD 521.43. per year.	Tax relief, specific rate depends on employee contribution.
Other incentives / flexibility	Withdrawals for first-time buyers, financial hardship, serious illness.	No other incentives. Funds can be withdrawn or used to buy an annuity when reaching SPA.

* : Minimum contribution rate will be increased to 3% from 2013

Auto-enrolment
In the UK, eligible employees with earnings above £7,475 (2011/12 earnings terms) aged 22 to State Pension Age (SPA) will be auto-enrolled in a staged process from October 2012, starting with large employers. The Government has announced that enrolment for employers with fewer than 50 employees will be delayed from April 2014 to May 2015.[2]

The self-employed and those aged 16 to 22 and SPA to 75 will have the right to opt-in to the scheme selected by their employer for auto-enrolment. Employees will have the right to opt-out at any time, but they will be automatically re-enrolled every three years.

The legislation stipulates a total minimum contribution rate of 8% of a band of earnings from £5,715 to £38,185 (2010/11 earnings terms), with at least 3% paid by the employer. The specific rate of minimum employee contribution will depend on how much the employer decides to contribute. Similarly, the Government contribution rate will depend on how much the employee decides to contribute. For example, if an employer decides to contribute the minimum 3% and the employee contributes 4%, the Government will contribute 1% in the form of tax relief.

In NZ, employees are only auto-enrolled when getting their first job or when switching jobs. Other individuals, including people aged 17 or under can decide to opt-in either through their employer or through a KiwiSaver provider. Individuals can opt-out only during the first 8 weeks of being auto-enrolled. Thereafter, they can apply for an unlimited number of contribution holidays of up to 5 years each.

Employees can choose to contribute 2%, 4% or 8% of full earnings. Non-employees can select a regular or varying amount. If the member does not select the rate, the minimum rate is used. Employers are required to make matching contributions of at least 2% of all earnings. The Government contributes through an annual tax credit to each individual of up to NZD 521.43 (£265). It also provides an incentive in the form of a NZD 1,000 (£508) kick-start payment when joining the scheme.[3]

Savings Vehicles

The two countries have opted for different delivery approaches in their savings vehicles that can be used for auto-enrolment:

- In the UK, the Government has set up the National Employment Savings Trust (NEST), although employers can auto-enrol employees into any qualifying pension scheme. NEST has to accept any employer wishing to enrol their employees. Other pension providers can choose who to offer access to their schemes.
- In NZ the Government has not set up a specific scheme. Any pension provider can register a scheme for KiwiSaver, provided it meets certain requirements. Auto-enrolled employees can choose their own KiwiSaver scheme, be nominated for one by their employer, or be allocated to a default fund by NZ Inland Revenue. Members can have only one KiwiSaver account during their working life.

As a consequence of the different approaches, individuals in the UK could end up accruing rights to different pensions, depending on the scheme used by their different employers during their working life; by contrast in NZ each person will have only one account. While individuals in the UK can consolidate different pension pots into one, transfers in and out of NEST are banned until 2017, at the earliest. The Government has recently launched a consultation on ways of aggregating small pots.[4]

UK legislation allows the pension pot to be used to withdraw funds or buy an annuity after reaching SPA. KiwiSaver members have more options. They can withdraw their savings (minus the Government contributions) to buy a first home or if experiencing financial hardship or serious illness.

Chart 2: KiwiSaver membership

	2008	2009	2010	2011
Total KiwiSaver membership	716,637	1,100,540	1,459,942	1,755,932
Of which opted-in *(as percentage of total)*	443,358 *(62%)*	673,911 *(61%)*	918,173 *(63%)*	1,109,207 *(63%)*
Of which auto-enrolled *(as percentage of total)*	273,279 *(38%)*	426,629 *(39%)*	541,769 *(37%)*	646,725 *(37%)*
Total KiwiSaver Membership aged 18 and over	609,717	914,499	1,185,091	1,438,455
Total members aged 18 and over as percentage of population 18-64	23%	34%	43%	52%
Percentage of those auto-enrolled who have opted-out	34%	34%	31%	28%

Sources: KiwiSaver Annual Report (2011); NZ Labour Force Survey

Key patterns in NZ and the possible lessons for the UK

Membership

As of 30 June 2011, membership in KiwiSaver represented over 50% of the working-age population (Chart 2). Around 63% of KiwiSaver members have opted -in to the system, while 37% have been auto-enrolled.

