How the UK Saves: The effects of phasing

Member experience from
National Employment Savings Trust (NEST)

How the UK Saves 2018 research supplement

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- April 2018 saw the first step in raising auto-enrolment minimum contribution rates, with an increase from 2% to 5%, of which at least 2% must now come from employers
- Our analysis of NEST member data shows that the increase has had no material impact on retirement savings behaviour. In the five months after phasing, member-led cessations were just 0.3 percent higher overall than in the preceding 5 months
- The total proportion of members ceasing payments (member cessation) increased by only 1.5 percentage points only some of which was likely attributable to the increase in contributions
- The research suggests that member inertia continues to have a powerful impact on member retirement savings behaviour. This is reflected in the small percentage of members who reacted to the mandatory contribution savings increase and confirms the importance of inertia to the efficacy of automatic enrolment.

As part of our research partnership, NEST Insight and Vanguard are delighted to present the first supplementary research publication to our How the UK Saves series. This paper focuses on understanding the impact of mandatory increases in minimum retirement savings rates.

The inaugural edition of How the UK Saves: Member Experience from the National Employment Savings Trust (NEST), published in 2018, reviewed in great detail the successful introduction of automatic enrolment. The 2008 Pensions Act initially required employers to automatically enrol eligible employees in a qualifying workplace scheme, originally with minimum total contributions of 2%, including at least 1% from the employer. Recognising that an initial contribution rate of 2% would be insufficient to deliver successful retirement outcomes, the legislation also stipulates incremental increases in the minimum contribution rate. Those increases, known as "phasing", first to 5% and then to 8%, effective in April 2018 and 2019 respectively, are the latest tests of the power and effectiveness of the UK retirement savings system. It has been widely reported, by NEST and other providers, that the behavioural response to the first increase was minimal. This research note supports this view with in-depth data, providing a baseline for the next phased increase in April 2019.

To test the impact of the first step in raising contributions from 2% to 5%, we have analysed NEST's data for the period from January 2017 to August 2018. This period includes both the final months of auto-enrolment "staging", when all UK employers became subject to auto-enrolment requirements, and the first period after phasing commenced in April 2018, when contributions were raised, to the end of August 2018.

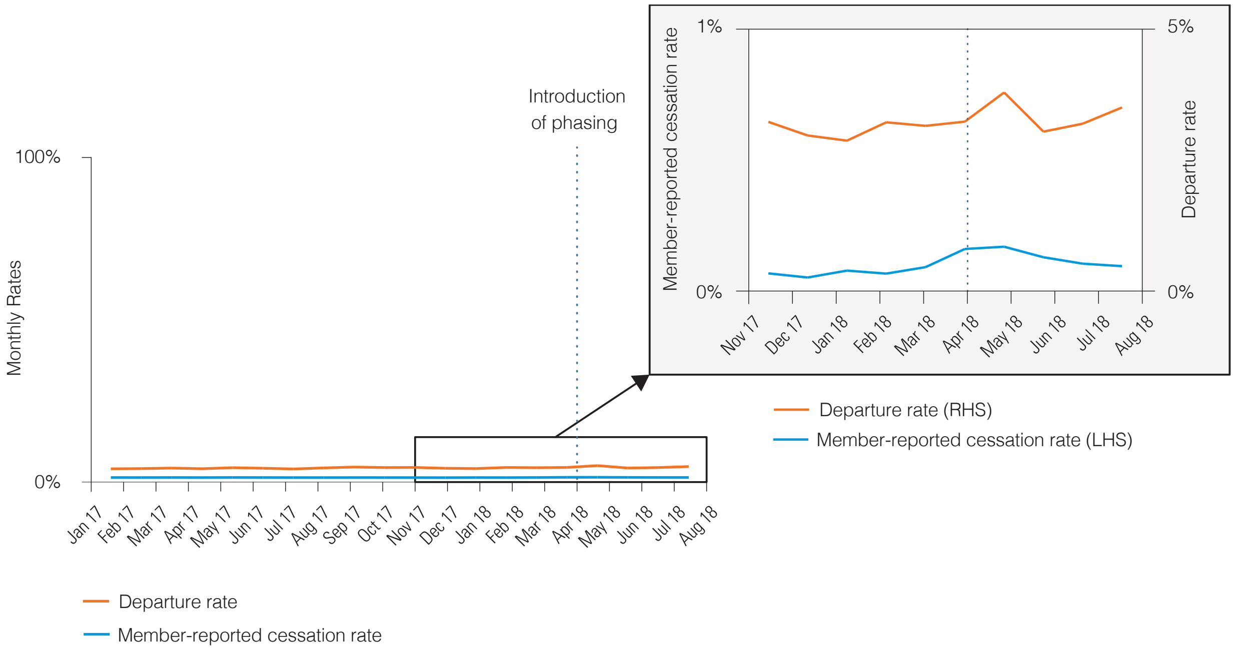
Effects of phasing

To properly understand the data on the impact of mandatory contribution increases it is important to clarify how 'cessations' are defined and captured within the NEST data set. Members have three methods of ceasing contributions to their NEST accounts:

1. through their online account
2. by contacting NEST directly or
3. by informing their employer.

