HOW THE UK SAVES: EFFECTS OF THE SECOND SAVINGS RATE INCREASE

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MEMBER EXPERIENCE FROM THE NATIONAL EMPLOYMENT SAVINGS TRUST (NEST)

As a part of our research partnership, Nest Insight and Vanguard are delighted to present this supplementary publication to our How the UK Saves series. This paper focuses on understanding the effects of the second increase in minimum contribution rates to the UK's national auto-enrolment system.

- April 2019 saw the second increase in the minimum contribution rates that UK employers must make on behalf of their workers to the national auto-enrolment system. Total minimum contributions increased from 5% to 8%, of which at least 3% comes from employers. This escalation process, known as phasing, began in April 2018, when the minimum contribution level rose from 2% to 5%.
- Our analysis shows that both increases had minimal impact on members enrolled with the National Employment Savings Trust (Nest), an occupational pension scheme. Among the small group affected, the impact was more pronounced on members who were newly enrolled, who appear more sensitive to the rate of change in savings, and less on existing members who appear unaffected by the ultimate level of savings.
- Overall participation remains high, at more than 90%. The second phasing increase did have a material impact on opt-out rates among newly enrolled members, increasing from 6% for members enrolled at 5% to 9% for members enrolled at 8%. However, overall opt-out levels remain far below the levels forecast prior to the start of the policy.
- As with the initial phasing increase, cessation rates[1] among existing members remain extremely low, but there was a slight and persistent increase driven primarily by members with short scheme tenure. Low levels of cessation, particularly among longer-tenured members, suggest a normalisation of savings behaviour.
- Overall opt-out rates are lower among shorter-tenured members who have been enrolled through multiple employers, suggesting a willingness to participate regardless of employer.

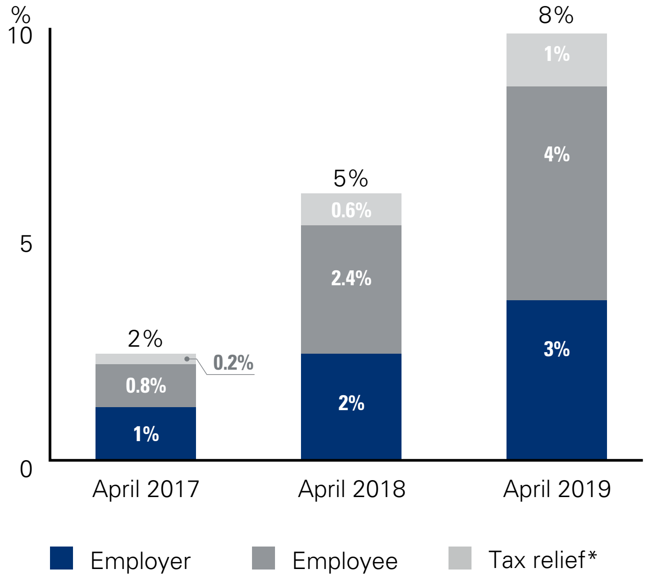
1 The proportion of actively contributing members who stop contributing.

- Though the second phasing event did have an impact on member participation, overall participation remains high. Overall, this analysis shows that the strategy of phasing contributions from lower to higher rates has been successful.

Background

The 2008 Pensions Act required employers to automatically enrol eligible employees in a qualifying workplace scheme. Incremental increases in the minimum contribution rates, known as phasing, became effective in April 2018 and April 2019 respectively. Figure 1 highlights the total contribution rate in each of the phases, apportioned by contributor.

Figure 1. Minimum contribution levels



Source: Vanguard, Nest Insight, 2020. *The state contributes to the worker's pension through tax relief, typically at their marginal tax rate.

