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NATIONAL EMPLOYMENT SAVINGS TRUST

NEST insight 2013

Taking the temperature of automatic enrolment

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Foreword

2013 promises to be an important year for the UK pensions industry. Despite being in its infancy, automatic enrolment is already beginning to change the way the UK saves.

For hundreds of thousands of people automatic enrolment will become a reality this year – a means for them to contribute to a workplace pension scheme, often for the very first time. So 2013 is the year workplace pensions start to 'go mainstream' for millions of workers, particularly in the private sector.

We're taking the first steps on a new journey, one that will take us through to 2018 and beyond. Along the way, up to 11 million new savers who previously had no access to a workplace pension scheme or weren't making any provision for their retirement will come on board, creating a substantial new market in the space of six years. In the private sector, many more people don't save in a workplace pension than do. That's going to change. And because this is a journey nobody has travelled before, there will be a number of lessons for us all to learn on the way.

Automatic enrolment sweeps away one of the biggest barriers to saving by harnessing inertia. However, there still remain a number of obstacles, ranging from the financial and the administrative to the emotional. In order to overcome these, all of us in the provider community need to continually develop our understanding of employers' and workers' perspectives and ensure we're thinking carefully about delivering change to maximum effect.

This report shares NEST's insights into the characteristics and behaviours of a new generation of savers. In the short time since our inception we've already learned a number of lessons. They've informed the way that we've designed the scheme, conducted our business and spoken to potential and existing members. No doubt there will be much more to learn as automatic enrolment progresses, which is why we intend to publish this document every year and track the way the consumers are behaving and how the market is responding.

One important lesson we've learned is that it can take a lot of time and effort for organisations to prepare for automatic enrolment, and yet many only engage with the challenges around six months before their staging date. This is, of course, at odds with The Pensions Regulator's (TPR) findings that it could take employers up to 18 months to be fully ready for automatic enrolment.

Providers and advisers will need to take this into account as they prepare to help onboard employers and members into their schemes. And all this needs to be done in a manner that reduces employers' administrative burden as much as is practically possible.

Automatic enrolment represents an opportunity for millions of people working today and many more in the future. As we move into the next phase of our journey we believe it's the collective duty of the industry to realise this opportunity. We'll be doing this in a challenging environment. The economic situation in the UK, Europe and around the world continues to be uncertain, with many households struggling under significant financial pressure. In addition, our research has shown that while many workers in the UK are confident managing their money day-to-day, understanding of long-term saving is low.

At the end of this report we set out our vision for 'what good looks like' for 2013.

Almost 6,000 employers are expected to have their staging dates this year. Making a success of that scale of activity is a formidable challenge in itself and it's where we at NEST will be focused throughout the year. I'm very grateful to the Department for Work and Pensions, the Association of British Insurers, the Chartered Institute of Payroll Professionals, the Confederation of British Industry, the National Association of Pension Funds, the Personal Finance Society and Which? for their contributions to this section. It demonstrates the strong consensus that exists to make automatic enrolment work and to keep focused on the positive impact it will have on society.

I hope that these insights we've gathered over the past five years will be a helpful contribution to the success of automatic enrolment. It's a journey that's just beginning, but one that I hope you will join us on as we navigate the twists and turns, as well as the inevitable bumps, on the road ahead.

Tim Jones,
chief executive officer

Executive summary

The purpose of this report is to give a snapshot of the automatic enrolment landcsape. It looks at the behaviours and attitudes of both the unpensioned workers who stand to benefit from automatic enrolment and the employers affected by the new workplace pension duties.

Research for this report included a wide variety of published research papers, our own qualitative and quantitative research and analysis of data from a number of different surveys conducted by the Department for Work and Pensions (DWP) and other organisations. A complete list of sources can be found in the Appendix to this document.

Key findings - the unpensioned

Throughout this document we use the term 'unpensioned workers' to refer to people who aren't currently saving in a qualifying workplace pension scheme and are eligible for automatic enrolment.

> "68 per cent of people working in the private sector don't contribute to a workplace pension."

Automatic enrolment will bring a more diverse audience into the pensions market. Rather than catering to a niche minority of higher earners, the market will need to take the mainstream into account. 68 per cent of people working in the private sector don't contribute to a workplace pension. The average salary for this unpensioned group is around £20,000 a year, compared to around £30,000 a year for the 32 per cent who do pay into a pension.

Unpensioned workers exist across all ages but almost a third are under 30 years of age. Pensions are likely to be a new experience for them. Older workers with higher incomes are more likely to already be in a pension.

Almost two thirds of the target group for automatic enrolment are men. The earnings threshold for automatic enrolment eligibility takes out the lowest earners, many of whom are part-time workers and many of whom are women.

Our research confirms that a lot of the unpensioned are finding the current economic climate difficult. One third say that all the money they earn typically goes on the basics, like housing costs, bills and groceries. Three in five said they have £100 or less and over a quarter say that they have less than £50 a week left after paying for living costs.

The majority manage their money carefully to make sure they can make ends meet. 74 per cent say that they are confident handling day-to-day financial decisions and 86 per cent say they check every pay slip. Things that aren't seen as immediate essentials are being squeezed out of the family budget.

> 63 per cent of people agree with the idea of automatic enrolment.

In these circumstances it's no surprise that people haven't made long-term saving a priority. The innate tendency to heavily discount future needs is being exacerbated by these pressing demands on people's cash. This tendency is reinforced by the way pensions are often presented, which many people find off-putting and disempowering.

But people aren't unaware of the longer term. They know that providing for their later years is important and only 14 per cent of them think that their current plans are adequate.

In this context, the idea of automatic enrolment is well received. Our research shows that 63 per cent of people agree with the idea of automatic enrolment. Research by the DWP shows that 70 per cent say they'll definitely or probably stay in once they've been automatically enrolled, 15 per cent will definitely opt out and 15 per cent are undecided. The value of their employer's contribution and the simple reassurance of knowing they have something put aside are key motivators here with 67 per cent agreeing it would mean they could stop worrying that they hadn't done anything about their retirement.

Automatic enrolment goes with the grain and makes sense to the majority of people it is intended to benefit. But making pension saving a part of every worker's life won't just happen by itself. People will want to know what happens to their money and what they'll get in the end. Answering these questions will mean addressing many of the misconceptions people have about pensions and investment, and finding new ways to talk about these subjects that will reassure and empower savers. Employers recognise this and want help and support in explaining pensions and automatic enrolment to their workers.

Key findings – employer readiness

While workers' and employers' needs will vary, it's clear that employers of all sizes will need to engage with the reforms as early as possible.

Employers' expectations of how long it will take them to comply vary. Almost half of the employers with over 5,000 workers who say they're ready for automatic enrolment have spent between 10 and 18 months preparing.

However, many employers have yet to confirm their scheme choice. Only 74 per cent of the largest employers have confirmed a provider for all their workers. Among employers with fewer than 5000 workers, less than half have confirmed their provider. A significant proportion of those with less than 1,000 workers have only just started to think about which provider they might use. Most small firms haven't even considered their compliance requirements as yet.

Awareness of the reforms is high, but many employers are less confident about the details. This is evident in the concerns that different employers have about complying with the reforms. The largest employers, those with over 5,000 workers, tend to have quite specific concerns about the challenges they face. Smaller employers have more general concerns but are fuzzier on the details.

Ease of administration is a key concern for all employers. The largest employers, who are most engaged with the reforms, are also concerned about payroll integration, identifying which workers are eligible for automatic enrolment and dealing with enrolment issues where there's a high turnover of staff. Communicating reforms to the workforce is another priority for employers, cited by around a quarter.

> "98 per cent of employers aware of the reforms have already sought or plan to seek advice."

Many expect to get help. 98 per cent of employers aware of the reforms have already sought or plan to seek advice. Many have high expectations around the level of support they'll receive from both their adviser and their payroll and pension providers.

Challenges around providing support for employers will change as staging progresses. Although the number of employers affected by automatic enrolment in the first year of staging is low, large businesses face specific administrative issues because of the size and structure of their workforce. They also employ a significant proportion of unpensioned workers.

The sharp rise in the number of employers needing to automatically enrol their workers after the first year of staging will bring its own challenges, particularly for pension and payroll providers. These smaller employers have lower rates of existing pension provision and less knowledge and experience regarding pensions than the larger organisations affected in the first year and it's likely they'll need more help to prepare.

Background

Automatic enrolment is a new way to encourage people to save for retirement in workplace pensions. This report looks at the world that automatic enrolment is being introduced into from member, employer and industry perspectives. We consider the challenges faced by each of these groups and ask what good looks like in terms of getting automatic enrolment introduced successfully and creating a pension-saving culture in the UK.

NEST has conducted a wide range of surveys using various research methods over the last five years to ensure that we understand the new market of 'unpensioned' workers, their employers and intermediaries. In total we've carried out approximately 60 surveys with around 18,500 people among our key audiences. These range from small scale in-depth qualitative projects using focus groups, to large sample quantitative surveys. Regardless of method, we always strive to ensure that the evidence we gather is based on a representative sample of the population the study focuses on.

Identifying unpensioned workers

Throughout this document we use the term 'unpensioned' workers to refer to people who are eligible for automatic enrolment. To be eligible for automatic enrolment a person must be:

- aged over 22 and below State Pension age
- working full or part-time in the UK
- not currently saving in a qualifying workplace pension scheme
- earning above a minimum level. This is £8,105 for the 2012/13 tax year and will be reviewed by the government every year. The government is proposing raising the minimum level to £9,440 for the 2013/14 tax year, subject to pending legislation.

