

SAVING

Leading the way

The UK's auto-enrolment experiment has been a success up until now. Will it prompt others in Europe to follow suit?

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Europe needs to save more. A lot more. That was the conclusion reached by Aviva in September, when it released a report that estimated that the continent, as a whole, has to save an additional €2 trillion a year to close its pension savings gap.

Assessing pension accrual in Europe since 2010, Aviva found that Ireland and Spain have seen the biggest increase in their retirement savings gap over the last six years. Spain's gap rose by 12 per cent to €192 billion, while Ireland's increased by 38 per cent and now sits at €28 billion.

But the report didn't just contain bad news. Some countries have bucked the trend and seen their gaps close. One of those was the UK, which recorded a 4 per cent decrease in its shortfall, to €365 billion.

The insurance company said that the country's introduction of auto-enrolment in 2012, which has seen millions of workers start saving into a pension scheme, was one of the

main reasons for its improved status. The policy, which sees employees placed into a pension scheme and given a month to opt out, has seen participation in retirement saving in the private sector go from 50 to 70 per cent in the space of four years.

"Automatic enrolment has shown that the behavioural nudge is a very powerful tool," Standard Life head of pensions Jamie Jenkins says.

"Almost seven million people in the UK who weren't saving into any kind of pension before are now saving into a workplace pension."

The Italian experience

One of the reasons why the UK has made a success of auto-enrolment to date is partly due to what happened in Italy almost a decade ago.

In 2005, the Italian government pushed through reforms designed to increase private provision. At the time, pension fund members did not exceed 2.6 million, or about 12 per cent of the workforce, according to figures from the OECD.

Employees were then asked in 2007 – a year earlier than planned – to decide whether they wanted their employment severance pay (Trattamento di Fine Rapporto or TFR), which had traditionally been built up and paid as a lump sum by an employer upon retirement or redundancy, to go into a private pension fund. Many of them turned down the offer. By the end of 2007, only 20 per cent of the workforce was in a scheme, leading to the failure of the reforms.

Reasons for the disappointing opt-in rates were varied. Many suspected smaller employers, a large bulk of the Italian economy, of discouraging workers from moving their TFR as they help companies with cheap financing. Others blamed the authorities for a rushed implementation and muddled communication, which may have confused some workers who had little financial wriggle room to start contributing into a fund.

But perhaps the most important factor was the manner in which the choice was presented. Employees were given a form to fill in and forced to make a conscious decision, a practice that violates the principles of behavioural economics, which argues that individuals should be shepherded into saving. It was a mistake that the UK picked up on.

Steve Webb, the UK Minister for Pensions between 2010 and 2015,

met with Italian representatives to find out more about their experience.

“*[The failure]* demonstrated that *[auto-enrolment]* is not a silver bullet,” says Webb, who is now director of policy at Royal London.

“You can’t just do it and expect it to work. You have to do it well.”

Savings culture and the state

Other countries in Europe have forgotten Italy’s attempt and asked whether a similar form of soft compulsion to the UK’s could work for them. But how do they know that they would truly benefit from auto-enrolment?

“My rule of thumb would be it depends on where you’re starting from,” Webb states.

“If you are in a country where when you join a firm you join the pension scheme, or culturally it’s just what you do, then auto-enrolment is less relevant. Whereas in a place like the UK, where the traditional paternalistic employer is on the decline and there’s less centralised bargaining, then it’s worth looking at.”

Considering the support offered by the state is also vital, says Jenkins. The level of healthcare, social housing and state retirement benefits all need to be placed into the mix when considering the suitability of auto-enrolment for a country.

“The less you have in the wider benefits that the state provides, then the more you need to save privately into a pension – and vice versa,” he says.

Squire Patton Boggs partner Clifford Sims agrees. “You need to start from state pension safety net,” he comments. “If the aim is to stop people falling into poverty then how generous is the state pension in the first place?”

“And if it’s super generous, then what does auto-enrolment add to that?”

With those criteria in mind, strong pension systems, such as those found in Denmark and the Netherlands, coupled with a deeply ingrained savings culture, would probably reap little benefit from auto-enrolment. Equally, in nations where the state pension is generous, such as in Spain and Sweden, the need for auto-enrolment is minimal.

Then there’s Germany, which some would argue has been running a type of precursor to auto-enrolment since the 19th century with its compulsory Public Retirement Insurance System.

Of those countries left who would consider auto-enrolment, careful consideration must be given to the infrastructure they currently have in place, as State Street Global Advisors head of European defined contribution Nigel Aston mentions.

“Countries without large pension providers would have to decide whether they need the equivalent of the UK’s Nest scheme,” he says.

“Nest has been a success because it’s where any employer can go if the commercial providers don’t find your business attractive enough. Whether or not other countries would have the appetite for what is effectively a state-funded provider remains to be seen. And if they don’t have that, then what do they have instead to ensure that every employer can find a home, no matter how big it is?”

The Irish

So far, most other countries have just kept a watchful eye on the UK. Italy has begun to re-introduce some auto-enrolment, but the drive has come from a handful of industry-wide pension funds, rather than government.

One country that has decided to go for it, however, after years of procrastination, is Ireland. Earlier

this summer, the Irish minister for Social Protection, Leo Varadkar, said that a new system was needed as the country’s current system, in which many people depend entirely on the state pension, was “unsustainable”.

Irish Association of Pension Funds CEO Jerry Moriarty says that the time is right for Ireland to implement auto-enrolment, as its situation is very similar to what the UK’s was prior to 2012.

“We’ve got less than half the working population here making any provision for retirement and while we have a state pension that could be seen relatively generous, it’s only designed to keep people out of poverty and is about €12,000 a year, which is about 34 per cent of average earnings,” he says.

“So if people do want an income retirement that they can enjoy then they’re going to have to save more themselves.”

Ireland is expected to follow the UK model to some extent, which could see it set in motion a gradual phasing in of employees, starting with the largest employers and then slowly moving to medium-sized and smaller ones over a number of years. However, Moriarty also expects the government to pick up some tips from beyond Europe.

“The Department of Social Protection is also looking at other systems, in particular New Zealand, as it’s a similar country in size population to us,” reveals Moriarty.

Whoever, the Irish imitate, he says that the government needs to get the reforms in motion.

“We probably would have introduced it a while back, but then we had the crash. I do think that now that we’re starting to see the beginning of a recovery and that it’s probably a good time to do something.

“We can’t delay this any further and just need to get on with it.” ■