This report evaluates the impact of phasing by evaluating opt-out and cessation behaviour separately. This approach enables a more detailed study of the factors that influence a worker's decision to stop saving. The Department for Work and Pensions (DWP) 2019 evaluation report for the automatic enrolment programme includes figures for 'stopping saving', which differ from the opt-out and cessation data shown in this report. The DWP data are taken from HM Revenue and Customs' Real-Time Information (RTI) system, which captures data direct from UK employers' payrolls. The 'stopping saving' rate derived from these RTI data is calculated as the proportion of all workplace pension savers who stop saving in a particular month, regardless of when they started saving, and so includes both opt outs and cessations. The DWP report classifies an employee as actively stopping saving if their employment is still active and eligible and more than 35 days have passed between their last employee pension contribution and last payment for the employment. Due to differences in data sources and methods, the findings of both reports should be considered when evaluating the efficacy of phasing on member participation.

As of April 2019, all eligible employees are enrolled at the minimum contribution rate of 8%, with the employee generally contributing 5% (including 1% in tax relief) and the employer a minimum of 3%.

This report studies the impact of phasing on overall savings behaviour of members of Nest by specifically evaluating the impact on:

- opt-out rates – the proportion of members who leave within 30 days of enrolment.
- cessation rates – the proportion of actively contributing members who stop contributing.

In our previous publication, *How the UK Saves: The effects of phasing*, we presented the impact of the first phasing event and concluded that the increase from 2% to 5% had no material impact on retirement savings behaviour. Opt-out rates among newly enrolled members as well as cessation rates among existing members were largely unaffected. In this publication, we explore the impact of the second phasing increase from 5% to 8%.

Effect of second phasing increase among newly enrolled members

Unlike the first phasing increase, the second had a noticeable impact on opt-out rates (Figure 2). There was essentially no difference in opt-out rates during the first phasing increase but a three percentage point increase, from 6% to 9%, during the second increase. Opt-out rates increase with age and are highest among enrolments in small and micro employers (firms with fewer than 50 employees).

Figure 2. Opt-out behaviour by default rate*

Ongoing enrolments April 1 2017 to December 31 2019

Default rate at enrolment	Opt-out rate*	Percent change
2%	5.8%	-
5%	6.3%	8%
8%	9.5%	52%

Source: Vanguard, Nest Insight, 2020.

Despite the increase, overall opt-out rates remain well below projected estimates. Prior to the implementation of the auto-enrolment policy, opt-out rates were predicted to be around 30%. In comparison to other schemes of similar structure, the current Nest opt-out rate is impressively low. For example, in the US, the state-based plan of Oregon, similar in design, has an opt-out rate of 28%. One major difference between Nest on the one hand, and the US state auto-IRA (individual retirement account) plans such as Oregon on the other, is the absence in the US plan of a mandatory employer contribution element. One plausible hypothesis is that the difference in opt out rates can be attributed to the presence of an employer contribution. Another possible explanation is Oregon's first dollar approach to enrolment.

*The reported opt-out rates may include a small percentage of re-enrolments. While opt-out rates among re-enrolments may be higher, our previous analysis suggests that these rates have no material impact on the overall opt-out rate of the Nest population. The reported opt-out rates may include a small percentage of re-enrolments. While opt-out rates among re-enrolments may be higher, our previous analysis suggests that these rates have no material impact on the overall opt-out rate of the Nest population.

Effect of second phasing increase among existing members

To properly understand cessation activity, it is important to clarify how 'cessations' are defined and captured by Nest. Members have three methods of ceasing contributions to their Nest accounts:

