Institute for Fiscal Studies

What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the UK

Jonathan Cribb
Carl Emmerson

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

Executive Summary
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Jonathan Cribb and Carl Emmerson[1]
Copy-edited by Judith Payne

Published by

The Institute for Fiscal Studies

ISBN 978-1-911102-26-7

November 2016

Background

Concerns about undersaving for retirement have led to policymakers implementing reforms aimed at boosting saving. One such policy is 'automatic enrolment' – where rather than having to choose to contribute to a pension, employees have actively to choose not to save in one. Since October 2012, the UK has been in the process of implementing the first-ever national roll-out of such a policy. This paper exploits the gradual roll-out of this obligation for employers to enrol their employees into a pension to estimate its effect on how much is saved in workplace pensions for private sector employees.

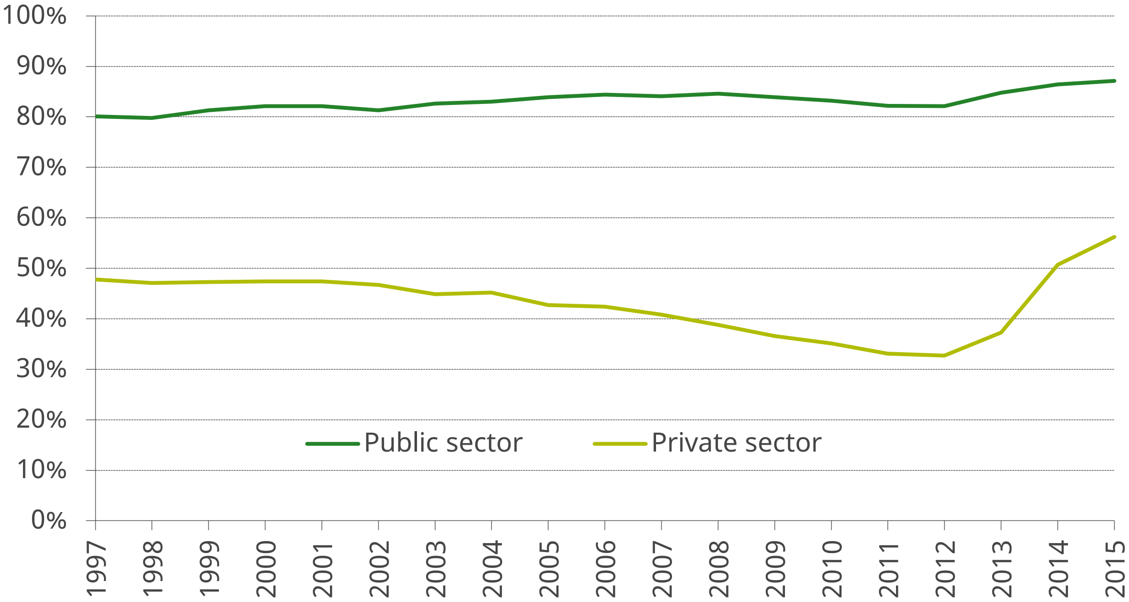
Trends in workplace pension membership

The general trend in membership of workplace pensions, split by public and private sector employees, is shown in Figure ES1. This covers all employees (i.e. including those outside the automatic enrolment target group because they are too young, too old or earn too little). Between 1997 and 2012, membership of workplace pensions among public sector employees was high – running at above 80% – and quite stable. In contrast, among private sector employees, membership of such schemes was much lower and falling over time,

[1] This is the executive summary of J. Cribb and C. Emmerson, 'What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the UK', IFS Working Paper 16/19, 2016 (https://www.ifs.org.uk/publications/8723).
This research is funded by the IFS Retirement Saving Consortium, which comprises Age UK, Association of British Insurers, Chartered Insurance Institute, Department for Work and Pensions, HM Revenue and Customs, HM Treasury, Investment Association, Legal and General Investment Management, Money Advice Service, and Tax Incentivised Savings Association. Support from the ESRC-funded Centre for the Microeconomic Analysis of Public Policy (CPP) at IFS, grant reference ES/M010147/1, is also gratefully acknowledged.

reaching below one-third of employees in April 2012 (with around 11% in a ‘defined benefit’ scheme and 22% in a ‘defined contribution’ scheme). Since April 2012 – which coincides with automatic enrolment starting to be introduced – pension participation has grown, with the increase among private sector workers between April 2012 and April 2015 more than reversing the decline in membership seen since April 1997.