A qualifying scheme is one that meets the requirements of the Pensions Act 2008.

Because 83 per cent of the public sector is pensioned, we've focused on the private sector in our research on the pensions market. Therefore, unpensioned only refers to private sector workers. NEST is open to all employers, but we expect that public sector organisations will mostly use their current provision for automatic enrolment purposes (see *Annual Survey of Hours and Earnings*, Office for National Statistics (ONS), 2011).

Pensioned workers are those who would qualify to be automatically enrolled whether they're in the public or private sector but are already saving into a qualifying workplace pension scheme.

UK pensions in recent history

The system of pensions that developed in the UK over the latter part of the twentieth century has hit problems. This system comprises a State Pension that was never intended to provide fully for retirement and a generous system of defined benefit workplace pension schemes. Not everyone has had access to the latter but overall the UK was seen to have a similar level of pension provision to other developed countries, with 56 per cent of the number of eligible workers participating in a workplace pension scheme (*Pensions Commission: Interim Report*, DWP, 2004).

In the private sector, the second half of this system has been gradually breaking down. Increasing longevity, tighter regulation and lower equity returns have put pressure on defined benefit schemes, with the majority now closed to new members. In some instances, provision has been replaced with defined contribution arrangements. In others, workplace provision has been eroded entirely. In some, usually smaller workplaces, provision never existed at all.

Attempts to reverse the decline by encouraging saving on a voluntary basis have not been successful. The Welfare Reform and Pensions Act 1999 introduced legislation that required employers with more than five employees to set up a 'stakeholder' pension scheme that would be open to all workers. These were intended to encourage pension saving among workers but take up was limited, particularly among lower earners.

The Pensions Commission

In 2005, the final report of the Pensions Commission recommended a new system for workplace pension saving intended to turn this situation around. This report set out the basis of a new pension settlement for the UK, of which NEST is a key part.

The commission concluded that while compulsion - forcing those in work to contribute to a pension - was a step too far, a purely voluntary approach to encouraging saving had not succeeded. Working with leading behavioural economists it undertook a comprehensive review of what had worked well in getting people to save in other countries. Studies in the US showed that automatic enrolment dramatically raised workplace participation rates across social classes and these studies have been particularly influential on the commission's findings.

Based on a broad consensus across the political spectrum, consumer groups, employer bodies and the pensions industry, the government reformed workplace pension provision along these lines. The commission proposed that all employers should have to offer a pension scheme to their workers and make contributions to their workers' pensions. Under the commission's proposals all workers earning over a minimum level would be automatically enrolled into the scheme.

It's generally agreed that a scheme like NEST is needed to ensure that all employers have access to a suitable workplace pension scheme. NEST can be used by employers of any size to fulfil their new duties under the Pensions Act 2008. This is part of what characterises our unique role within the pensions industry.

A partnership between state, employers and individuals

The consensus on changes to pension provision in the UK, based on the Pensions Commission proposals, is based on a partnership between government, employers and individuals.

Alongside workplace pension reform the government has also made changes to the State Pension age and released plans for a 'flat rate' State Pension. The government plans to introduce the flat rate pension gradually from April 2017 with the initial value set above the basic level of means-tested support, currently £142.70 per week for a single pensioner (see the government white paper *The Single-tier Pension: A Simple Foundation For Saving*, January 2013).

The new flat rate pension will make it easier for all workers to plan and save for their retirement and it will be the bedrock for many people. Pension saving through automatic enrolment will add to that and help workers achieve their aspirations to have an improved quality of life in retirement

The workplace provides a convenient way of reaching almost everyone in employment and of providing them with an accessible way to save. As the place where people earn money, it also means that it's easier to make contributions at source and easier for employers to contribute.

Of course, there is nothing to stop people making their own provision outside the workplace. Private pension products, individual savings accounts (ISAs) and other savings and investment options exist to help people to do just that. However, the experience of the UK over the last two decades suggests that it is not enough just to make these choices available in order to get enough people saving.

NEST

NEST is a new workplace pension scheme that can be used by any employer to meet their workplace duties. It was established by statute as part of the workplace pension reforms and is the only scheme in the UK with an obligation to take any employer, regardless of the size of their business.

NEST is run in the interests of its members by a Trustee - NEST Corporation. The Trustee is currently made up of 11 Trustee Members. It doesn't have shareholders and doesn't distribute a profit. It has a combination charge of a 0.3 per cent annual management charge and 1.8 per cent on contributions, which is equivalent to a 0.5 per cent annual management charge over the long term.

It's been designed to be easy to manage online for both employers and members, based on in-depth research into their needs. Our research programme has covered investment, communications and usability, with findings in each area directly reflected in the product's features.

Automatic enrolment and workers

Introduction

Automatic enrolment will bring around 11 million people into workplace pensions (*Overview of Workplace Pension Reform*, DWP, 2012). So what do these automatically enrolled members look like, what do they think about pensions and how might they behave?

This section summarises what we know about unpensioned workers and looks at how they're different to the people the industry has served to date.

We've created some fictional case studies based on NEST research to help bring our findings to life. These include projections about how much extra money in retirement individuals might get from saving in NEST. These are based on a member starting to save in October 2018, which marks the end of phasing and the beginning of automatic enrolment operating in a 'steady state'.

For illustrative purposes only, they also assume a full contribution history for each potential member from October 2018 through to retirement. Methodology and assumptions are the same as the NEST Pension Calculator at **nestpensions.org.uk/pension-calculator**

Insight in this chapter is based on NEST's wide body of evidence. A number of important points can be identified from the analysis and research summarised in this section.

- Automatic enrolment will bring a more diverse audience into the pensions market than before. Rather than catering to a niche minority of higher earners, the market will need to take the mainstream into account.
- Unpensioned workers are confident short-term financial planners and budgeters. Some of them are concerned about whether they can afford pension contributions but for many pensions simply aren't seen as a priority. Even if they had more money, other things would take precedence. Holidays, home improvements and socialising are seen as far higher priorities.

- Taking into account limited understanding of investment together with the current economic climate and damaged confidence in the financial sector, people are nervous about putting money into a pension. Most people tend to focus on the downside – the chance of losing money. Fear of making the wrong decision is a key reason for not having put plans in place for retirement.
- Even though they're not currently saving, many unpensioned workers know what a pension scheme is, in the broad sense. Around 50 per cent have had some form of company pension or currently pay into a personal pension. 41 per cent have been offered a pension at work before and refused it, 17 per cent stopped contributing while still employed and 16 per cent have stopped and started contributions throughout their career.

Pensioned and unpensioned workers

The unpensioned are the 68 per cent of private sector workers who don't currently pay into a workplace pension (*Annual Survey of Hours and Earnings*, ONS, 2011). Given the size of the group, it isn't surprising that unpensioned workers have similar characteristics to the working population generally. Unpensioned workers exist across the range of gender, age, earnings and social class.

Pensioned workers tend to earn more than the working population generally. Higher earnings are linked with higher educational attainment, higher occupation level and higher financial literacy. Pensioned workers, then, are not the average and differ in a number of important ways from most people. Rather than being a niche minority, those coming into pensions as a result of automatic enrolment represent the mainstream of society.

Much like the rest of the working population, unpensioned workers come from all kinds of backgrounds and have all kinds of needs, hopes, fears and expectations.

Table 1: The vital statistics of automatically enrolled workers

Characteristic	Working aged population *Base: 24.1 million, but aged 16 to State Pension age*	(Eligible) Pensioned *Base: 11.1 million, includes private and public sector*	Unpensioned *Base: 11 million, includes private sector only*
Gender	Male: 51% Female: 49%	Male: 50% Female: 50%	Male: 63% Female: 37% 1
Age	Under 22: 6% 22-30: 22% 31-40: 23% 41-50: 26% 51-60: 19% 61-65: 4%	Under 22: N/A 22-30: 15% 31-40: 26% 41-50: 32% 51-60: 23% 61-65: 4%	Under 22: N/A 2 22-30: 31% 31-40: 25% 41-50: 24% 51-60: 17% 61-65: 4%
Black minority ethnic (BME)	White: 85% BME: 15%	White: 89% BME: 11%	White: 81% BME: 19% 3
4 Earnings*	Median: £21,500 9 out of 10 earn less than: £47,200	Median: £29,500 9 out of 10 earn less than: £57,900	Median: £19,800 9 out of 10 earn less than: £38,500
5 Occupation level	Managerial and professional: 44% Intermediate and skilled: 23% Semi skilled: 18% Routine and other: 15%	Managerial and professional: 63% Intermediate and skilled: 22% Semi skilled: 10% Routine and other: 5%	Managerial and professional: 36% Intermediate and skilled: 25% Semi skilled: 20% Routine and other: 18%
Annual household income	Less than £25,000: 32% £25,000-£40,000: 25% £40,000-£55,000: 19% £55,000-£70,000: 10% £70,000 plus: 14%	Less than £25,000: 18% 6 £25,000-£40,000: 24% £40,000-£55,000: 23% £55,000-£70,000: 14% £70,000 plus: 21%	Less than £25,000: 36% £25,000-£40,000: 29% £40,000-£55,000: 18% £55,000-£70,000: 8% £70,000 plus: 9%
Working pattern	Full time: 78% Part time: 22%	Full time: 87% Part time: 13%	Full time: 88% 7 Part time: 12%
Highest educational qualification achieved	Degree level: 32% Other higher below degree: 10% A-Levels or highers: 12% National BTEC: 7% GCSE equivalent A-C: 23% GCSE equivalent C-G: 5% Other qualifications: 9% No formal qualifications: 2%	Degree level: 43% Other higher below degree: 11% A-Levels or highers: 10% National BTEC: 5% GCSE equivalent A-C: 19% GCSE equivalent C-G: 3% Other qualifications: 7% No formal qualifications: 1%	Degree level: 25% Other higher below degree: 10% A-Levels or highers: 11% National BTEC: 8% GCSE equivalent A-C: 26% GCSE equivalent C-G: 6% Other qualifications: 12% No formal qualifications: 2%

Source: Family Resource Survey 2010-2011
*Source: ASHE 2011 (Annual Survey of Household Income)

The vital statistics of automatically enrolled workers

Table 1 opposite compares the key demographic statistics of unpensioned workers, pensioned workers and the working population. The statistics provide us with a snapshot understanding of unpensioned workers in the UK today. It should be noted that this picture will change if automatic enrolment is successful.

