Framing paper

The Aspen-NEST Insight
Transatlantic Collaboration

Working together

NEST Insight and The Aspen Institute Financial Security Program are coming together in a transatlantic collaboration to help solve the next generation of retirement challenges. The partnership will seek to enhance understanding of, and provide new insight into, how the retirement system can be improved for low to moderate earners. Through research and discussion, it will help policy-makers and the industry to identify and test potential solutions that can form the next phase of innovation in this sector.

Introduction

The 20th century saw the emergence of the idea of retirement as we have come to know it: defined by more than merely the 'risk' of outliving one's productive working capacity and instead becoming, for many, an aspirational 'third age' of life.

Different welfare systems grew up around the world to reflect this new normal, with the United States (US) and the United Kingdom (UK) aligning by the latter part of the century around a 'liberal' framework[1] with a prominent role for private saving through the workplace, traditionally through **defined benefit** (DB) structures.

However, in recent years progress has been threatened as inequality, non-standard forms of employment, and longer lifespans have stretched retirement resources to their limit. In response to these uniquely 21st century pressures, two respected leaders in retirement security are joining forces. The UK's NEST Insight unit and The Aspen Institute's Financial Security Program (FSP) in the US are launching a transatlantic collaboration to help solve the next generation of retirement challenges.

In this paper we set out what we believe those challenges to be, and introduce the Aspen-NEST Insight Collaboration. The partnership will seek to enhance understanding of, and provide new insight into, how the retirement system can be improved for the target populations that our organisations share – those on low and moderate incomes. Through research and discussion, it will help policy-makers and the industry to identify and test potential solutions that can form the next phase of innovation in this sector.

21st century pressures:

Inequality

Non-standard forms of employment

Longer lifespans

[1] Esping-Andersen, G. (1990) "The Three Worlds of Welfare Capitalism." Cambridge, UK: Polity Press (describing the Esping-Andersen typology of welfare systems).

Parallels between the systems

The US and UK retirement systems are structurally similar in design, serve similar labour markets, suffer from similar challenges, and have sought similar solutions to resolve them. There is a strong history of shared thinking and insight, and of parallel development paths in the two countries.[2] Crucially, we believe that this means the next set of challenges across the two systems are also closely related, and will require similar responses.

Both systems have traditionally relied upon comparable structures to deliver retirement income security, often referred to as the 'three-legged stool' in the US:

> mandatory pay-as-you-go **Social Security** in the US and the **State Pension** in the UK

> **occupational pensions**

> personal or supplementary savings.

Over the last 20 years and more, various structural shifts have taken place that are perceived to have undermined these systems – and again, these are common to both countries. Increasing longevity and a declining birth rate have put pressure on the sustainability of the first pillar or 'leg.' In the US, the Social Security system is expected to exhaust its trust fund in 2035.[3] In the UK, where benefits are funded from general taxation, the Independent Pensions Commission forecast in 2005 that, even though the relative value of benefits was projected to decline significantly due to indexation rules, total costs would rise by around 1 per cent of gross domestic product (GDP) by 2050 without reform.[4]

At the same time, those same demographic shifts, coupled with regulatory and financial challenges, were undermining the sustainability of the second 'leg' – largely DB pensions. Employers started to move away from providing DB pensions, and both countries instituted protection regimes for the members of failing DB plans. The Pension Benefit Guaranty Corporation was set up in the US, and the UK created the Pension Protection Fund.

> **"...defined contribution plans, originally viewed as a third 'leg' of supplementary savings products, have taken over as the dominant form of occupational retirement provision."**

As a result, **defined contribution** (DC) plans, originally viewed as a third 'leg' of supplementary savings products, have taken over as the dominant form of occupational retirement provision. Workplace DC plans tend to be less generous than traditional occupational DB plans, place greater risk directly on the saver, and are often structured as wealth, not income, products.

