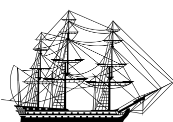
Universal Workplace Savings

A 'pillar 2.5' for retirement saving?



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Overview

A number of governments have made targeted public policy interventions intended to dramatically expand workplace pension saving. We group these approaches under the banner Universal Workplace Savings (UWS).

We review several major UWS interventions taken around the world to create a typology of options available for reforms to workplace pensions. We found these primarily vary on four key parameters:

1. how they stimulate demand
2. what role employers play
3. how they stimulate supply
4. whether and how people can access their savings before and after retirement

We are likely to see more novel UWS approaches, using or combining these parameters, in the future.

There are also lessons to be learnt from existing UWS interventions. The state of existing infrastructure for collecting saving contributions, the state of commercial pension provision and the state of consumer financial wellbeing can have significant effects on the options available to policymakers. Changing patterns of work and competing pressures on households will also have an impact.

The 'right' model to serve any particular population will need to be sympathetic to the culture and existing institutions in place. Effective pension reform recognises the realities of path dependency.

Section 1

Building on the five pillars of saving

A number of countries and jurisdictions around the world have moved in recent years to expand workplace pension saving through targeted public policy interventions. We group these models under the banner Universal Workplace Savings (UWS) and look at the emergence of this new model.

To date, UWS programmes have mostly been implemented in systems with a high historic dependence on replacing income in retirement through compulsory workplace or personal pensions, what the World Bank has defined as 'pillar 2' of its five-pillar model of retirement provision (see table 1). As a result, implementation of UWS programmes has mostly been focused on addressing declines in the adequacy or equality of distribution in pillar 2. These declines have been partly driven by a shift from defined benefit (DB) to defined contribution (DC) pension models.

Table 1. The World Bank's existing five pillars of financial security for later life

Pillar	Objectives	Characteristics	Participation	Funding
0	Older age poverty protection	Basic or social pension, at least social assistance, means-tested or universal	Universal or residual	Budget or general revenues
1	Older age poverty protection Income smoothing	Public pension plan, publicly managed DB or notional DC	Mandated	Contributions, possibly financial reserves
2	Income smoothing Older age poverty protection through minimum pension	Occupational or personal pension plans, fully funded DB or DC	Mandated	Financial assets
3	Consumption smoothing	Occupational or personal pension plans, partially or fully funded DB or funded DC, possibly tax-favoured	Voluntary	Financial assets
4	Older age poverty protection Consumption smoothing	Access to informal support (e.g., family) Formal social programmes (e.g., healthcare) Other individual financial and non-financial assets (e.g., home ownership)	Voluntary	Financial and non-financial assets

Source: Adapted from Robert Holzmann and Richard Hinz, *Old age income support in the 21st century: an international perspective on pension systems and reform* (Washington, DC: World Bank, 2005)

There is now a growing recognition that UWS programmes might also play a valuable role in improving the sustainability of systems primarily based on replacing income through public pensions, the World Bank's 'pillar 1'. These publicly financed systems are under strain due to ageing populations, with pressures expected to mount as the baby boom generation, the youngest of whom are now in their 50s, continue to enter retirement.

Many of the solutions currently being used to address the pension shortfall do not fit neatly into pillar 2 as traditionally understood. Rather, they are more a hybrid of pillar 2 and pillar 3, which is comprised of voluntary saving, sometimes encouraged through favourable tax treatment.

In a sense, these newer UWS interventions represent the rise of a new pillar of retirement income provision, a 'pillar 2.5' in the World Bank's five-pillar template.

This paper suggests a typology of the different flavours of UWS intervention being used today. In considering the emergence of this hybrid UWS 'pillar 2.5', it raises some questions and issues that might face policymakers in choosing among them.

It starts from the premise that the different UWS approaches seen to date are a reasonably loose grouping of interventions that variously focus more on either the demand side (driving take-up) or the supply side (increasing access) or some combination of both. The approaches take a range of positions on the role of employers in making contributions, the importance of existing versus new public and private market participants and the savings and access goals of the retirement income provision. As such, they differ also in the degree to which they approach true 'universality' and whether that universality comes in the form of participation or merely access.