The headlines from these statistics are:

1. Although the proportions of men and women currently in a pension scheme are roughly similar, almost two-thirds of the target group for automatic enrolment are men. The earnings threshold for automatic enrolment eligibility takes out the lowest earners, many of whom are part-time workers and many of whom are women.
2. Older workers with higher incomes are more likely to already be in a pension. Unpensioned workers exist across all ages but almost a third are under 30 years of age.
3. The unpensioned workers group is more ethnically diverse than those currently in a pension.
4. Median earnings for unpensioned workers are substantially less than for those already in a pension - £19,800 compared to £29,500 - but only around 8 per cent less than the £21,500 median earnings of the working population as a whole.
5. Pensioned workers are more likely to be in higher managerial occupations than unpensioned workers.
6. Unpensioned workers are more likely to live in a low-earning household than pensioned workers.
7. The vast majority of unpensioned workers who'll be affected by automatic enrolment work full-time.

Earnings data has been generated on a different methodological basis to numbers published by ONS. The gross annual earnings estimates presented here are calculated using a variable that was derived by multiplying gross weekly pay by 365/7. Official ASHE estimates for gross annual earnings use data that is provided by respondents specifically in respect of gross annual earnings for the tax year that ended on 5 April in the reference year. ONS also applies a standard set of filters to analyse annual earnings and these have not been used in the analyses presented in this paper.

The categories we've used to produce estimates for the public and private sectors elsewhere in this table are different to those used in the ONS ASHE statistics. For ASHE estimates, ONS classifies non-profit bodies and mutual associations as 'not classified'. DWP has included these businesses in the private sector category.

For ASHE estimates, ONS excludes jobs for which workers are not on adult rates of pay, such as those on reduced rates for reasons of apprenticeship, training or age. These jobs have been included in the analyses presented in this paper.

Where are they employed?

Unpensioned workers are found in all types of employment, from small organisations to large. Approximately two fifths of them work for employers with no more than 49 workers. A third of them work for organisations with 1,000 or more workers .

Unpensioned workers can be found across all sectors, but some sectors have a much lower proportion enrolled in a pension scheme than others. For example, the hospitality sector has the lowest levels of pension scheme membership as a proportion of workers.

The table 'Private and not-for-profit employer population by size' on page 31 shows the distribution of unpensioned eligible workers between different-sized employers.

How financially confident are unpensioned workers?

- Unpensioned workers are often skilled domestic budgeters who manage very tight budgets. Long-term savings isn't seen as a priority.
- Behavioural economics show that people heavily discount the future in favour of the present, and this attitude appears to become stronger the less people earn.
- One third of unpensioned workers say that all the money they earn typically goes on the basics, like housing costs, bills and groceries.
- When pressed to give a figure on what they had to spend after living costs, three in five said that this totalled less than £100 per week.
- Over a quarter of unpensioned workers say that they have less than £50 a week after basic living costs. Many said they still wouldn't prioritise pensions even if they had more money.

The picture of unpensioned workers and financial confidence isn't straightforward. Like the rest of the population, they do well in some areas of financial planning and less well in others.

"Right now I have competing priorities but I'll re-think that, especially as the employer contributes too."

Billy is 29 and a management trainee. He knows it's important to make provision for retirement, but he planned to start looking into pensions in a year or so.

When he's automatically enrolled by his employer his first reaction is to opt out. However, he does some research and discusses it with a few colleagues and family members. He decides it would be smart for him to start saving as early as possible, especially because his employer will be contributing too, but he'll definitely be keeping an eye on performance.

Billy earns £25,817. If he saves with NEST until he's 68 he could have a final retirement pot of £141,000 in today's money. This could give him a cash lump sum of £35,200 and an extra £111 a week on top of his State Pension and any other money he's put aside for his retirement.

Short-term money management

Our research with unpensioned workers shows that far from being unsophisticated with money matters, they're often skilled domestic budgeters who creatively manage very tight budgets to cover all essentials and spending priorities. With some we found that they adopt a mental accounting approach, applying different rules to different mental pots of money. In some cases, these pots might be physical too, such as cash put to one side to cover an expense expected in the short term.

"I have four envelopes. One for food, one for bills, one for social and one for savings – that one is always empty by the end of the month. So how can I think about retirement as I just get by now? People like me don't have pensions. We just get on with life and work until we can't work anymore."

Janice is 45 and has worked as a hairdresser for 20 years. She works long hours and loves the social aspect of her job. Her income is a stable family resource. Her husband is a cab driver and works for himself, so that side of things can be erratic. She manages their money to the penny to try and make ends meet.

She imagines they'll be relying on the State Pension but also working for as long as possible. She isn't at all sure about being automatically enrolled. For one thing, she just doesn't trust pensions. She's told it'll serve as a top up to her State Pension so decides to give it a go but she's extremely wary and will check every payslip and annual statement.

Janice earns £17,161. If she saves with NEST until she's 68 she could have a retirement pot of £41,700 in today's money. This could give her a cash lump sum of £10,400 and an extra £34 a week on top of her State Pension and any other money she's put aside for her retirement.

Short-term planning is the area where unpensioned workers feel most comfortable. 74 per cent say they're confident handling day-to-day financial decisions while only 39 per cent are confident handling long-term decisions. 82 per cent of pensioned workers feel confident with short-term planning, and 57 per cent feel confident with long-term planning, notably more than among unpensioned workers.

Long-term financial planning

While unpensioned workers are adept at managing their money in the short term, long-term financial planning simply isn't a priority for many unpensioned workers. Unpensioned workers have far less in savings than pensioned workers do, with 38 per cent having less than £5,000 in savings, compared with 20 per cent of pensioned workers. When asked about retirement plans, 80 per cent stated that they plan to work as long as they can, while 70 per cent mentioned the State Pension.

While there are a number of reasons for a lack of long-term financial planning, the ability to manage money would appear to be the least of them. Instead, the evidence of behavioural economics shows that people generally discount the future in favour of the present and that attitude becomes stronger the less people earn. In addition, many people feel that they have no option but to focus on the here and now due to tight budgets.

One third of unpensioned workers say that all the money they earn typically goes on the basics. When pressed to give a figure on what they had to spend after living costs, over a quarter of unpensioned workers said they had less than £50 a week, and three in five said that this totalled less than £100 per week. Pensions, therefore, could be considered a luxury for these people rather than a necessity. However, a good proportion stated they still wouldn't prioritise pensions even if they had more money.

The current economic climate has exacerbated this tendency. Many unpensioned workers are feeling the squeeze more than ever. For example, around 20 per cent of unpensioned workers report that their income has decreased over the last five years.

Unpensioned workers' attitudes to pensions and the reforms

- Only 14 per cent of unpensioned workers were reasonably confident that their retirement plans would be adequate.
- 47 per cent say they have put off saving for retirement for fear of making the wrong decision.
- 63 per cent agree with the idea of automatic enrolment. Even those who appear to have rejected pensions in the past still generally support the reforms.
- Half of unpensioned workers claim to have only a basic knowledge of pensions.
- There are a number of common misunderstandings that both those with and without previous experience share. Most of these concern investment and outcomes.

We asked unpensioned workers:

'Thinking about your own situation, which of the following, if any, do you have specifically in place for retirement?'

Many pointed to some sort of retirement plan. 70 per cent mentioned the State Pension, 49 per cent planned to downsize their home and 26 per cent expected an inheritance to help them. However, only 14 per cent were reasonably confident that their retirement plans would be adequate. This perhaps accounts to a large extent for the support of the reforms, with two-thirds believing automatic enrolment to be a good idea.

However, it seems that even when people accept and believe rational arguments for retirement planning they still don't act. It's been well-documented already that people have a tendency to leave things as they are - the status quo bias - and put off decision making – the procrastination bias. But there are other factors at play.

First, while pensions are simultaneously dull and complicated, they can provoke a negative emotional response from some people. The responsibility of making the right decision about something so important can be daunting and many simply don't have the confidence to act. 47 per cent of unpensioned workers say they have put off saving for retirement for fear of making the wrong decision. The concepts and language generally used in the pensions industry don't help people understand what they're getting involved with or communicate the information they need to take control.