[2] Gruber, Jonathan, et al. (2016). "Social Security Programs and Retirement around the World." National Bureau of Economic Research.
[3] Research, Statistics, & Policy Analysis, Social Security Administration (2017), "Summary: Actuarial Status of the Social Security Trust Funds, July 2017."
[4] Second report of the UK Pensions Commission, 2005.

Importantly, in both countries the decline in DB provision and the move towards less generous DC plans were mirrored by a decline in both access (fewer people offered plans) and coverage (active participation in plans). As of 2012 in the UK, private sector participation in a workplace plan among employees eligible for **automatic enrolment** had fallen to around 42 per cent, from 51 per cent in 2006.[5] In total, as many as 14 million people may have been 'undersaving' for their retirement based on their expected capacity to smooth consumption into retirement.[6] In the US, current estimates show 55 million people, nearly half of the private sector workforce, are not offered a plan at work.[7] This is down from a high of 63 per cent being offered a plan in 1998.[8]

In recent years, the rise of behavioural economics, which from early on has included retirement savings as a core focus, has signalled a path to addressing the coverage challenge, at least for traditional employees. Developed in the US and first applied there as a plan-level feature, automatic enrolment has dramatically increased participation in plans that use it, while **auto-escalation** through mechanisms such as the Save More Tomorrow program[9] have utilised similar default mechanisms to increase contribution levels.

These ideas have transitioned from the academic and corporate spheres into that of public policy. In the US, the shift towards automatic enrolment began in earnest in 2006, upon passage of the Pension Protection Act, which encouraged employers to automatically enrol their workers into DC plans. More recently, US policy on automatic enrolment has shifted to the states, with five states adopting programmes introducing a form of state-wide automatic enrolment, and Oregon starting to enrol members in its Oregon Saves programme during 2017. In 2012, the UK government began implementation of a national automatic enrolment 'mandate' through which all employers would be required to make workplace pensions an 'opt-out' rather than 'opt-in' benefit. The UK approach also used the idea of auto-escalation to inform its policy design, with minimum contribution rates starting low then rising over time.

Thus, in many respects, the blueprint for normalising workplace pension saving throughout the population is well understood. Challenges remain, especially in the US, where there are a stubbornly high number of workers without any access to a plan and adoption of automatic enrolment at workplaces with coverage is still not universal.[10] And in both countries, moving from 'saving at all' to 'saving enough' to meet individuals' needs and expectations for later life remains difficult. But if phase one of addressing a looming crisis in 'pillar two' provision was around participation, it is reasonable now to ask where the next set of challenges lie.

[5] Department for Work and Pensions, (2017) Automatic Enrolment Review 2017: Analytical Report.
[6] IBID
[7] John, David and Koenig, Gary (2014). "Workplace Retirement Plans Will Help Workers Build Economic Security" Fact Sheet. AARP Public Policy Institute (reporting that 55 million private sector workers aged 18 to 64 were not offered a workplace retirement plan in 2013).
[8] Munnell, Alicia and Bleckman, Dina. (2014) "Is Pension Coverage a Problem in the Private Sector?" Center for Retirement Research, Boston College (reporting in Figure 1 that between 1979 and 2012, the high-water mark for percentage of full- and part-time private sector workers aged 25 to 64 offered a retirement plan at work was 63% in 1998).
[9] Thaler, Richard H., and Shlomo Benartzi. (2004) "Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving." Journal of Political Economy, vol. 112, no. S1
[10] Plan Sponsor Council of America (2018). "PSCA Releases Results of 60th Annual Survey of Profit Sharing and 401(k) Plans" (finding that 60% of the 590 defined contribution plan sponsors surveyed reported offering a plan with an automatic enrolment feature in 2016). See also The Vanguard Group. (2017), Figure 15 of How America Saves 2017 - Pressroom (finding that 45% of the 1,900 qualified plans for which Vanguard provides recordkeeping services use automatic enrolment).

The next set of challenges

For some, the obvious next challenge, after participation and accumulation, is how savers can or should best access their savings, both in terms of the guidance they receive and the products on offer. And indeed this is in many ways the great unfinished business of the transition to DC. Without built-in annuities or other reliable income streams, DC savers will be vulnerable to out-living or mismanaging their nest egg, with dire consequences. Both our organisations have work programmes examining these questions.