The 'right' model of UWS for any given country will be somewhat dependent on the shape of the current system, the maturity and strength of existing institutional actors and the population's cultural attitudes to questions of market freedom and government intervention. Nonetheless, many of the issues will be the same across countries, and this new typology aims to help policymakers consider the approaches they might take in the future.

Section 2

Four key parameters

We found that UWS policies have differed across at least four key parameters: 1) how they stimulate demand, 2) what role employers play, 3) how they stimulate supply and 4) whether and how people can access their savings before and after retirement.

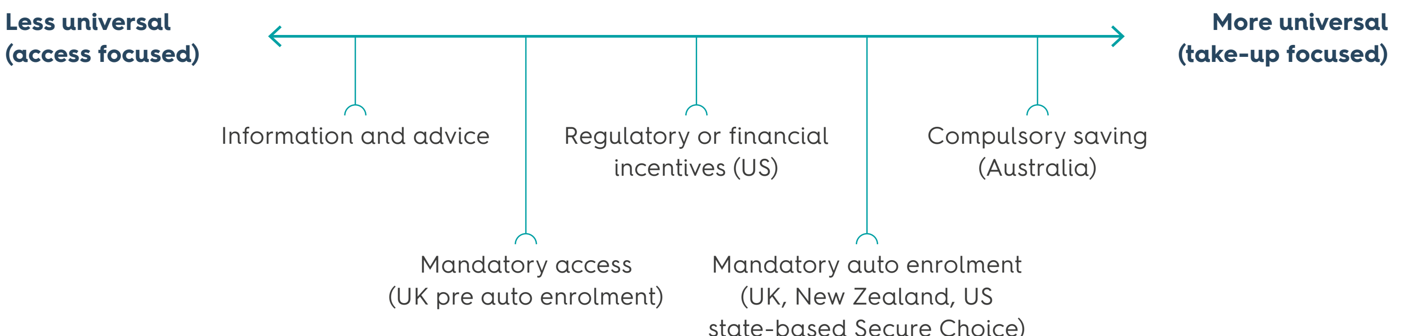
Stimulating demand

The 'most' universal systems – where participation is close to 100% of the working population – have made participation in a workplace saving scheme mandatory. For example, at one end of the spectrum, in Australia all workers are enrolled in the superannuation system, which has mandatory contributions set at 9% of worker salaries.

A range of weaker demand-side interventions have been utilised:

- **Mandatory auto enrolment:** These involve auto enrolment at the employer level, but the individual worker retains the right to opt out of the system. Examples include the UK, New Zealand and US states such as California, Illinois and Oregon with 'Secure Choice' programmes, which automatically enrol workers in a private individual retirement account (IRA).
- **Regulatory and financial encouragement supporting vountary adoption of default approaches:** These have supported auto enrolment and auto escalation, as seen in the US.
- **Regulatory and financial encouragement targeting other employer-led measures:** These include weaker measures to increase take-up, for example non-discrimination regulations in the US.
- **Mandatory 'access' to a saving plan:** One example is the stakeholder designation that was used in the UK before auto enrolment was introduced in 2012. This required any employer with five or more workers to designate a DC pension scheme for its workers if the employer did not directly provide a workplace pension scheme or contribute to a group pension plan.
- **Information, advice and guidance-based campaigns**