Secondly, pensions are often simply not on people's minds for most of the time. This is especially, but by no means exclusively, the case for younger people. People struggle to imagine themselves in the future and this potentially deters them from doing anything about it.

"Hadn't thought about it before. Now it just comes out every month and I still don't think about it."

Alex is 25 and works as an administrative assistant. When her employer tells her about their plans for automatic enrolment, she's not sure what it's all about. She shows her dad who says that it's a good idea, so decides not to opt out. Subsequently, Alex doesn't really think about it anymore apart from maybe when she receives her annual statement.

Alex earns £17,120. If she retires at 68 she could have a final retirement pot of £111,000. This could give her a cash lump sum of £27,700 and an extra £86 a week on top of her State Pension and any other money she's put aside for her retirement.

Despite pensions not being front of mind for many people, 63 per cent overall agree with the idea of automatic enrolment. It seems that even those who appear to have rejected pensions still generally support the reforms. 59 per cent of those that have been offered a pension at work before and refused it, or have stopped and started contributions, agree with the principle.

What do people understand about workplace pensions?

Half of unpensioned workers claim to have only a basic knowledge of pensions. Our research suggests that even this basic knowledge is likely to be flawed and based on misunderstandings and misconceptions. In fact, our research shows that even people who have contributed to a workplace pension make fundamental errors and have gaps in their understanding.

Most of these concern investment and outcomes. Those experienced with pensions are more likely to be familiar with defined benefit schemes. This means they usually think that their employer is responsible for managing the scheme pension and will turn their pension fund into an income for them at the end.

People are keen to know more. While they aren't interested in detailed information on pensions, there's an appetite to have clear answers to two central questions:

- What happens to my money - where does it go and how safe is it?
- How much will I get at the end?

"I regret stopping when I finished my last job and this will give me the kick I need to get going again. The figures I see in here are right for me. £50 I can stretch to. I can adjust for that."

Paul is 39 and works in a clerical role at a distribution warehouse. He's used to reshuffling the family finances to cover expenditure and have a little left over for treats for the family. He understands that budgeting for retirement is important, so when he's automatically enrolled he's kind of relieved. Saving into a pension scheme had been on his mind for a while, but he hadn't got round to doing anything about it. He has a lot of questions though and did quite a bit of searching online for reassurance that it was worth putting money aside.

Paul earns £23,895. If he saves with NEST until he's 68, he could have a final retirement pot of £81,300. This could give him a cash lump sum of £20,300 and an extra £65 week on top of his State Pension and any other money he's put aside for his retirement.

What do people understand about investment?

- Everyone understands that the goal of a pension is to grow their contributions but people are less clear where this growth will come from.
- Many people expect their pensions to grow in a uniform upward fashion.
- People in a pension scheme struggle to picture what happens to their money or where it actually goes.
- For unpensioned workers, retirement planning is about safety and securing the future, and therefore at odds with chance, risk and uncertainty.
- For the automatically enrolled member, risk is inherently negative and is more to do with the chance of making a loss than it is about chance of making a gain.

Our research on investment communications started with a foundation qualitative study in 2010. We published the results as *Understanding reactions to volatility and loss*. From this research, it became clear to us that not everyone understands that money contributed to a pension is invested. Many of those who did understand this were unclear about what investment actually means.

Everyone understands that the goal of a pension is to grow their contributions so that they have more money in retirement. Where people are less clear is where this growth will come from. Some expect that growth will simply come from employer contributions on top of theirs, plus interest. As such, they expect their pensions to grow in a uniform upward fashion.

People are used to the term 'investment' and they often feel they know what it means more or less, but in fact they struggle to picture what happens to their money or where it actually goes. The concept is intangible, even for people who feel they're familiar with the term.

Similarly, although people are generally familiar with the phrase 'the value might go down as well as up', few understand how or why this could be. Many imagine that it refers exclusively to their final outcome, rather than any fund value variance along the way, and to their contributions, rather than fluctuations in the level of growth achieved.

There's a general sense of unease around pensions. Many people – both with and without any previous experience of pensions – are concerned about how safe their money is. News stories of pensions being raided and savers losing all of their money still linger in the collective memory. It seems to them that investment contributes to and exacerbates this.

There's reasonable awareness that investment is something to do with the stock market. Media coverage and discussion of the recent financial crisis and related slumps and crashes conjure up negative connotations of the financial sector.

How do people feel about risk and uncertainty?

For unpensioned workers, retirement planning is all about being prudent, sensible and conservative. It's implicitly about safety and securing the future, and therefore at odds with chance, risk and uncertainty. They see the decision to give up money now in order to have money in retirement as a protectionist course of action on both an emotional and practical level. That is, they feel better knowing that they are taking these steps and expect that they will have at least the equivalent of their contributions to spend in retirement.

For the automatically enrolled member, risk is inherently negative and is more to do with the chance of making a loss than the chance of making a gain. Similarly, uncertainty is always perceived in a negative light and suggests the possibility of a disappointing or worst-case-scenario outcome, rather than the possibility of getting a better outcome than expected or even just slightly less.

"It would be good but maybe it's too late for me. I save in ISAs every year and I have my holiday fund, which is important. The money at the end would have to be substantial for me to find the extra cash today. That might sound short-sighted to you but you only live once and you never know what will happen in the future."

Tony is 55 and a foreman at a distribution centre for big kitchen appliances. He's thought about retirement a bit and is looking forward to working out what to do next. His mortgage is paid off, so he could downsize, and he has no debts. He's got a couple of pensions from jobs in the past, but he's not sure how much they'll be worth. He's also got some ISAs, but he's said that he'll never be rich. Still there's more important things in life. When Tony's automatically enrolled he's not sure about it, but decides it's worth going with because of the employer contribution. He'll always look at the annual statement though and weigh up performance against alternatives such as ISAs.

Tony earns £22,737. If he saves with NEST until he's 68 he could have a final retirement pot of £24,200. This could give him a cash lump sum of £6,050 and an extra £20 a week on top of his State Pension and other savings.

This 'all or nothing' scenario that many unpensioned workers imagine is largely based on their understanding of investment and a consequence of the economic context and erosion of faith in the financial sector. The global economic events since 2008 have re-affirmed their conviction that anything can happen and does happen. Most people tend to focus their response to risk on the downside – the chance of losing.

Because people often respond to risk emotionally rather than rationally, survey data measuring risk 'appetite' is likely to be somewhat unreliable. For this reason answers given to survey questions on risk appetite can't be directly applied to the level of investment risk taken in any scheme.

However, we can surmise that those who are the most risk-seeking are generally the highest earners and have the most capacity to deal with the downside of the risk they're taking.

How will automatically enrolled workers react to being in a pension?

- The experience of the US suggests that post-automatic enrolment, workplace pension participation stabilises at around 85 per cent.
- DWP research shows that 70 per cent of those eligible for automatic enrolment said they would probably or definitely stay in. 15 per cent are undecided and 15 per cent say they would definitely opt out.
- 58 per cent said that not missing the money taken out before they were paid would be something that motivated them to stay in the scheme long term.
- People are confused about how big a role a workplace pension scheme will play in delivering their retirement income.

The policy driver for introducing automatic enrolment in the UK is clear. What is less clear is how individuals will react. International evidence suggests that when people are defaulted into a pension scheme, participation rates are higher than they would be in an entirely voluntary opt-in context.

But all countries differ in terms of their policy environment and culture. It can't be known for certain exactly how automatically enrolled pension members will behave in the UK based on experience overseas. Will they opt out and in what numbers? Will they continue to contribute throughout all their years of pension membership? Will they contribute more than the legal minimum? To what extent will they engage and interact with their pension, given their participation was by default?

Although there's likely to be significant interest in opt-out rates as automatic enrolment gets under way, it will be important to keep focused on actual participation in workplace pension schemes first and foremost. A pure focus on the proportion of individuals opting out may obscure an overall rise in the number of people actually saving in a pension scheme. In the later part of staging in particular many smaller employers will be offering a pension scheme to their workers for the first time. Reaching these workers is a key element of the reforms.

The overall policy intent is to get more people saving for retirement. A key measure of success will be what proportion of workers are participating in a workplace pension overall, even if opt-out rates are higher than anticipated.

What might opt out look like?

Nevertheless, one of the ways of monitoring progress towards higher participation levels is how many newly enrolled people opt out. The evidence on opt out will begin to emerge over the next few years as automatic enrolment is rolled out. Currently there are only estimates based on either opt-out rates from similar approaches abroad or stated intentions provided through survey responses. Survey responses on intention to opt out can't provide any real measure of behaviour, but it may provide some indicators and insights.

Both of these sources of information have significant limitations and neither can really be treated as an accurate guide. Approaches adopted abroad might be similar but none are directly comparable. Mindsets could well be different in the UK from other countries that have or had an opt-out option, such as Sweden, New Zealand, Chile and the US.

However, examples around the world illustrate behavioural evidence and give us an indication of what might happen in the UK. The experience of the US suggests that post-automatic enrolment, workplace pension participation stabilises at around 85 per cent and that willingness to remain in does not vary substantially by income (see *Measuring the Effectiveness of Automatic Enrolment*, Nessmith, Utkus and Young, 2007). Something similar is observed in KiwiSaver, where there has been a decreasing trend in the number of opt outs since its introduction (see *KiwiSaver Annual Report 5*, 2012).