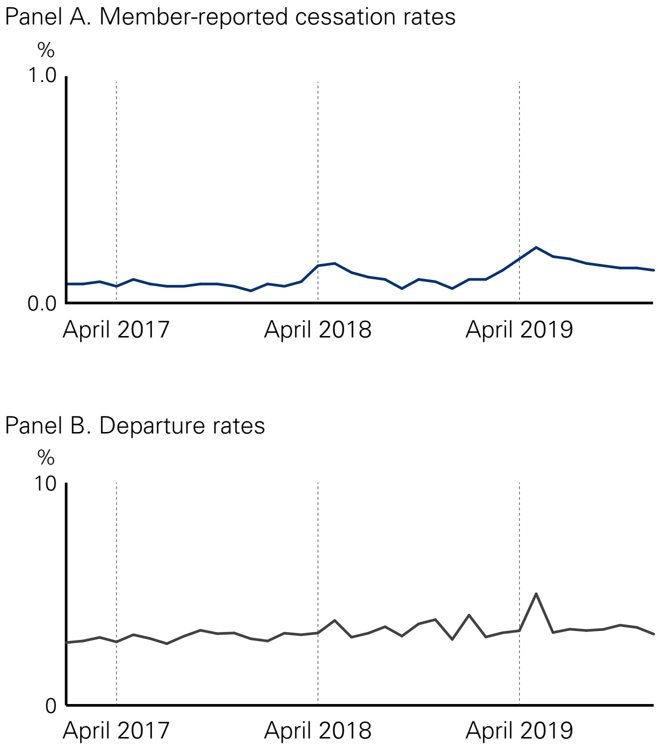
1. Through their online account;
2. By contacting Nest directly or;
3. By informing their employer.

Methods 1 and 2 are grouped under 'member-reported cessation rates' and 3 is captured within the 'departure rate'. To minimise 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 a request to their employer to stop contributions.

In general, member-reported cessations are exceedingly low. Fewer than 0.3% of active members stop contributing to their accounts over any given period (Figure 3 – Panel A). In the periods immediately following phasing increases, there was a noticeable albeit small increase in member-reported cessations. Unlike the first phasing period, higher cessation appears to persist in the months following the change.

Figure 3. Impact of phasing on cessation rates over time

Monthly rates January 2017 to December 2019



Source: Vanguard, Nest Insight, 2020.

Departures rates (Figure 3 – Panel B) also increased slightly after the final phasing increase, but returned to normal levels after only one month.

Drivers of cessation

Though overall cessation is very low, a more detailed analysis highlights some important findings regarding retirement savings more broadly. Figure 4 shows the marginal change in the probability of member cessation across a number of different factors. Both the direction and magnitude of each of the bars highlight the relative impact of each category.