Chart 1. The demand-side approach to replacing income



Role of employer contributions

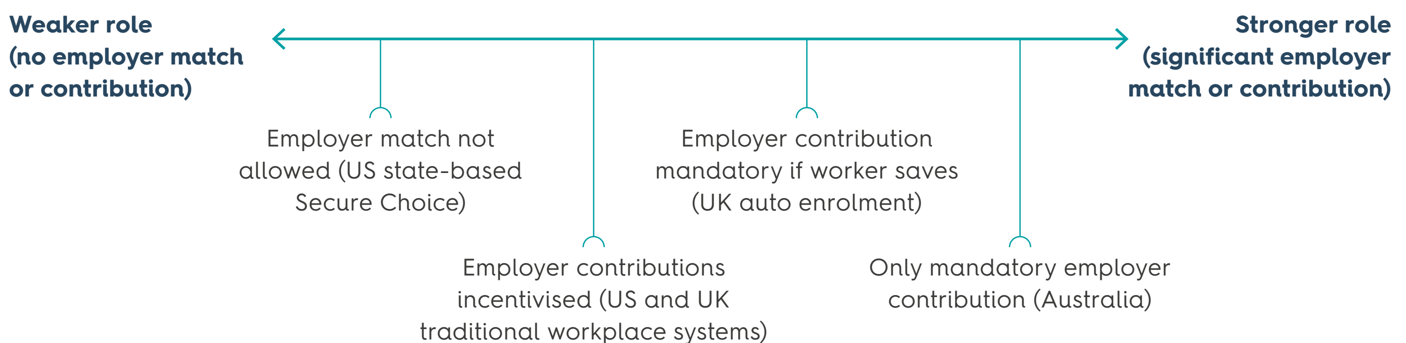
Many pillar 2 systems have traditionally enlisted employers in contributing directly to workers' pension funds. Often this has taken the form of a match contingent on the worker's own level of saving.

UWS approaches vary in the role that employer contributions play. In Australia's superannuation system the 9% compulsory contributions are made exclusively by the employer. The worker is encouraged through favourable tax treatment to add to their pension, but this is voluntary.

Starting from this extreme, further variations include:

- **Mandatory employer contributions only where the worker contributes:** This is the approach used in the UK auto enrolment system.
- **Employer contributions are allowed but not compulsory:** This is the traditional approach in voluntary workplace models but is not usually a feature of government-led UWS interventions.
- **Worker contributions are solely allowed:** The Secure Choice programmes available in California, Oregon and Illinois and being set up in other US states do not allow employers to contribute into the individual's auto IRA.

Chart 2. The employer's role in replacing income



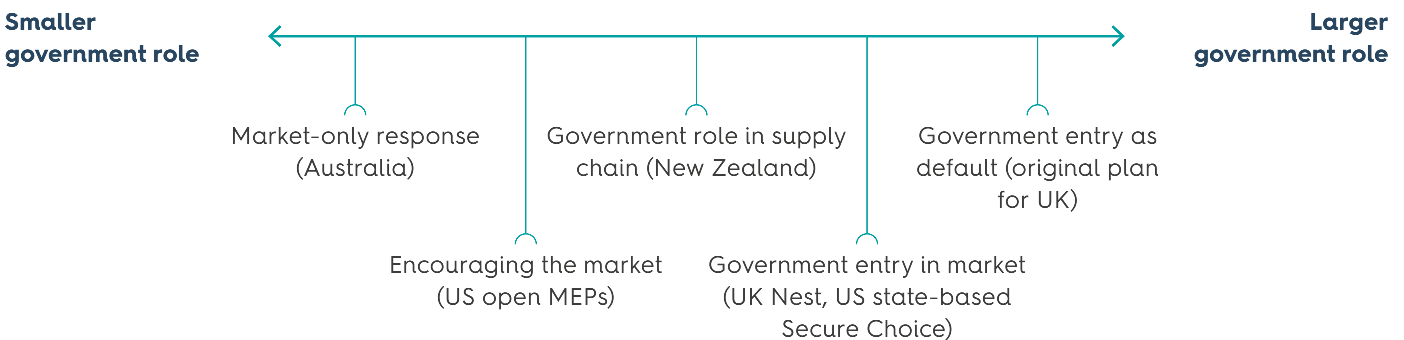
Stimulating supply

Approaches to stimulating supply are similarly varied. Some systems focus on demand-side interventions, leaving the supply side to the existing commercial market. Others combine demand-side interventions with supply-side ones. And still others take a 'supply only' approach, seeking to increase saving by establishing product classes or providers intended to be more attractive to underserved populations and, in turn, drive higher take-up more organically.