The DWP's research in 2012 showed that 15 per cent of those eligible for automatic enrolment said they would probably or definitely opt-out when asked what they would do if enrolled by their employer. 70 per cent said they'd definitely or probably stay in and the remaining 15 per cent were undecided (see *Attitudes to Pensions: the 2012 Survey*, DWP, 2012).

In our own research we asked a sample of unpensioned workers to consider what would influence them to opt out of the scheme. Affordability is the top reason given, cited by 82 per cent of those surveyed. 79 per cent say that a lack of information at the time that they're automatically enrolled could influence their decision to opt out. 61 per cent express a high level of concern about automatic deductions taking place at source.

However, triggers for opt out are more immediate and practical than motivators to stay in. Evidence suggests that motivators to stay in the scheme are more emotional. The knowledge that their pension is being taken care of through a low-maintenance approach driven by their employer gives savers peace of mind. Flexibility is also a strong message, considering the history among qualifying members of taking breaks in pensions and employment throughout their lives.

While perceptions of affordability remain a clear potential trigger to opt out and a front-of-mind concern for the majority, more than half think that not missing the money taken out before they're paid would be something that would motivate them to stay in the scheme. This suggests that if the initial possibility of opt out is overcome, retention may be easier once the savings habit is acquired.

Automatic enrolment and employers

Introduction

As well as trying to develop a clear picture of the workers who will be automatically enrolled by their employers, it's equally important that we have a strong understanding of the organisations they work for.

This section looks at the private sector and not-for-profit employers affected by the reforms. It highlights some of the key characteristics of UK employers and summarises research we've conducted into employer preparations and readiness for the reforms.

To help bring our research to life, we've created fictional employer case studies in this chapter. They're based on NEST research into employer attitudes and readiness. These reflect prevailing attitudes among different types of employer.

In our view, the key insights from our analysis and research are:

- From 2014 onwards, the shift from supporting a relatively small number of employers with a large number of workers in the first year of staging to supporting thousands of employers automatically enrolling their workers each month presents an unprecedented challenge to the industry. In addition, smaller employers have lower rates of existing pension provision and less knowledge and experience regarding pensions than the larger organisations affected in the first year.
- Even though awareness of the reforms is high, many employers are less confident about the detail.
- Many employers are yet to confirm their scheme choice.
- Expectations of support are high.
- Almost half of employers with more than 5,000 workers who say they're ready for automatic enrolment have spent between 10 and 18 months preparing.
- Most small firms haven't yet considered their compliance requirements.
- Ease of administration is a key concern for all employers. The largest employers are more likely to be concerned about payroll integration, indentifying which workers are eligible for automatic enrolment and dealing with enrolment issues where there's a high turnover of staff. Smaller employers have more general concerns but are fuzzier on details.
- The challenge of communicating reforms to the workforce is a key concern for employers.

How the employer landscape will change

The challenge of the second year of staging

The sheer number of employers having to automatically enrol eligible workers over the next few years presents significant challenges to NEST, the wider pensions industry and related business service providers. The significant increase in the number of employers needing to automatically enrol their workers after the first year of staging will be particularly challenging.

There are approximately 1.2 million private sector and not-for-profit employers who will have to automatically enrol their workers by the end of staging. Between them they employ approximately 11 million eligible but unpensioned workers. 97 per cent of these employ fewer than 50 workers and are therefore likely to have a duty to enrol workers some time after June 2015.

"I've heard of the reforms, and know they will affect us in 2014, I think, but I haven't yet had time to look into the detail of what they might mean for us."

Sarah is HR manager for an engineering firm that employs around 150 workers. The firm set up a stakeholder pension scheme several years ago, but hardly anyone joined it, and in recent years it hasn't really been promoted.

Sarah has seen the reforms talked about in HR media. She hasn't looked into the detail yet but is pretty sure her staging date is still over a year away. She's assumed that she will be able to use her current pension scheme but is concerned this might be difficult. She's also worried about the extra time administration of automatic enrolment may take as she only has a small team, none of whom know much about pensions.

She plans to spend more time looking into it this year and will probably go back to the financial adviser who helped set up their stakeholder scheme to make sure she understands all the available options.

Very few employers have more than 1,000 workers. This means that in the first year of staging - between October 2012 and September 2013 - only a very small proportion of the total number of employers will have to comply.

However, in the second 12 months there will be a significant increase in the number of employers having to comply with the new duties each month. Between April and July 2014, thousands of employers will start automatically enrolling workers every month.

Table 2: Private and not-for-profit employer population by size

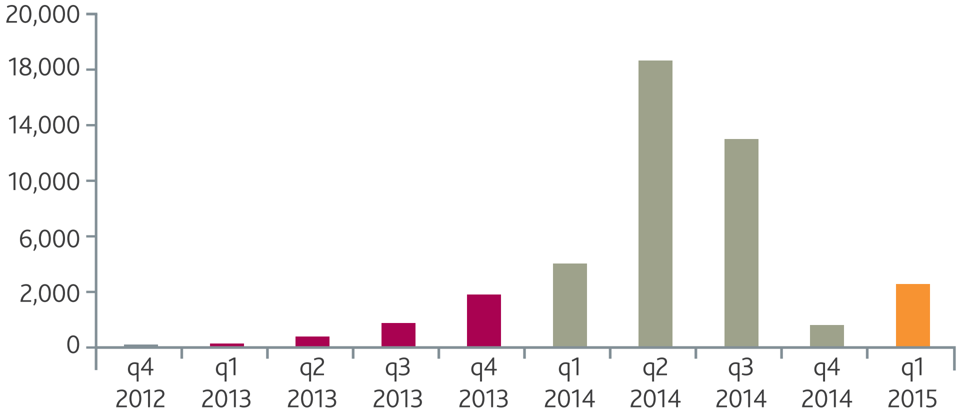
Employer size	Count (figures are rounded)	Percentage
1-4 workers	735,000	62%
5-49 workers	410,000	35%
50-249 workers	32,000	3%
250-1,000 workers	6,000	less than 1%
1000-4,999 workers	1,000	less than 1%
5,000+ workers	300	less than 1%
Total	1,184,000	100%

Source: NEST analysis of the Inter-Departmental Business Register, ONS, 2011

The challenge in the first year of staging

Although a relatively small number of employers have a duty to enrol their workers in the first 12 months of staging, it doesn't mean that there will be no challenges for the pensions industry in the first year. Large businesses face specific administrative issues because of the size and structure of their workforce and they also employ a significant proportion of unpensioned workers.

Figure 1: Staging forcast for employers with 50+ workers



Source: *Automatic enrolment: DWP staging profile and forecast volumes of PAYE schemes the employers are required to register*, TPR, 2012

"We've spent quite a lot time working with our advisers and provider thinking through how the business should respond to the reforms."

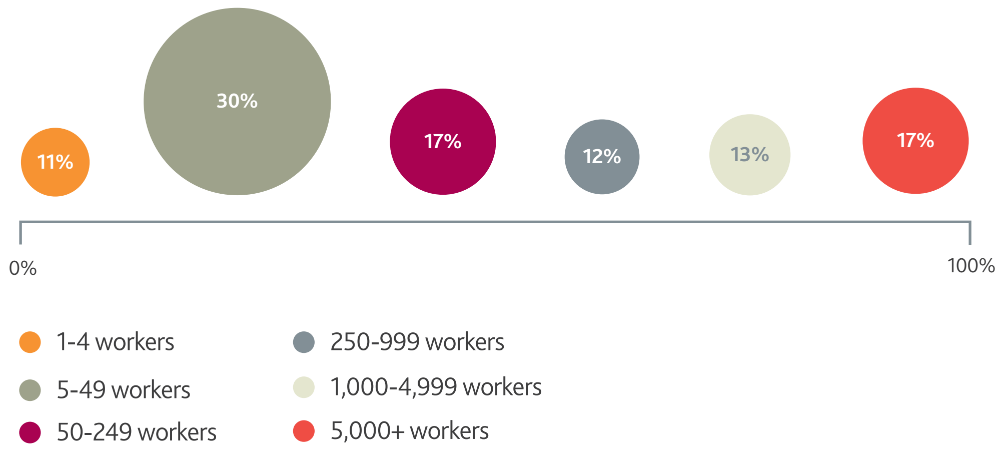
Alan is the benefits director at a major retailer. It employs several thousand workers and has a staging date within the first 12 months. It employs a significant number of younger workers with many only working for them for a short period of time. Although they currently offer a contributory pension to workers after six months of service, take up varies and is lowest among those employed in their shops.

Alan has been aware of the pension reforms for several years and the business started thinking in detail about how to comply 18 months ago. Alan quickly realised that input was going to be needed from across the business and has involved people from HR, legal, finance and payroll functions. One of the key challenges for the business has been working out the best approach to identify eligible workers and ensuring they're enrolled on time. They're using different schemes for different groups of staff to take account of high turnover in some areas.

Of the 11 million individuals currently not saving for retirement in a compliant workplace pension scheme, almost a third or 3.2 million workers are employed by organisations with 1,000 or more workers. Most of these have to automatically enrol their eligible staff by October 2013.

A further 29 per cent of eligible workers who are unpensioned work for employers with between 50 and 999 workers. Many of these organisations will have a staging date between October 2013 and April 2015, with the remaining 41 per cent working for organisations of 49 or less workers. These are likely to have a staging date some time after June 2015.