Membership in KiwiSaver is roughly equally split between men (48%) and women (52%). Membership is higher for those aged 18-24 and for those in their late 50s, compared to the eligible population. For example, people aged 18 to 24 represent around 14% of KiwiSaver members, while they represent only 11% of the eligible population. The higher membership among young workers may be related to the requirement of automatically enrolling employees when entering the job market. The higher membership among older workers may indicate their higher level of awareness on the need to save as they approach retirement and on the incentives offered by KiwiSaver, compared to other saving options. In comparison, a higher proportion of employees could be automatically enrolled in the UK because of the requirement to enrol eligible employees in their current jobs, as well as those starting new jobs.

The opt-out rate in NZ, defined as the proportion of people auto-enrolled who decided to opt-out has been about one third in the four-year period to 2011. While employees can only opt-out up to 8 weeks after being auto-enrolled in NZ, UK employees will be able to opt-out at any time.

However, there could be differences in the opt-out rate in the UK compared to NZ, as eligible employees in their current jobs, and not only those joining the workforce or changing jobs, will see a new deduction in their pay. This group may show different opt-out behaviour.

An evaluation survey has found that more than 25% of respondents did not join KiwiSaver because they said they could not afford it and more than 30% said they had other savings for retirement.[5] However, an almost equal proportion of respondents did not join because of fear of changes to the scheme in the future. Such attitudes could be related to the different changes implemented since the KiwiSaver scheme went live in 2007:

- The minimum employee contribution has been reduced from 4% to 2% of all earnings from 1 April 2009.
- The minimum employer matching contribution has also been reduced from 4% to 2% of all earnings from 1 April 2009.
- A NZD 40 (£20) subsidy on scheme fees and an employer tax credit has been removed.

More changes were introduced in New Zealand's Budget 2011:

- The member tax credit was reduced from a maximum of NZD 1,042.86 (£530) to NZD 521.43 (£265).
- Employer contributions will no longer be exempt from tax from April 2012.
- The minimum employee and employer contribution rates will rise from 2% to 3% from April 2013.[6]

During the November 2011 general election campaign many parties proposed changes to KiwiSaver. The National (centre–right) party, which leads the new Government, has proposed to auto-enrol all workers once the Government Budget returns to surplus. Therefore, more changes to the system could be discussed in the near future.

The changes and uncertainties about the future could explain why some eligible people have decided not to join. There may be an implication for the UK in that continuous changes before, during and after the system is fully rolled-out could affect people's trust in the system.

Contributions

Contribution patterns to KiwiSaver show that employees and employers tend to stay at the default contribution rate set in the legislation (Chart 3). Around 62% of KiwiSaver members who joined before 1 April 2009 are contributing 4% of all earnings, which was the minimum contribution rate when they joined. Similarly, around 80% of members who joined after 1 April 2009, are contributing at the current minimum rate of 2%. Around 91% of employers contribute the minimum default rate of 2% as of June 2011.