Figure ES1. Workplace pension membership rates among public and private sector employees, 1997 to 2015

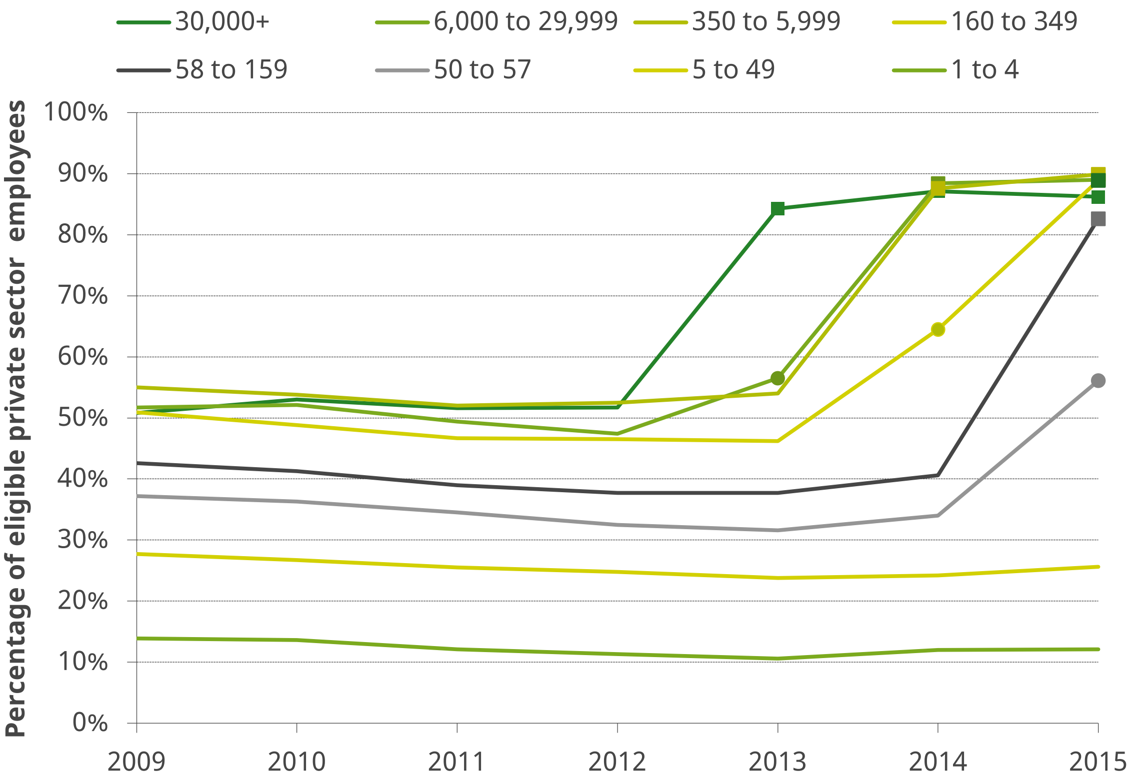


Note and source: See Figure 1 of main paper.

Automatic enrolment is the process by which employers have to enrol employees into a workplace pension scheme, which employees can then choose to leave if they wish. Contributions to the scheme have to be *at least* 2% of earnings between £5,824 and £42,385 (in 2015–16), of which at least 1% has to come in the form of an employer contribution. The minimum levels of contributions are planned to increase significantly in 2018 and 2019. Automatic enrolment is being gradually introduced, with larger employers affected before smaller ones. The very largest employers were obliged to introduce this policy in October 2012, and by February 2018 it will have been extended to all employers. Upon introducing automatic enrolment, an employer is only obliged to enrol its ‘eligible’ employees automatically: those who are aged between 22 and their state pension age, earn over £10,000 per year and have worked for their employer for at least 3 months.

To estimate the impact of automatic enrolment, we take eligible private sector employees and exploit the fact that the new obligations to enrol eligible employees automatically were applied to the largest employers first and then gradually applied to smaller employers over time. The key assumption is that, in the absence of the policy, the trend in workplace pension membership would have been the same across employers of different sizes. Evidence on the validity of this assumption, and a first impression of the impact of automatic enrolment, is provided in Figure ES2. Prior to April 2012, workplace pension membership was, on average, higher among larger employers but followed a similar downward trend over time for all sizes of employer.