Figure 2: Distribution of unpensioned eligible workers among different-sized employers



Source: NEST analysis of the *Annual survey of hours and earnings* and the *Employers pension provision survey*, 2011

The challenge of smaller employers

- Large numbers of employers included in the later part of staging currently offer no workplace pension scheme.
- Approximately a third of employers with between 50 and 999 workers have no provision or shell provision.

The increasing number of employers affected by the reforms in the second year is just part of the challenge. In addition, these smaller employers have lower rates of existing pension provision and less knowledge and experience regarding pensions than the larger organisations affected in the first year. This is likely to mean that the challenges the pensions industry faces in helping employers comply with the reforms will significantly change over the next few years.

There are approximately 4.5 million workers currently saving in a workplace pension scheme, to which the employer contributes more than 3 per cent. Nearly 90 per cent of the employers affected during the first year of staging already have a workplace pension scheme of some sort in place for some or all of their workers, and make contributions at or above the minimum set out by the new duties. Even among employers offering most of their workers contributions below the minimum required by the new duties – 7 per cent of those with 1,000-4,999 and 10 per cent of those with 5,000 or more workers – there is a scheme in place where some workers are offered at least the minimum level.

"I've seen some ads on TV but to be honest I'm not quite sure how it will affect my business."

John set up and runs a property management business. He now employs 10 people. He doesn't currently offer any pension scheme to his workers. He's been focusing on building up the firm's client base and recently it has been particularly tough competing for new business.

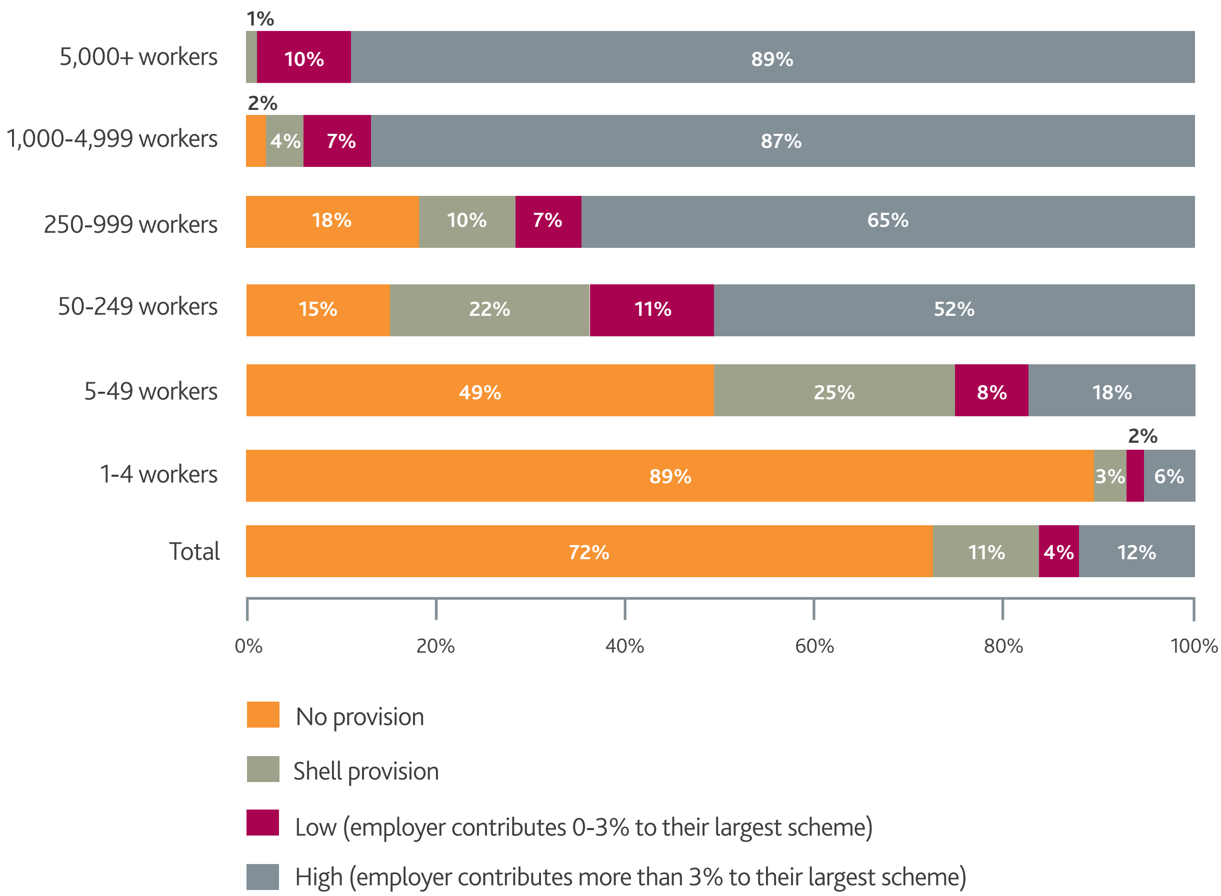
Although John has seen some adverts he's not quite sure what the reforms mean for his business. He wouldn't feel confident choosing a pension scheme for his staff on his own, and worries about how time-consuming administering it might be. It's something he'll probably ask his accountant about, and he hopes he'll be reassured that he doesn't need to worry about it any time soon.

Conversely, large numbers of the employers included in the later part of staging currently offer no workplace pension scheme. This includes 89 per cent of employers with between one and four workers. The challenge for NEST and the rest of the pensions industry will shift to supporting large numbers of employers who have limited pensions experience and who may be relying on others to assess the most appropriate way for them to comply with their duties.

Between October 2013 and April 2015, increasing numbers of employers coming to automatic enrolment will either not offer a scheme at all or have what is best described as 'shell provision', typically a stakeholder scheme set up at some time in the past but with no workers enrolled in it. Approximately a third of employers with between 50 and 999 workers have no provision or shell provision.

Although the largest organisations are likely to offer a scheme with pension contributions of more than 3 per cent, we've already noted that 3.2 million eligible unpensioned workers are employed by organisations with more than 1,000 workers. This indicates that a significant proportion of individuals either don't take up the offer of a workplace pension scheme or are currently ineligible for the pension scheme offered by the employer. This is one of the key reasons for the introduction of automatic enrolment. Without the nudge of being automatically enrolled, many individuals are likely to continuously postpone saving for retirement and many employers will continue to exclude some workers from the existing schemes for various reasons.

Figure 3: Level of pension provision among different-sized employers



Source: NEST analysis of the *Employer's pension provision survey*, 2011

Size matters, but so do other factors

- Size is a key indicator of employers' current pension arrangements, knowledge, experience and attitudes to pension provision.
- Employers' attitudes are likely to range from those who have a strongly benevolent outlook to those who place far less value on the benefits they offer to workers.
- Most of the smallest employers haven't started thinking about how they will comply with the reforms.
- The largest employers have a significantly more detailed understanding of the reforms and are better prepared for them than smaller employers.

Our research has consistently identified size as a key indicator of employers' current pension arrangements, knowledge, experience and attitudes to pension provision. However, it's also clear that size is not the only factor affecting their attitudes and behaviour.

Other issues affecting the attitudes to pensions and the reforms for individual employers include things like:

- the structure of the company
- industry characteristics
- previous benefit provision
- experience and financial knowledge of the pension decision-makers.

In addition, an employer's approach to compliance is likely to be heavily shaped by wider issues, such as the current economic climate.

An employer's size or sector is therefore not enough on its own to confidently predict their likely attitudes to pensions and the reforms. Employers' attitudes are likely to range from those who have a strongly benevolent outlook and want to actively look after their staff to employers who place far less value on the benefits they offer to their workers.

How are employers preparing for the reforms?

Apart from building an understanding of employer attitudes, current pension provision and experience, we've also been monitoring employer readiness for the reforms. This work has highlighted employers' awareness of the reforms, their level of understanding of detailed elements of the reforms, their expectations of support and advice and their level of preparedness.

Our research has focused mainly on those employers with a staging date before April 2015, organisations with more than 50 workers. As staging progresses we will of course look more closely at awareness and preparations among employers with fewer than 50 workers. Our research indicates that most of the smallest employers haven't started thinking about how they will comply.