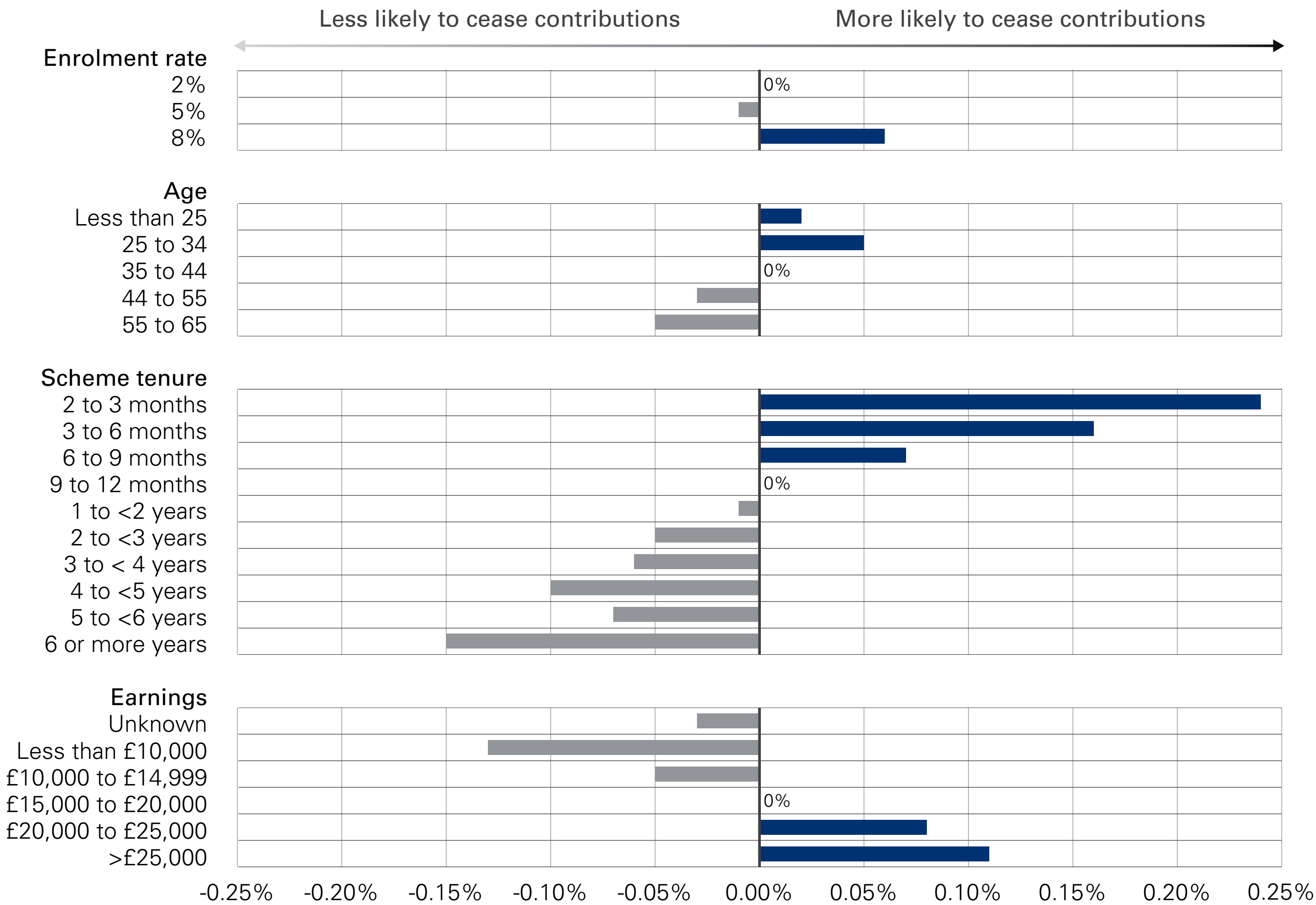
Scheme tenure with Nest has by far the most significant impact on cessation rates. Members with scheme tenure of less than nine months are far more likely to cease contributions. The relatively short tenure of this group suggests that this could be "late opt-out" behaviour - an unfulfilled intention to opt out during the 30-day opt-out window. For these individuals, an increase from contributing no earnings to Nest, to contributing 5% of earnings, appears too much of a savings shock. Conversely, the probability of cessation declines as scheme tenure increases, suggesting a normalisation of retirement savings behaviour. Through either inertia or inattentiveness, longer-tenured members appear ambivalent to the higher overall savings rate. This finding may also highlight the efficacy of the "phasing" approach, loosely modelled after Save More Tomorrow (see Thaler and Benartzi). That model shows that employees are more likely to sign up for contributions if the default rate is low and they are willing to pre-commit to future increases. Clearly, this is true among the Nest members as their tenure increases.

As noted earlier, cessation activity is higher at the minimum contribution rate of 8%. The impact of age is lower but does show that younger members are slightly more likely to stop contributing. The analysis also included gender and employer size but found no significant impact of these factors on cessation.

The impact of member earnings is both expected and puzzling. Members earning less than £15,000 were less likely to cease contributions, whereas those earning more than £20,000 were more likely to do so. For members earning less than £15,000, there are a number of reasonable explanations for their lack of cessation. Given that members earning less than £10,000 have to actively enrol in Nest, these members are far less likely to override their own choice to save in the scheme. These individuals may have also opted into the scheme at a higher rate, given that some employers choose to enrol workers at a higher rate initially, and may have been unaffected by the increase. For other lower income members,

Figure 4. Factors that impact member-reported cessations

Marginal change in the probability of member-reported cessation - 0.20% on average



Source: Vanguard, Nest Insight, 2020.