Chart 3: Employee and employer contribution rates in NZ

Rate	Percentage of members joining before 1 April 2009	Percentage of members joining after 1 April 2009	Percentage of employers as at June 2011
2%	33%	80%	91%
4%	62%	18%	2%
8%	5%	2%	<1%
Other%	<1%	<1%	7%
Total	100%	100%	100%

Source: KiwiSaver Annual Report (2011)
100% are all members as of 30 June 2011 that have made two or more consistent contributions over the April to June period

Making contributions at the default rate may not be enough to secure a decent retirement income for some individuals. A median earner making contributions to KiwiSaver at 4% of full earnings and receiving employer contributions at 2% could achieve a total replacement rate at age 65 of around 55% of pre-retirement earnings, with around 40% from the NZ Superannuation (state pension) and 15% from KiwiSaver.[7] This is below the OECD average of around 65%.[8]

In the UK, the Pensions Commission estimated that an auto-enrolled median earner making total contributions of 8% of band earnings would be able to achieve a total replacement rate of around 45% of pre-retirement earnings, from which a private pension would represent around 15%.[9] The Commission also estimated that to reach the target replacement rate of 65%, total contributions would have to be doubled to 16% of band earnings.

The NZ experience illustrates that employees and employers tend to make contributions at the legal minimum. In the UK, some observers have pointed out that one of the ways for employers to pass on the increased costs of auto-enrolling their eligible employees could be by "levelling down" to the minimum contribution rate of 3% of band earnings. It was estimated in 2009 that only 10% of employers were making pension contributions of 3% or more.[10] However, they accounted for more than half of all private sector employees, as large employers are more likely to offer generous pension schemes. Thus, decisions made by this small number of employers could have a significant effect on total pension savings.

It is hard to predict whether a significant proportion of employers and employees will make contributions at the legal minimum once auto-enrolment is rolled-out. However, the NZ experience shows that awareness must be raised about the need to increase contribution levels to achieve some individuals' desired replacement rates.

Total assets in KiwiSaver funds have increased significantly from NZD 701million in 2008 to around NZD 9.2bn as of March 2011, representing around 14% of the life and insurance market in NZ.[11]

Conclusions

Notwithstanding the significant differences in legislation, auto-enrolment rules and market structure , the experience of NZ with auto-enrolment provides useful lessons for the UK:

- Compared to the NZ system, the UK retains complexity which may require later simplification.
- Workers in the UK could end up accruing rights to different pensions: NEST, stakeholder pensions, etc.
- Opt-outs in the UK could be influenced by the requirement to enrol all eligible employees, and not only those joining the workforce or changing jobs, as in NZ.
- The NZ experience shows that employees and employers tend to contribute at the legal minimum rate. However, this may not be enough for some employees to achieve their desired replacement rate.
- Coverage of the target population and total pension savings could be significant.
- However, affordability and fear of changes in legislation once the system is rolled-out may affect employees' participation.

In sum, while auto-enrolment in workplace pensions could significantly change the UK pensions landscape, the NZ experience provides some useful lessons regarding the factors that may affect the outcome of this policy.

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1 DWP (2011) *Pensions Bill, Workplace pension reform legislation. Impact Assessment* p.47
2 DWP (2011) *Government announces changes for small business to the automatic enrolment timetable.* Available: dwp.gov.uk/newsroom/press-releases/2011/nov-2011/dwp135-11.shtml
3 Inland Revenue (2011) *KiwiSaver Evaluation Annual Report*, pp. 6-7.
4 DWP (2011) *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots*
5 FINSIA (2011) *KiwiSaver and Retirement Savings*, p.8.
6 Inland Revenue (2011) *KiwiSaver Evaluation Annual Report*, p.7.
7 Rashbrooke, G. (2009) "Simple Effective and (Relatively) Inexpensive: New Zealand Retirement Provision in the International Context", *Social Policy Journal of New Zealand* (36), p. 101. This calculation assumes net investment return of 5% per annum and nominal earnings growth of 3.5% per annum.
8 OECD (2011) *Pensions at a Glance 2011*, p.120.
9 Pensions Commission (2005) *A New Pension Settlement for the Twenty-First Century*, p. 274. Assumed AMC 0.3% and average earnings growth.
10 DWP (2010) *Employers' attitudes and likely reactions to the workplace pension reforms 2009: Report of a quantitative survey*, p.26.
11 Inland Revenue (2011) *KiwiSaver Evaluation Annual Report*, p.23.
* Exchange rate: £1 = NZD 1.89, as of 16 January 2012

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