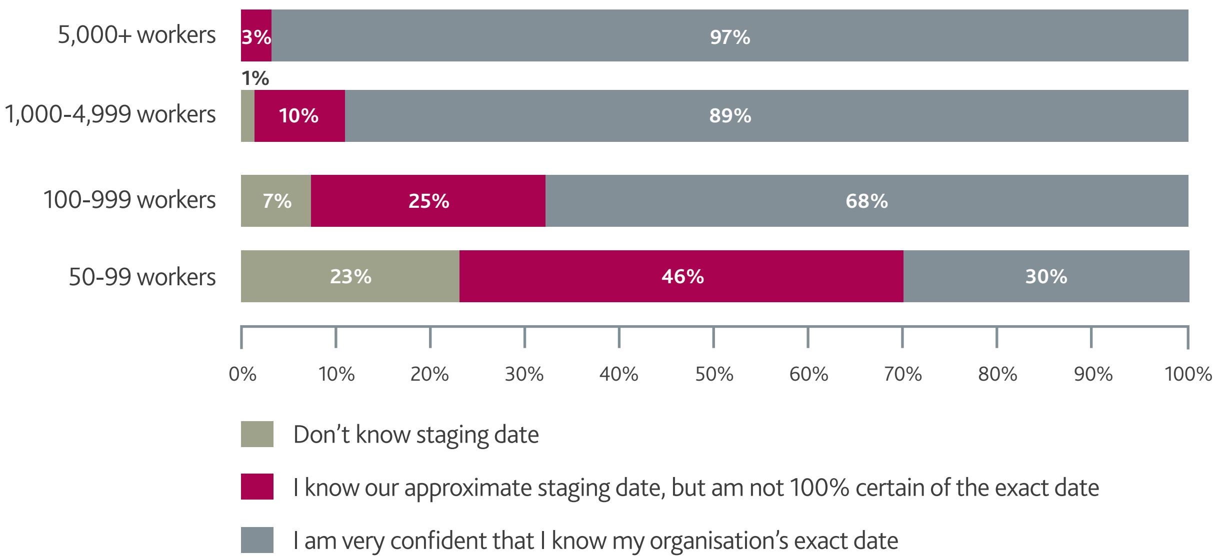
We've consistently found that the largest employers have a significantly more detailed understanding of the reforms and are better prepared for them than smaller employers. As they are likely to have a staging date within the first six months this is understandable. It may also suggest that the various stakeholders in the pension reforms face a significant challenge to help employers with a more distant staging date engage with their new duties early enough to give them time to prepare.

High awareness, but fuzzy on the details

Awareness of the reforms, at least among employers with a staging date during the first couple of years, is high. In our research we've found that among employers with more than 50 workers, 96 per cent are aware of the workplace pension reforms.

As well as high levels of general awareness of the reforms, almost all of the largest employers are confident they know their exact staging date. Confidence is significantly lower among employers likely to have a staging date sometime after the first 12 months of staging. Only 68 per cent of employers with between 100 and 999 workers are very confident they know their exact staging date. This reduces to 30 per cent of employers with 50 to 99 workers.

Figure 4: Level of confidence that employers have about knowing their staging date



Source: NEST Employer readiness research, 2012

Awareness of the reforms is of course not the same as employers understanding what their new duties entail. The fact that significant numbers of smaller employers are not aware of their exact staging date suggests they may not have started to build a detailed understanding of what they need to do in order to comply. We'll explore their understanding of the reforms and preparedness for them in greater detail later on.

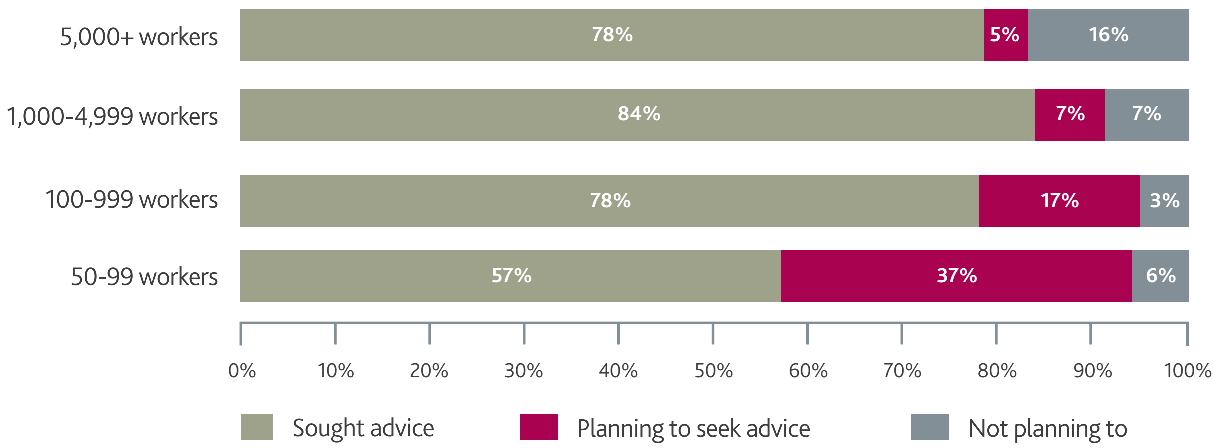
Expectations of support are high and advisers have a crucial role to play

- 98 per cent of employers that are aware of the reforms have already sought or plan to seek advice.
- The source of advice varies depending on the size of the business.
- As well as turning to professional advisory services, large numbers of employers also say that they have sought or plan to seek advice from their pension provider.
- Around half to two-thirds of all employers with over 50 workers expect to get a lot of support from their adviser and pension providers.

Regardless of size, large numbers of employers expect a lot of support from advisers, pension providers and payroll companies to help them comply with their new duties. The exact type of support they expect will almost certainly differ from employer to employer and depends heavily on size. The challenge for the pensions industry is to make sure there's capacity to meet their expectations. In the second year of staging and beyond, when thousands of employers will need to comply each month, financial advisers are likely to have a crucial role to play in helping employers prepare.

In our latest tracking research we've found that 98 per cent of those employers aware of the reforms have already sought or plan to seek advice. This includes eight out of ten employers with more than 1,000 workers, three-quarters of those with 100-999 workers and over half of those with 50-99 workers who have already sought advice.

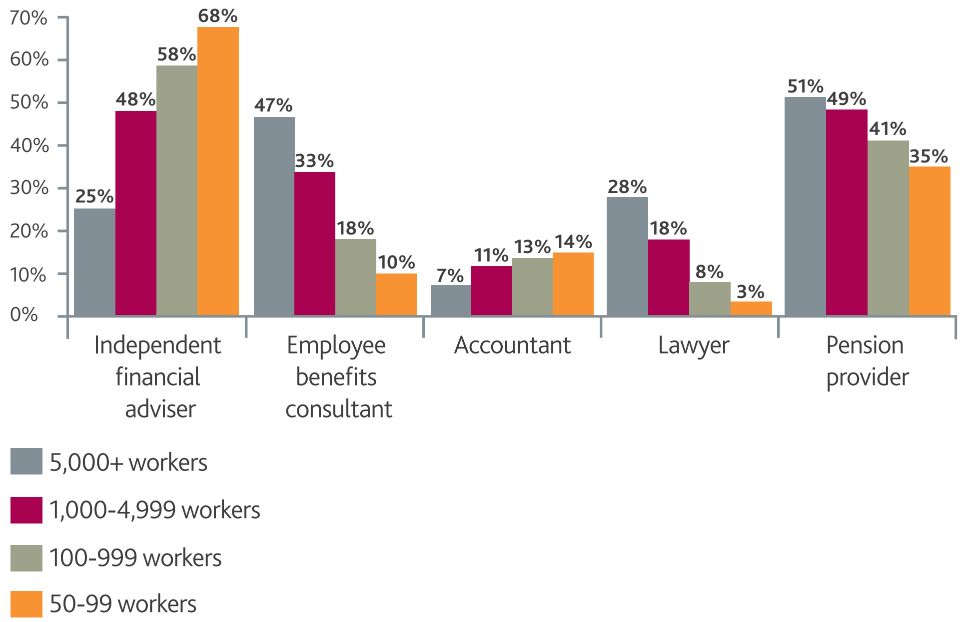
Figure 5: Proportion of employers who have sought or plan to seek advice



Source: NEST employer readiness research, 2012

The source of advice varies depending on the size of the business. Employee benefit consultants will be the most likely source of advice for employers with more than 1,000 workers. A greater proportion of employers with 50 to 999 workers say they would turn to an independent financial adviser (IFA) for advice. Although Figure 6 indicates that only a minority of employers with more than 50 workers expect to seek advice from an accountant, we know from other research that a larger proportion of the smallest employers are likely to go to their accountant for help.

Figure 6: Proportion of employers who will or have sought advice from different sources



Source: NEST employer readiness research, 2012

As well as turning to professional advisory services, large numbers of employers also say that they have sought or plan to seek advice from their pension provider. This suggests that employers will be relying on providers to help them navigate their way through the reform requirements.

The fact that many of those with a staging date post-2013 have started seeking advice is encouraging, particularly as there is some concern that employers may underestimate how long it will take to prepare. This may not, however, indicate that employers are as far on with their planning as you might expect. We'll discuss how many employers have yet to confirm their provider or completed their preparations in the final part of this chapter.

In a recent tracking survey we explored how much support employers expected to receive from advisers, payroll and pension providers. Around half to two thirds of all employers with over 50 workers expect to get a lot of support from their adviser and pension providers. Employers have similarly high expectations of support from their payroll providers. Over three quarters of employers with more than 50 workers expect to get a lot or a fair amount of support from their payroll provider.

Our research also indicates that expected reliance on advisers is greater at the early understanding stages of the process with more employers expecting to rely on payroll providers at the later stages, such as setting up and making contributions. Similar proportions expect to rely on pension providers at all stages. Employers with more than 5,000 workers are more likely to expect to rely on their pension provider to manage the opt-out process - 45 per cent compared to 23 per cent of all employers with over 50 members of staff.

The likelihood of employers seeking advice and their expectations around support present significant challenges to the whole pensions industry. The significant increase in the number of employers needing to enrol workers in the second 12 months of staging and beyond presents an even more challenging picture.

Those closer to their staging date have a better understanding of the new duties

- Many large employers are concerned about dealing with payroll integration, identifying eligible workers and dealing with enrolment issues.
- The largest businesses are likely to have engaged to a greater degree with the detail of the reforms than employers with later staging dates.