Figure ES2. Workplace pension membership rates among private sector employees eligible for automatic enrolment, by employer size in 2012



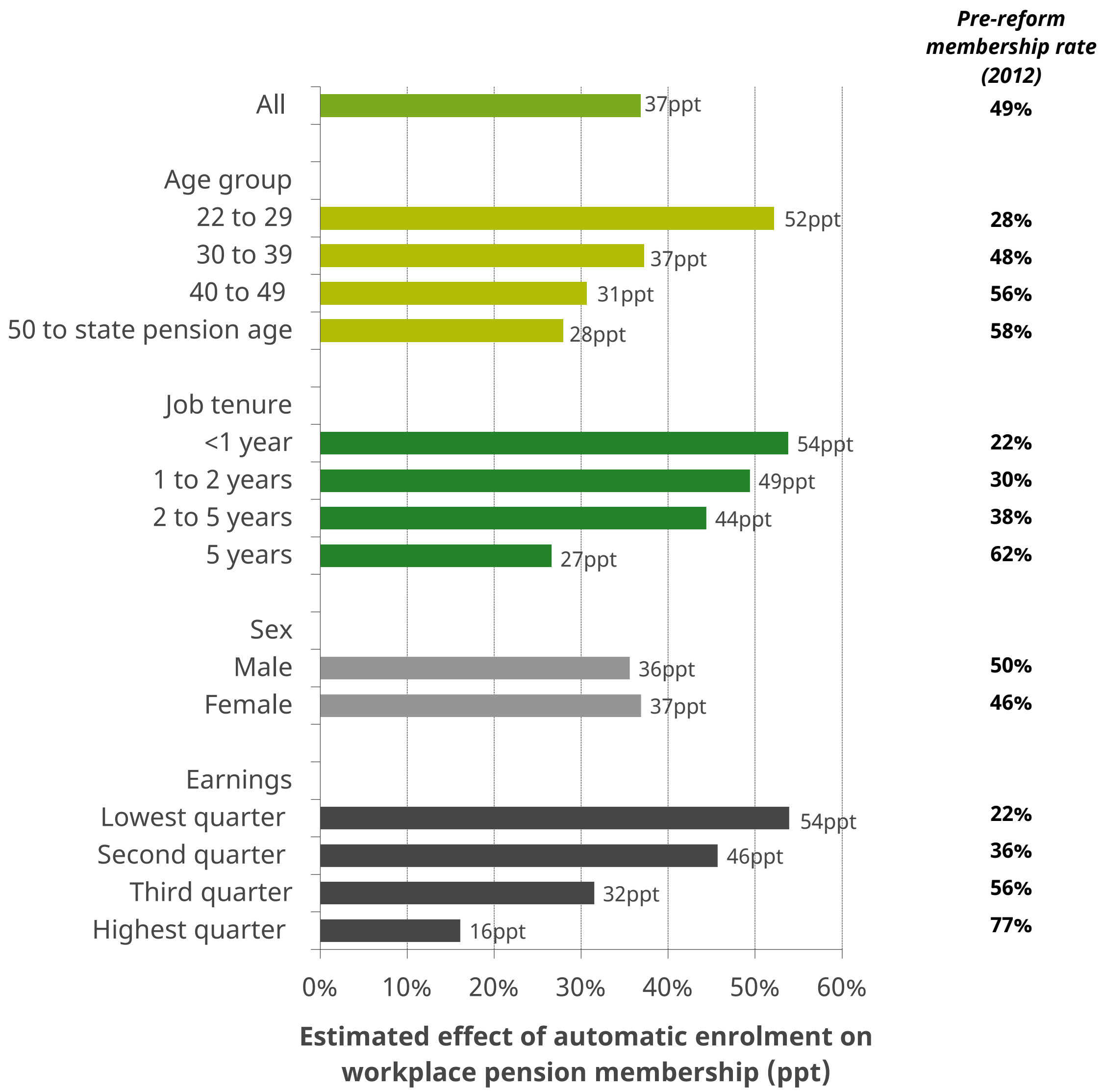
Note and source: See Figure 2 of main paper.

The squares on each line in Figure ES2 denote pension membership observed among employers who were obliged to have introduced automatic enrolment, while the circles represent membership among employers who were within three months of having automatic enrolment fully in place (and were therefore partially, but not fully, affected by auto-enrolment). It is clear from the figure that the introduction of automatic enrolment is associated with a sharp jump up in workplace membership among eligible private sector employees. In April 2012, workplace pension membership across all groups was around, or substantially below, 50%. By April 2015, average private sector pension membership in employers who had introduced automatic enrolment had jumped to 88%.