Specific variations include:

- **Relying on market-only solutions:** In Australia's superannuation system, some providers are legacies of the programme's origin as part of a collective bargaining agreement with trade unions. Other providers are only available in particular Australian states or regions. Fundamentally, however, all of the supply to meet saving mandates is conducted through commercial or profit-for-member businesses independent of the government.
- **Encouraging market-only approaches:** Current legislation in the US aims to make it easier to establish open multiple employer plans (MEPs), on the basis that these might make it easier or more attractive for smaller firms to offer a plan for workers. The Small Business Retirement Marketplace introduced in Washington state is another example.
- **Government entry or participation in parts of the value chain:** In New Zealand contribution collection and reconciliation is done through the government's revenue and taxation service, whilst the products into which people save are provided by the commercial market.
- **Government entry in a mixed market:** In the UK the government established the National Employment Savings Trust (Nest) as one scheme option employers can use to comply with pensions obligations towards their workers, whilst other options are available in the competitive market. Similarly, the US state-based Secure Choice plans in California, Illinois and Oregon offer workers the auto IRA as one option employers and, in some cases, individuals can use. Versions of this auto IRA proposal also exist in proposal form at the federal level in the US, but only in a nascent form.
- **Government entry as the 'default' option:** This is where employers are required to enrol into a state-run plan unless they opt out by providing something else for their workers. Government as the default was originally proposed in the UK before the decision to establish Nest in a mixed market.

Chart 3. The supply-side approach to replacing income



Savings and income horizon

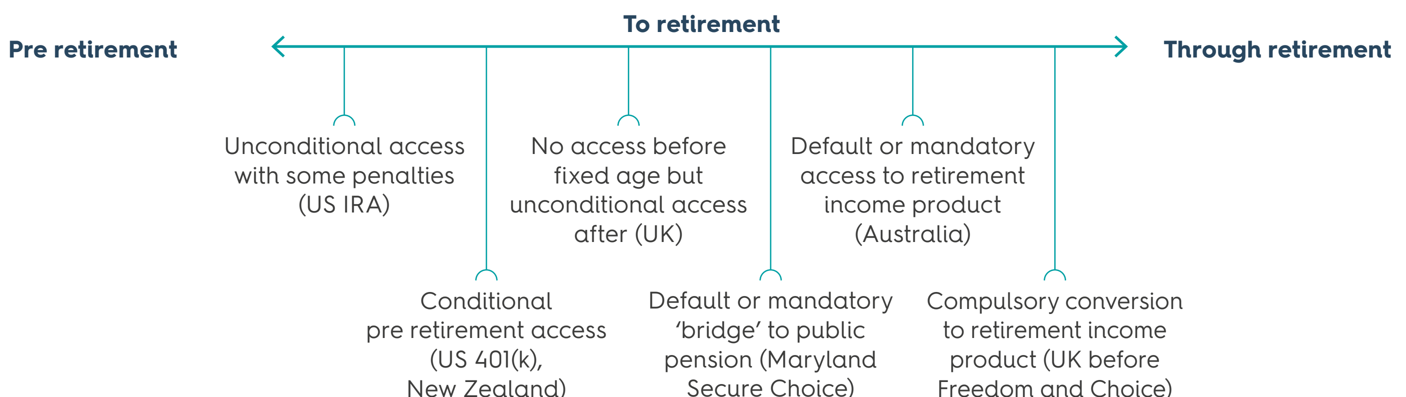
The other main source of variance in UWS approaches centres on how much the intervention, intentionally or implicitly, targets a specific savings outcome and, if so, the time horizon of that outcome.