Note: Logistic regression model used to predict the probability of cessation. Full model included Gender and Employer Size but these variables were insignificant.

particularly those earning around £10,000, the impact of the contribution increase may have been muted by a concurrent increase in the National Minimum Wage as well as in tax-free allowances.

However, for those members earnings above £20,000, the effects are more difficult to explain. In some cases, the increase in contribution rate may have resulted in a more noticeable decrease in wages. Since contributions are determined on annual earnings starting at £6,163, the actual cost of a 4% contribution paid by a higher earner is in fact larger as a proportion of earnings. Other unobservable factors may also influence their cessation behaviour; this question certainly requires further study.

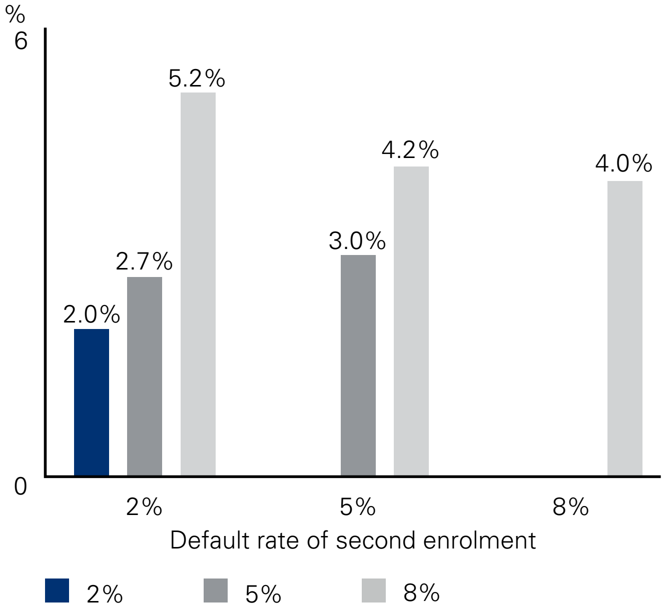
Job change and default rates

Given that people with short job tenure may have changed jobs more than once during the multi-year phasing process, it is worth asking whether employees who are exposed to higher levels of contributions as they move into new employments exhibit different behaviour.

Around 30% of all Nest enrolments involve previous Nest members enrolled at different times by different employers, many of whose subsequent enrolments occurred at a higher default rate. Figure 5 evaluates opt-out behaviour among members who have been enrolled in Nest by two different employers, representing three-quarters of multiple employer enrolments. There a number of interesting observations to be made among this group.

Overall opt-out rates, regardless of the enrolment rate, are significantly lower than the average opt-out rates displayed in Figure 2. This suggests that workers' willingness to save in retirement schemes does not change from employer to employer. However, there is further evidence to suggest that, among a small group of workers, higher default rates may have a negative impact on participation. Opt-out rates among those defaulted at 8% are highest (albeit very low more broadly) even if the member was previously enrolled at a lower rate.

Figure 5. Opt out rates among members with two employer enrolments



Source: Vanguard, Nest Insight, 2020.
The legend represents the default rate of the first enrolment.

Implications

Overall, within the design of auto-enrolment, stepping up default contribution rates annually was a very effective strategy. Over both phasing periods, the impact of the annual two percentage point increase on both participation and continued savings was minimal in the broadest sense. The vast majority of Nest members were unaffected. For many members, the total impact of phasing was partially offset by simultaneous changes in tax-free allowances as well as increases in the UK National Minimum Wage. But consistency of contributions among longer-tenured Nest members as well as the low opt-out rates among members who churn through multiple employers suggest that mandatory retirement savings has become normalised among workers.

The analysis in this report does suggest that, at the margin, there is some effect of higher default rates on workers' willingness to participate in workplace savings. This effect is strongest among new entrants entering at a higher contribution level rather than on those previously enrolled. This finding requires further analysis if policymakers consider higher default rates in the future.

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