The impact of automatic enrolment on workplace pension coverage

Regression analysis on the data underlying Figure ES2 allows us to estimate precisely the causal impact of automatic enrolment on workplace pension membership among eligible private sector employees. The results are shown in Figure ES3. Overall, this suggests that automatic enrolment increased workplace pension membership by a remarkable 37 percentage points (from a base of 49% prior to automatic enrolment in April 2012).

Figure ES3. Estimated impact of automatic enrolment on membership of workplace pensions among different subgroups of eligible private sector employees



Note and source: See Tables 3 and 5 of main paper. All of these effects are statistically significantly different from zero at the 1% level.

We also break this impact down by various characteristics, as is also shown in Figure ES3. Most strikingly, we find that among those aged 22 to 29, among those who have been with their employer for less than a year and among the lowest quarter of eligible earners (that is, those earning between £10,000 and £16,730 in April 2015), the introduction of automatic enrolment has increased workplace pension membership by over 50 percentage points (ppt). For each of these characteristics, automatic enrolment is having a larger impact on workplace pension membership among those groups for whom coverage, pre-reform, was lower. We find very little difference in the impact of the policy between men and women.

The impact of automatic enrolment on contributions to workplace pensions

Although the impact of automatic enrolment on pension membership is substantial, the impact on the amounts saved in a workplace pension may not be very large because the minimum contributions are low. Before we assess the impact of automatic enrolment on the amount of contributions, it is worth setting out how much was contributed prior to the reform.

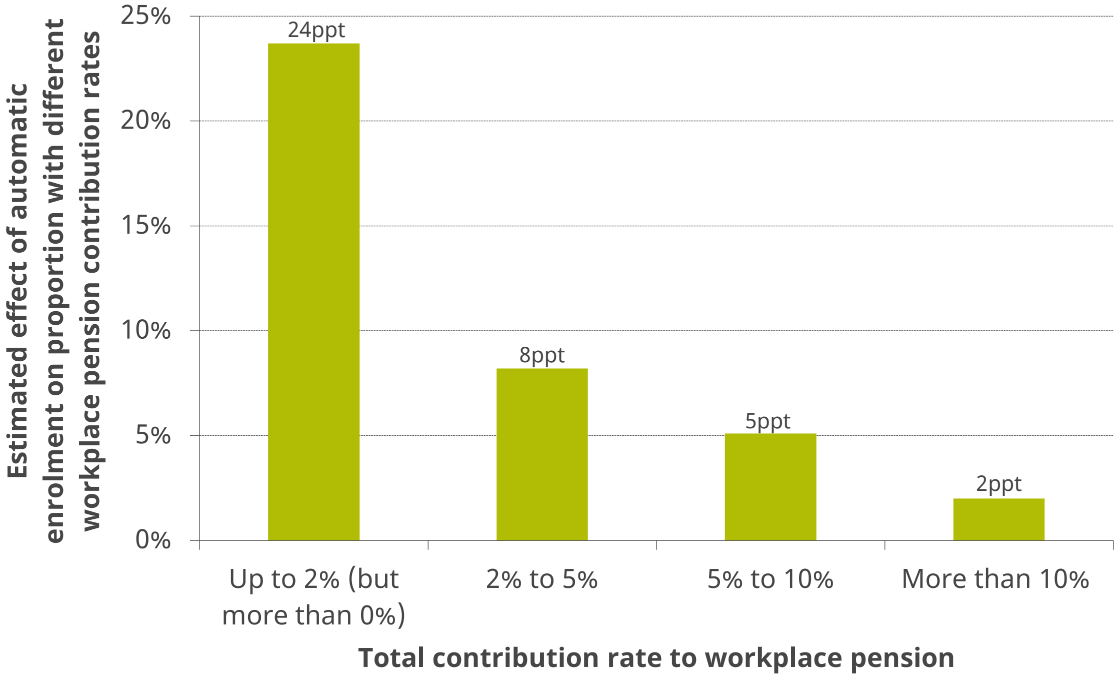
Across all eligible private sector employees in April 2012 – including the majority who were not members of a workplace pension scheme – the average contribution rate to workplace pensions was 7.0% of total earnings, of which 4.9% was from employers and 2.1% was from employees. However, since 51% of eligible employees were not participating in a workplace pension in 2012, the average contribution rate for eligible employees who were members of a scheme was 14.4% of earnings.