In broad terms, UWS interventions may prioritise financial outcomes on three time horizons:

- **'Through retirement':** These focus more or less narrowly on replacing income in older age. Some systems focus purely on this. For example, until recently the UK mandated that DC assets had to be converted to a life annuity by age 75 and that individuals could not access these funds before age 55. 'Through retirement' solutions need not be mandatory, however. Some, for example the comprehensive income product for retirement (CIPR) reforms in Australia, have focused primarily on ensuring or encouraging access to a retirement income within the existing system. Other 'through retirement' approaches, in both Australia and the US, have required a minimum level of distributions from the individual's retirement accounts starting at a defined age.
- **'To retirement':** Here the goal is the accumulation of assets in a pension vehicle in time for retirement. Individuals have relative freedom over the timing and purpose of withdrawals from the saving vehicle once retirement is reached. The Freedom and Choice regime, introduced to the UK in 2014 to allow individuals to begin to access savings at age 55 for any reason, is an example.
- **'Pre retirement':** The savings goal is or can also be broader than replacing income when the individual leaves full employment. Some UWS approaches provide conditional pre retirement access to savings. In the US, 401(k) retirement plans, where employers voluntarily provide an auto contribution plan that workers can opt in to, withdrawals before age 59½ are subject to a penalty fee except when the individual can demonstrate a medical or other allowed hardship. Others provide largely unconditional, though often tax-penalised, access, such as in the Secure Choice auto IRA programmes in California, Oregon and Illinois and private IRAs available across the US commercial market.

Recently an alternative that sits conceptually between the 'pre retirement' and 'to retirement' types has emerged. The idea, being developed in the US state Maryland for its Secure Choice programme, is to create a social pension 'bridge' where at least some UWS savings would be targeted at providing partial income replacement between full employment and the individual's claim for their Social Security public pension entitlement. By deferring their public pension claim date, they would have access to a larger monthly payment, maximising their retirement income in the longer term.