But for this to even be an issue, individuals must first accumulate retirement savings. A surprisingly high number of individuals in both the US and UK are simply not there yet. This is particularly true for the segments of the population that NEST Insight and Aspen FSP care most about – low-to-moderate earners, those in smaller firms or outside traditional employment, and those without

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a legacy of some accumulated DB rights. For these populations, the more immediate challenges centre around the growing trend of non-traditional employment and the increasingly complicated and unstable household balance sheet. NEST Insight and Aspen FSP believe these two issues affect the financial health of British and American families in similar ways and thus deserve special, joint attention from our organisations:

> **Non-traditional employment**

Automatic enrolment, the process of an employer signing up its workers on an opt-out rather than opt-in basis, hinges on a traditional employer-employee relationship and works best when that relationship has longevity. High turnover and workforce mobility, defining characteristics of today's US and UK labour markets, already diminish the efficiency of the model. More fundamentally, the traditional employer-employee relationship has been complicated by the rise of self-employment and contingent labour models. Thus, a significant number of workers are systematically excluded from forms of retirement provision that are based on the presence of an employer. These groups suffer all the same barriers to making provision for themselves as are now well understood for other workers, plus, potentially, additional attitudinal and practical barriers such as higher income volatility. While traditional automatic enrolment is not a viable solution, other behaviourally-informed interventions may prove effective at overcoming inertia and getting these non-traditional workers saving for their long-term financial security.

> **Unstable household balance sheets**

Retirement is far from the only financial concern facing today's working households. Wage growth has slowed while income swings from month to month have increased, making it difficult to meet expenses without taking on debt. At the same time, housing, education, and, in the US, health care costs have increased. Emerging research indicates that paycheck-to-paycheck living extends much further up the income spectrum than previously understood.[12] Under these circumstances, families face complicated trade-offs between saving for retirement, paying off debt, investing in human or physical capital, and building up a short-term savings buffer. Consumers make these choices with a limited set of financial tools – ones that often address each goal independently. More holistic information on family balance sheets and a better understanding of how integrated financial solutions and hybrid product models might address this challenge would represent a major advance.

[11] See, for example, JPMorgan Chase Institute (2016). Paychecks, Paydays, and the Online Platform Economy.

Identifying solutions

In order to make progress on these key, next-generation challenges, NEST Insight and Aspen FSP are combining efforts as part of a formal collaboration that will expand the reach and power of the two organisations' research and ideas. As we build a channel for cross-pollinated solutions, the following principles will guide our activities:

❯ **Rigorous research and insight**:

There is still much to learn about the contingent workforce and household balance sheet, both in and of themselves and as they relate to the retirement system.

❯ **Emphasis on big data and technology**:

Quantitative and qualitative data collection is happening at a massive scale, both by NEST itself, as well as by governments, philanthropies, non-profits, and private business. Linking these data sets could accelerate product development through machine-learning algorithms, for example, as well as our own common understanding of the problems.

❯ **Incorporating new voices and perspectives**:

For too long, the conversation about retirement has been dominated by those served fairly well by the current system. The Aspen Institute has long been committed to bringing diverse voices together to solve some of the thorniest problems facing the world. That commitment will be necessary here to ensure that we see the problems facing the retirement system with a fresh perspective.

❯ **Building on existing work**:

Our organisations, alongside many others, have made important contributions to this space in the last few years. Traditionally staid conversations about retirement policy have been infused with cutting-edge ideas like portable benefit design and **rainy-day savings** accounts. We aim to continue those important dialogues.

The Aspen-NEST Insight Collaboration

The Aspen-NEST Insight Collaboration will create a platform from which to analyse, research, and identify solutions to the retirement challenges laid out above. NEST has already proved that a more inclusive retirement system is possible, but neither of our organisations are content with the progress to date.