We estimate that automatic enrolment increased the average (total) contribution rate by 1.05% of earnings, with employer contributions being increased by 0.6% and employee contributions by 0.5%. These are substantial effects, and they mean that by April 2015 average contributions had climbed to 8.1% of earnings (with 5.4% coming from employers and 2.7% coming from employees).

One potential downside of automatic enrolment is that, in some settings, there is evidence that some employees have ended up saving less than they otherwise would have done. This is because the 'default' contribution rate can be so salient that it can cause some people to choose that level instead of a higher contribution rate. We can examine whether this has occurred in the UK by looking at the impact of automatic enrolment on the distribution of contributions to workplace pensions.

We find that automatic enrolment has led to a large increase in the percentage of employees with relatively low, positive contributions to a workplace pension. Figure ES4 shows that the proportion of employees with total contributions to their pension that are greater than zero but less than 2% of earnings has increased by 24 percentage points. This is consistent with many people making and receiving the minimum contributions mandated by the government under automatic enrolment.

Figure ES4. Estimated impact of automatic enrolment on distribution of total contribution rates to workplace pensions, among eligible private sector employees



Note and source: See Table 7 of main paper. All of these effects are statistically significantly different from zero at the 1% significance level.

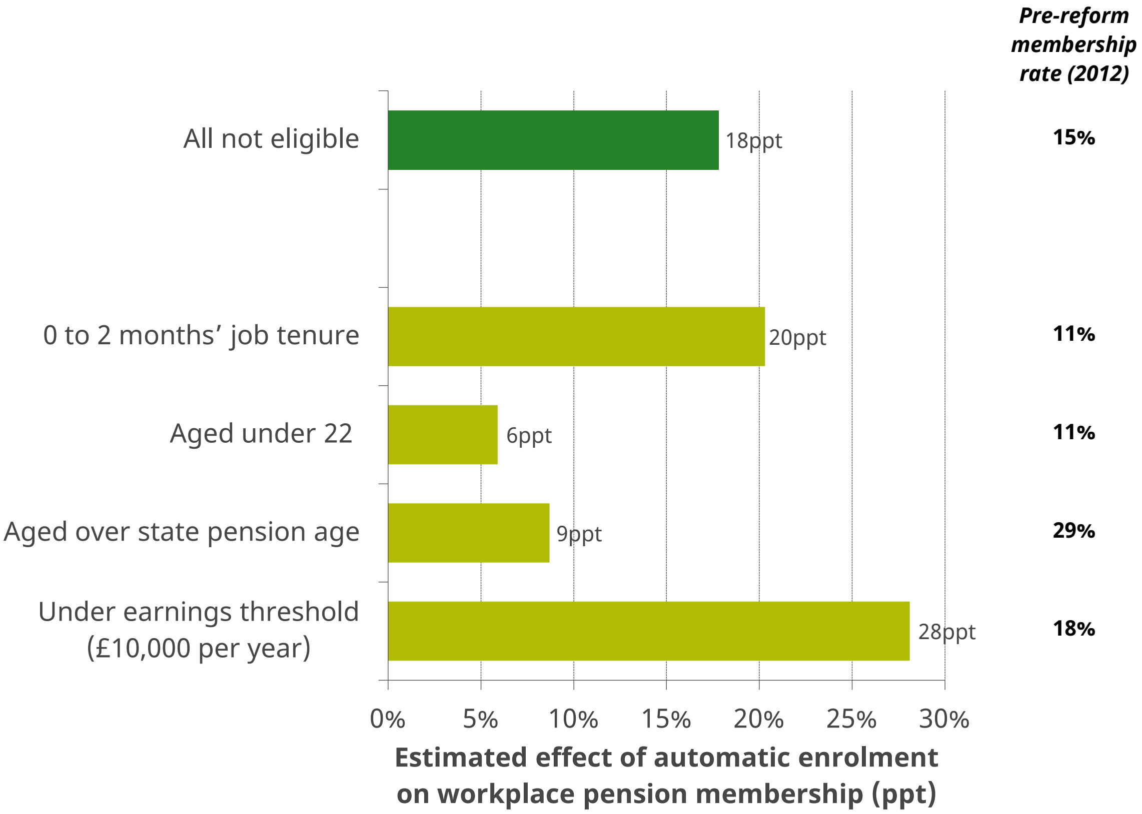
This makes up most, but not all, of the increase in workplace pension membership. Looking at greater levels of pension contributions – which automatic enrolment might have made less prevalent – we find that these have also become *more common* as a result of automatic enrolment. The proportion of people with a total contribution rate of between 5% and 10% of earnings has increased by 5 percentage points, for example. One reason for this is that some employers are contributing substantially more than they are mandated to by the government. The proportion of eligible employees receiving an employer contribution in excess of 5% of their total earnings is found to have increased by 4 percentage points. The move by some employers to automatic enrolment at more than the current minimum level cannot be explained purely by employers choosing to move directly towards enrolling at the long-run minimum contribution levels, since these are currently set at well below 5% of total earnings.