Chart 4. The time horizon for replacing income

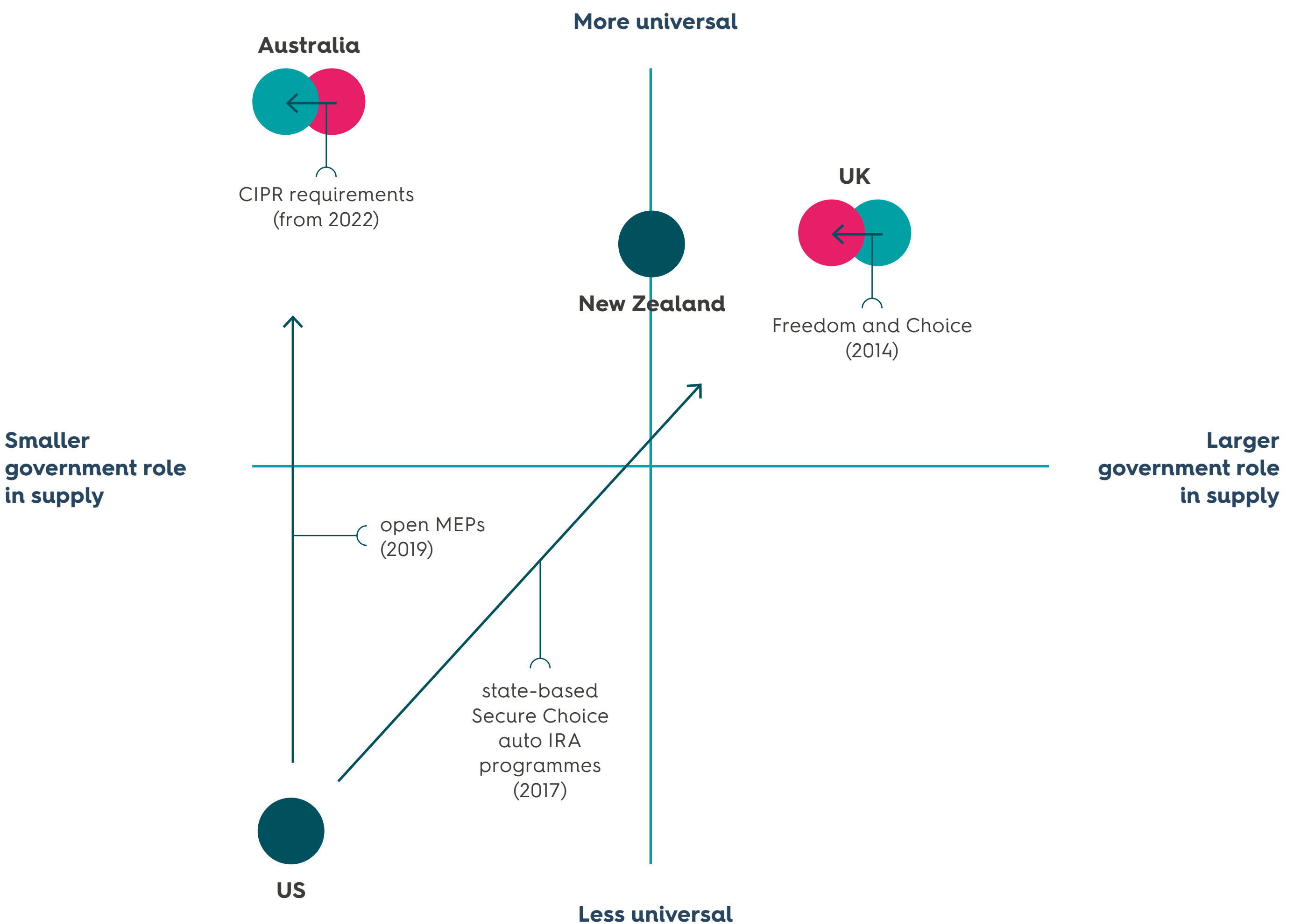


Section 3

The current state of play in UWS systems

These four key parameters can be used to classify UWS systems as they exist today and to consider how recent and planned reforms have shifted the parameters of retirement provision in those systems.

Chart 5. Summary of UWS approaches



At the time of writing, some existing UWS programmes are actively considering shifts in their key parameters.

For example, the US state-based Secure Choice plans, such as those already established in California, Oregon and Illinois, are examining built-in retirement income options.

In the UK, regulators are introducing simplified pathways for those who do not seek advice about income replacement at retirement. UK pension providers will be required to offer or signpost these pathways to their members.

Section 4

Informing UWS decisions

The analysis above prompts the question as to which models policymakers might seek to replicate if going down their own UWS path. The easy answer is there is no easy answer. Few if any retirement systems start from a blank sheet of paper when considering reforms.

The 'right' solution for any given system is likely to be the product of a proper understanding of likely path dependencies out of the existing system as well as the cultural and economic context of the population being supported. There is no getting around the differences in attitudes to, and the scale of, taxation and income inequality in Northern European and Scandinavian countries compared to the US and the UK, for example.

However, there are a few instructive lessons from specific cases that may be generalisable to the future, in particular:

- **The state of collection and reconciliation infrastructure, including payroll infrastructure:** In New Zealand the auto enrolment system was able to piggyback on the government's revenue and taxation system for handling the collection and reconciliation of pension contributions. This set-up minimises work for employers. It also potentially reduces costs for providers, albeit whilst potentially benefitting some business models over others.

  In the UK a similar model was ruled out because, at the time, the HM Revenue & Customs systems would have introduced significant out-of-market risk with contributions. In addition, other IT change priorities, such as the introduction of real-time information for tax, meant there was no near- or medium-term path to resolving this risk. Some proposals in the UK advocated the creation of a new 'clearing house' structure for auto enrolment. This would have enabled a New Zealand-style carousel, run by either the government or industry, that automatically assigned employers who didn't make an active choice of a scheme into a qualified provider. However, such new infrastructure was deemed too expensive. Subsequently, similar benefits in efficiency have been realised through the integration of pension provider platforms with payroll software systems.

- **The state of commercial pension provision and investment structures:** In the UK and US the commercial DC provider market is mature and there is a significant opportunity to leverage existing capacity through policy interventions to expand coverage. Any novel interventions – for example, the creation of Nest in the UK – can be focused on those parts of the market that remain the hardest to serve, such as lower-wage earners whose asset levels may be less attractive to existing providers.

  Systems with a less mature DC provider market may need new institutions, whether the goal is to make the system's reach broader, for example by handling all collection and reconciliation activity, or deeper, for example by delivering more of the value chain, such as record-keeping and potentially also investment.