In the US, states are beginning to expand access to automatic enrolment to some traditional employees, but even those fairly modest efforts have been met with fierce opposition. Lessons from the NEST program could help build political consensus in the US, improve state implementation efforts, and even allow the US to jump directly to second-generation solutions that build on the lessons of implementation in the UK.

In the UK, automatic enrolment has successfully integrated over 9 million new savers into the retirement system,[12] but challenges remain around increasing contribution levels, reaching contingent workers, and understanding the place of retirement savings relative to broader household finances. Emerging research in the US around income and expense volatility, the relationship between retirement savings and debt, and **liquid asset poverty** could inform policymaking in both the UK and the US going forward.

The collaboration will lead to joint research and publications, public and private convenings, and cross-promotion of thought leadership. Both NEST Insight and Aspen FSP are excited about the direction of this partnership, and we are eager to get started.

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[12] The Pensions Regulator (2018) Declaration of compliance report: July2012 - end February 2018. London, UK. Available **here**.

About our organisations

NEST Insight

NEST Insight is a collaborative research unit set up by NEST Corporation in 2016 to help understand and address the challenges facing NEST members and other defined contribution savers.

NEST Corporation was set up by the UK Government as part of the implementation of automatic enrolment.

NEST Insight's work is made possible by the generous support of its strategic partner, Vanguard. For more information about NEST Insight, visit: **nestinsight.org.uk**

The Aspen Institute Financial Security Program

The Aspen Institute Financial Security Program (Aspen FSP) leverages human insights and entrepreneurial thinking to find policies, products, and services that deliver greater financial security for millions of Americans.

Aspen FSP connects the world's best minds to find breakthrough solutions for America's family financial security crisis. Aspen FSP's work on retirement security is made possible through funding from Prudential Foundation, JPMorgan Asset Management, MetLife Foundation, Ford Foundation, AARP and TIAA. For more about Aspen FSP, visit: **aspenfsp.org**

Join the effort

For more information about the Aspen-NEST Insight collaboration, see **aspenfsp.org** or **nestinsight.org.uk**.

We are always seeking additional partners and support, so please contact **insight@nestcorporation.org.uk** or **fsp.info@aspeninstitute.org** if you're interested in joining the effort.

Glossary

Automatic enrolment – The process by which employers sign up employees for a benefit plan automatically, giving employees the choice to opt out instead of opt into a plan. This strategy has proven highly successful at increasing participation in the retirement system.

Auto-escalation – The process of incrementally increasing employee contributions to a benefit plan over time. This strategy, first introduced by the Save More Tomorrow program, has successfully increased many participants' contributions.

Defined Benefit (DB) – A type of retirement plan in which an employer or sponsor promises a specific pension payment that is pre-determined by a calculation of employee tenure and other factors rather than by employee contributions. DB plans typically involve a lifetime income component that pays out a steady distribution over the course of retirement.

Defined Contribution (DC) – A type of retirement plan in which employees contribute a defined amount of their income to an employer-sponsored account, sometimes matched by employer contributions. DC plans typically do not incorporate lifetime income and instead culminate in lump-sum or annual payouts upon retirement.

Liquid asset poverty – Lacking the readily accessible savings to live above the poverty line for three months should one face an income disruption.

Occupational/workplace pensions – Work-based retirement plans in the UK and US, historically of a defined benefit nature. They are often referred to as 'pillar two' or the 'second leg of the stool.'

Rainy-day savings – A pool of money set aside to cover near-term emergencies. Typical benefit plans do not provide workplace-based opportunities to set aside these savings automatically, despite growing need – nearly half of Americans and Britons lack just $500 in savings.

Social Security – The US government-run system of social welfare providing provisional monetary assistance to people in retirement or with disability. It is a mandatory, pay-as-you-go system that is often referred to as 'pillar one' or the 'first leg of the stool.'

State Pension – The UK government-run system providing a base level of income in retirement to most citizens on the basis of their National Insurance record. It is a mandatory, pay-as-you-go system that is often referred to as 'pillar one' or the 'first leg of the stool.'

Contact us