This does not absolutely rule out any 'levelling down' (where some employers might respond to the higher cost of providing employer pension contributions to more people under automatic enrolment by reducing the generosity of employer pension contributions). However, our analysis does mean that if it is happening, it is being more than offset by some employers choosing to enrol their employees at contribution rates that are well above the minimum. But we also find no evidence of employer contributions being reduced even when looking at those among whom this might have been most likely to occur: employees aged 22 to 29, earning less than median earnings, who have worked for their firm for less than a year.

The impact of automatic enrolment on workplace pension membership of those not automatically eligible

Finally, we examine the impact of automatic enrolment on workplace pension membership of those outside the target group. Perhaps surprisingly, we find that coverage of workplace pensions has been boosted significantly. Figure ES5 shows the estimated impact across this group as a whole and across different subgroups. We find evidence of a particularly large increase in workplace pension membership among those earning below £10,000 a year, of 28 percentage points, and among those who have been with their employer for less than 3 months, of 20 percentage points.

Figure ES5. Estimated impact of automatic enrolment on pension membership rates of private sector employees who are not eligible for automatic enrolment



Note and source: See Table 13 of main paper. Analysis restricted to those earning at least the lower earnings limit (£112 per week in 2015–16).

Conclusion

The first nationwide roll-out of automatic enrolment into pensions is underway in the UK. The results from this study suggest that, while some employees are choosing to opt out, coverage of workplace pensions had been increased by a substantial 37 percentage points by April 2015. This effect is larger among groups – younger employees, lower-earning employees and lower-tenure employees – where pension membership was less common prior to the reform being implemented. Those outside the direct target group of the policy – because they are too young, too old, earn too little, or have been with their employer for less than 3 months – have also had their workplace pension membership rates boosted significantly.

While most of those brought into workplace pensions are, for now, making relatively low contributions, we find that the proportion of employees with a total contribution rate of at least 5% of earnings has increased as a result of automatic enrolment. This does not absolutely rule out any ‘levelling down’, but it does mean that if it is happening it is being more than offset by some employers choosing to enrol their employees at contribution rates that, in some cases, are in excess of the 3% of ‘qualifying earnings’ minimum that will be expected from all employers from April 2019.

The additional amounts contributed to private sector workplace pensions as a result of automatic enrolment are significant. We estimate that, in total, the reform increased contributions to these pensions by £2.5 billion per year by April 2015, of which £2.3 billion was from eligible employees and over £100 million was from those outside the target group. Unless opt-out rates increase dramatically, this effect is very likely to rise significantly as those working for smaller employers are automatically enrolled and as minimum contributions increase. Indeed, analysis from the Department for Work and Pensions (DWP) suggests that automatic enrolment would increase workplace pension saving by £17 billion per year by 2019, and this DWP calculation does not include the effect of employers automatically enrolling employees in schemes more generous than the minimum.

Our research has not looked at the extent to which this increased workplace pension saving has increased overall saving, or instead substituted for saving that would have taken place outside of workplace pensions. But previous evidence suggests that employees might not have responded to automatic enrolment by reducing their saving elsewhere. Finally, an important, but still unanswered, issue is where the increased employer contributions that we find are coming from. They will be leading to at least one of lower wages, reduced employment, increased prices or lower profits, all of which could affect retirement saving.

Nevertheless, this paper has shown that the UK’s implementation of automatic enrolment has so far led to substantial increases in workplace pension participation and saving. This is likely to lead to many individuals having higher levels of private resources for retirement than they would have had in the absence of this policy.