  Systems with a mature investment sector but an immature DC provider market may be able to 'split the difference' by establishing a central collection, clearing and record-keeping function for pension accounts, whilst having investment providers compete in the market to manage savers' assets.

Even in mature systems, complete coverage to include even the lowest-value accounts might require some degree of intervention or subsidy.

– **The state of consumer financial wellbeing:** Individuals' financial wellbeing is shaped by their earnings and household indebtedness as well as other social policies, such as those addressing provision of housing, healthcare and education.

Systems with relatively low levels of personal debt, including student debt, and low out-of-pocket healthcare costs may be better positioned to focus interventions solely or substantially on illiquid retirement saving, whereas others may be more motivated to include some form of early-access or hybrid liquid and illiquid savings to their systems. Equally, systems whose populations are on average more financially resilient in other respects may feel there is less risk in adopting a more compulsory pension saving model, without the need for the safety valve of allowing workers to opt out.

Section 5

Limitations of Universal Workplace Savings

The various UWS approaches described in this paper have had significant success in increasing participation in private workplace pension saving. However, they are not a panacea.

Retirement income provision continues to be inadequate for some individuals. And other systemic economic shifts have meant that even the most successful UWS interventions will need to continually evolve.

Some of the key challenges for UWS approaches include:

- **The changing patterns of labour-market participation:** The rise in self-employment, contract and gig work weaken or sever the traditional employer-employee relationship. This may reduce trust in, and the quality of, the actual products into which people save by diminishing fiduciary oversight and employer paternalism. Even in systems where the fiduciary role does not sit with employers, the changing nature of work disturbs the instrumental role employers play in enacting default mechanisms such as auto enrolment, payroll deduction and auto escalation. Alternative mechanisms will need to be developed to maintain the pension participation levels achieved through traditional workplace models. Systems will also need to keep pace with the labour market impacts of rising longevity, for example in terms of measures such as the removal of fixed retirement ages.
- **Retirement income adequacy:** Systems that rely on government-set contribution levels and other defaults are effective. However, they are blunt tools when applied across a diverse population of workers. To be effective, they are often necessarily set to the lowest, or at least a lowish, common denominator. The barriers to people getting in the habit of saving in the first place can also limit their habit of voluntarily adding to their contributions. These obstacles to changing saving behaviour tend to act more powerfully on those who start saving through a default saving system rather than doing so as an active choice. The problem of getting those who 'should' save more than the default level to actually do so is still in need of a solution.
- **Working life income adequacy:** UWS systems generally serve to expand coverage to traditionally more economically vulnerable individuals as these are the individuals less likely to already be saving. One reason they may be less likely to be 'sold on' saving is because they are less likely to have been 'sold to' by pension providers. Naturally, these individuals may face more complex and competing pressures on their household finances before retirement, including proportionally higher housing costs and greater indebtedness.

Section 6

Conclusions

Supporting people's living standard in retirement remains a fundamental goal.

Systems with very different starting points are coalescing around the need to replace working-life income with private savings and investments through DC structures, where most of the formal risk sits on the individual's balance sheet.

This can be seen as an evolution in the World Bank's influential five-pillar model in that it arguably blurs pillar 2 – traditionally made up of compulsory private saving through the workplace – and pillar 3 – voluntary saving. Increasing population coverage, often using strong behavioural interventions and focusing on the workplace as a key channel for participation, have been common in this new hybrid 'pillar 2.5'. We call this the Universal Workplace Savings (UWS) model.

Whilst UWS approaches differ on key parameters, all move at some level beyond the 'rational economics' of expecting organic demand, perhaps supported by increasing education or public information campaigns, to be sufficient to bring about the scale of change needed in saving. The 'right' model for any particular population will need to be sympathetic to the culture and existing institutions in that place. Effective pension reform recognises the realities of path dependency. However, successful models have emerged that lean on strong nudges such as auto enrolment and auto escalation, perhaps mixed in with aspects of compulsion such as employer mandates.

We are likely to see more novel UWS approaches, perhaps combining different mixes of the parameters identified in this paper, in the future.

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