In terms of reporting, methods 1 and 2 are grouped under 'member-reported cessation rates' and 3 is captured within the 'departure rate'. To minimize the reporting burden, employers are not required to specifically report a member's cessation of contributions to NEST. As a result, departure rates in any given month make no distinction between employees leaving employment and those who have made a request to their employer to cease contributions. This means the departure rate captures all who have ceased to contribute to their NEST account, whether or not as a result of leaving their employment or making an active decision to stop contributions.

Figure 1. Monthly member-reported cessation and departure rates
Active NEST members from January 1, 2017, to August 31, 2018



Source: NEST, Vanguard 2019

It is clear from **Figure 1** that the April 2018 increase in contribution rates (phasing) has had very little impact on member-reported cessation rates (blue line). The immediate rise was very low, at 0.1%, in the months following the increase, or slightly more than 1% a year. Even then, the impact was only temporary as member-reported cessation rates returned to previous levels by August 2018.

Prior to phasing, monthly departure rates averaged 3.0% per month (red line). As discussed, these monthly departure rates reflect both members who leave their employer and those who report to their employer a desire to stop contributing. Therefore any unusual increase in departure rates may indicate an increase in cessation activity reported to the employer directly. The percentage of departing members increased from 3.2% in March to 3.6% in May. Again, as with member-reported cessations, we observe a return to previous departure patterns in the months following the introduction of phasing.

Figure 2. Impact of contribution increase
Cumulative totals

	Before phasing *Nov 2017 to Mar* 2018	Phasing and after *Apr 2018 to Aug 2018*		Impact
Departure rate	15.9%	17.0%	Employer-reported cessation rate (estimated):	+1.2%
Member-reported cessation rate	0.4%	0.7%	Member-reported cessation rate:	+0.3%
			Percentage point change	+1.5%
			Percent change	+9.4%

Source: NEST, Vanguard 2019

Figure 2 looks at the five-month period prior to phasing and compares it with the five months after phasing. We have estimated the change in employer-reported cessation rates as the difference in the cumulative totals of the departure rates in the relevant periods before and after phasing. In effect, this assumes that the entire increase in departures is accounted for by extra cessation. In practice however, other factors potentially contributed to changes in member behaviour; notably the issuance of annual benefit statements coincided with the increase and thus may also explain some of the effect. Further, a degree of seasonality may exist in the data, which we shall consider in future iterations of the research. Therefore, this assumed change in employer-reported cessation plus the known change in member-reported cessation provides a fair upper-bound reflection of the impact of phasing. These two figures combined suggest that the impact of phasing was a 1.5 percentage point increase in total cessations, equivalent to a 9% rise relative to (the low base of) the period before phasing.

It is interesting to note that in absolute terms, the increase in departures in May 2018 (underlying the percentage change shown in Figure 1) was around nine times the increase in cessations reported by members directly. This may make sense as a reaction by members to an immediate decrease in take-home pay. One can believe that their first response to this reduction would be for them to ask their payroll department for the reason behind the change in their pay.

Figure 3.	Ongoing opt-out rates before and after phasing
Before Jan 2017 to Mar 2018	6.3%
After Apr 2018 to Aug 2018	5.7%

Source: NEST, Vanguard 2019

Another measure of the impact of phasing is to look at 'opt-out' rates, i.e. the percentage of employees who take an active decision not to join the scheme when they join a new employer. As originally highlighted in How the UK Saves 2018, opt-out rates for employers that completed the initial staging requirements of automatic enrolment settled down to an 'ongoing' figure of approximately 6%. As demonstrated in **Figure 3**, the higher contribution rate has had no subsequent impact on worker participation in NEST. Ongoing opt-out rates have remained unchanged at 6%.

Implications

Although there has been some effect from phasing, the impact has been both minimal and temporary.

In the initial auto-enrolment period, minimum contributions totalled 2%, of which at least 1% came from the employer. The member's 1% contribution included tax relief, and therefore in the initial stage of auto-enrolment the typical member's take-home pay was only reduced by 0.8%. The first step of phasing increased the employer's contribution to at least 2% and the member's contribution to 3%. Again, adjusting for tax relief, the member is now contributing 2.4% of their take home pay, three times as much as before. For many members however, the total impact of this change was partially offset by simultaneous changes in tax-free allowances and a rise in the UK National Minimum Wage.

The minimal reduction in retirement saving participation resulting from this reduction in savers' take home pay both underscores the behavioural power of automated savings and bodes well for the final step of phasing in April 2019.

Definitions used in the charts:

Cessation – a NEST member's decision to stop contributing to a pension account while still working with the employer who enrolled them.

Member-reported cessation – a cessation reported by the member via their online account or directly to NEST.

Member-reported cessation rate – the number of members who have requested online or to NEST that their contributions should cease, divided by the number of active members.

Departures – NEST members for whom contributions are no longer made via the employer. Departures can include members who leave their employer altogether or who choose to stop contributing by notifying their employer.

Departure rate – number of members who have either left their employer or who have requested to their employer that their contributions should cease, divided by number of active members.

Employer-reported cessation impact – estimated percentage of NEST members who have asked their employer to cease contributions as a result of phasing, calculated as the difference in departure rate for the five-month period after phasing, versus the five-month period prior to phasing.

Cessation rate – the sum of member-reported and employer-reported cessations.

Post-phasing time period includes April 2018.

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