Ensuring an organisation is ready to comply with the new duties isn’t just about choosing a compliant pension scheme. It’s also about the mechanics of implementing the changes. For an employer these include organising their data and systems and telling their workers about what’s happening.

In our tracking study we've explored the operational challenges that concern employers most. It provides some insight into employers' recognition of these challenges. In Figure 7 you can see that employers are most likely to cite the increased burden of day-to-day administration as one of the two biggest operational challenges they are most concerned about.

Between a fifth and quarter of employers with over 5,000 workers told us that they are most concerned about:

- dealing with payroll integration
- identifying eligible workers
- dealing with enrolment issues where there's a high churn of workers.

This greater focus on more specific operational challenges among the largest organisations may reflect a more informed view of the implications of the reforms because they're the first to be affected. It may also reflect the likely complex nature of large employers' arrangements, which often have different groups of staff on varying terms and conditions.

As well as exploring the business challenges that concern employers, we've also asked them how confident they are that they understand specific details of the reforms. These results also reflect the possibility that the largest organisations may have engaged to a greater degree with the detail of the reforms than employers with later staging dates.

Table 2 shows the proportion of employers who are very confident or certain that they understand specific elements of the reforms. We can see from these results that even among the largest employers there are many that are not very confident they understand specific details such as how data will need to be organised or what changes they need to make to administrative systems. They do tend, however, to be more likely to understand some of the more specific detail than smaller employers. For example, over three quarters are confident they understand such things as:

- the overall timelines
- exactly which workers they need to automatically enrol
- what and when they have to communicate to their workers
- how they need to calculate contributions.

The proportion of employers confident in their understanding reduces significantly among employers with less than 1,000 workers. Only around half – and in some cases a third or less of employers with between 100-999 and 50-99 workers – are very confident that they understand some of the specific elements of the reforms. When you analyse the proportion that are confident about all seven aspects presented to them you see that even among the largest employers only 50 per cent are very confident or certain in their understanding. Confidence in all seven aspects was much lower among employers with fewer than 5,000 workers.

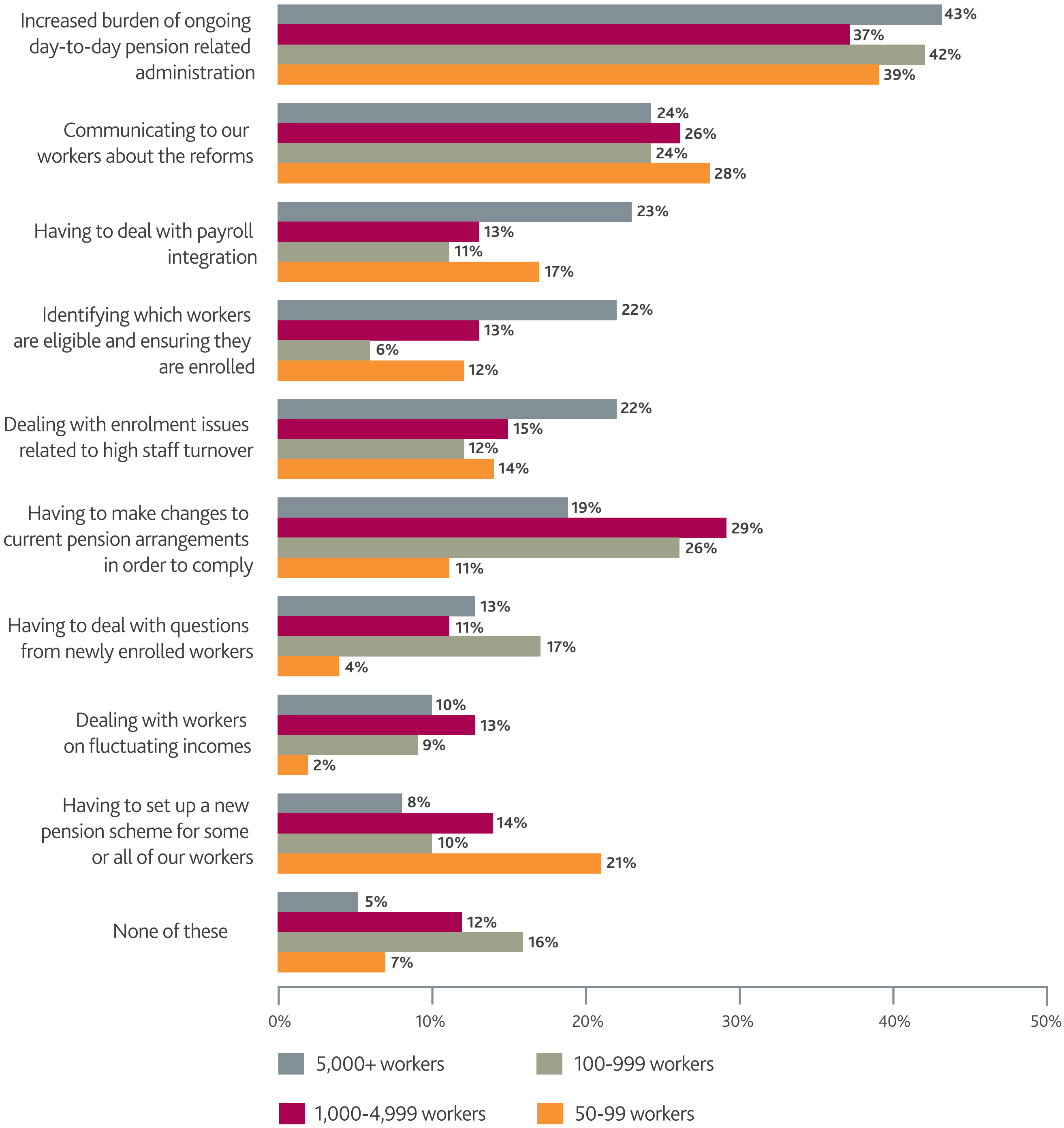
It's perhaps not surprising that employers with staging dates over 12 months away have a lower understanding of these issues. However, it may also indicate that these employers haven't fully grasped how soon they need to start preparing. We'll look at this again later in this chapter.

Table 3: Proportions of employers very confident or certain that they understand specific elements of the reforms

How confident are you that you understand....	50-99	100-999	1,000-4,999	5,000+
Exactly what type of workers you need to automatically enrol.	50%	54%	71%	87%
The overall timelines set out by the reforms. This includes staging date, potential waiting periods, opt-out periods and pay reference periods.	36%	48%	68%	79%
How you will need to calculate employer and worker contributions.	52%	49%	64%	82%
What and when you are legally required to tell different groups of workers.	36%	50%	64%	82%
What changes you may need to make to your administrative systems.	36%	34%	43%	60%
How your data will need to be organised.	30%	37%	43%	58%
All seven aspects.	16%	17%	24%	50%

Source: NEST employer readiness research, 2012

Figure 7: Main operational challenges identified by employers



Source: NEST employer readiness research, 2011

Communicating the new duties to workers

- Employers consider high-quality communications from the provider as one of the important factors that influences scheme choice.
- Communicating automatic enrolment to workers is one of the key operational challenges cited by around a quarter of employers with more than 50 workers.

Our research has found that employers are conscious that workers may have questions about being automatically enrolled and will look to them for answers. Many are concerned about having to field these questions.

It's not surprising, therefore, that we have also consistently identified that employers consider high-quality communications from the provider as one of the important factors that influences scheme choice. In our tracking research we found that 90 per cent of employers thought that clear and straightforward communications were very important or of utmost importance when considering which pension scheme to choose. Communicating automatic enrolment to workers is also one of the key operational challenges cited by around a quarter of employers with more than 50 workers.

Although employers may not fully understand the communications challenges they face, they do realise it will be important to clearly communicate what's happening to their workers. Qualitative research conducted by NEST looking at employers' workplace communications expectations clearly identified that all employers expect some form of communications support either from their provider or adviser. The degree to which they'd like to develop bespoke communications for their business varies, with many smaller businesses being comfortable with provider-branded materials.

Sticking with what they've got

- Around three-quarters of employers with over 50 members of staff plan to use their existing contributory pension scheme to comply with their new duties.
- Larger employers are more likely to expect to put a new scheme in place alongside their current scheme.

When employers are asked how they expect to comply with the reforms, we've consistently found their initial response is to say they would use or extend their existing scheme. Our latest research found that around three-quarters of those employers with more than 50 workers that already have a contributory pension scheme in place plan to use it to comply with their new duties.

Larger employers are more likely to expect to put a new scheme in place alongside their current scheme. 45 per cent of the largest employers expect to set up a new scheme, compared with 10 per cent of employers with 50 to 99 members of staff. This increased expectation to use an additional scheme might indicate the greater complexities of the largest workforces. However, it might also indicate that smaller employers haven't yet fully engaged with the details of their new duties. As they do so, they may decide there are sound business and operational reasons to set up an additional scheme and not just rely on extending their current provision.

We've already noted that the administrative burden is the biggest perceived operational challenge presented by the reforms. Three quarters of employers say that ease of scheme set-up and ease of day-to-day administration are very important or of utmost importance when considering which scheme to choose. This desire to use their current provision is not surprising, since it's likely to be perceived as the most straightforward way to comply in terms of administration.

Linked to this is the fact that many employers say they would prefer to use one scheme for all their workers.

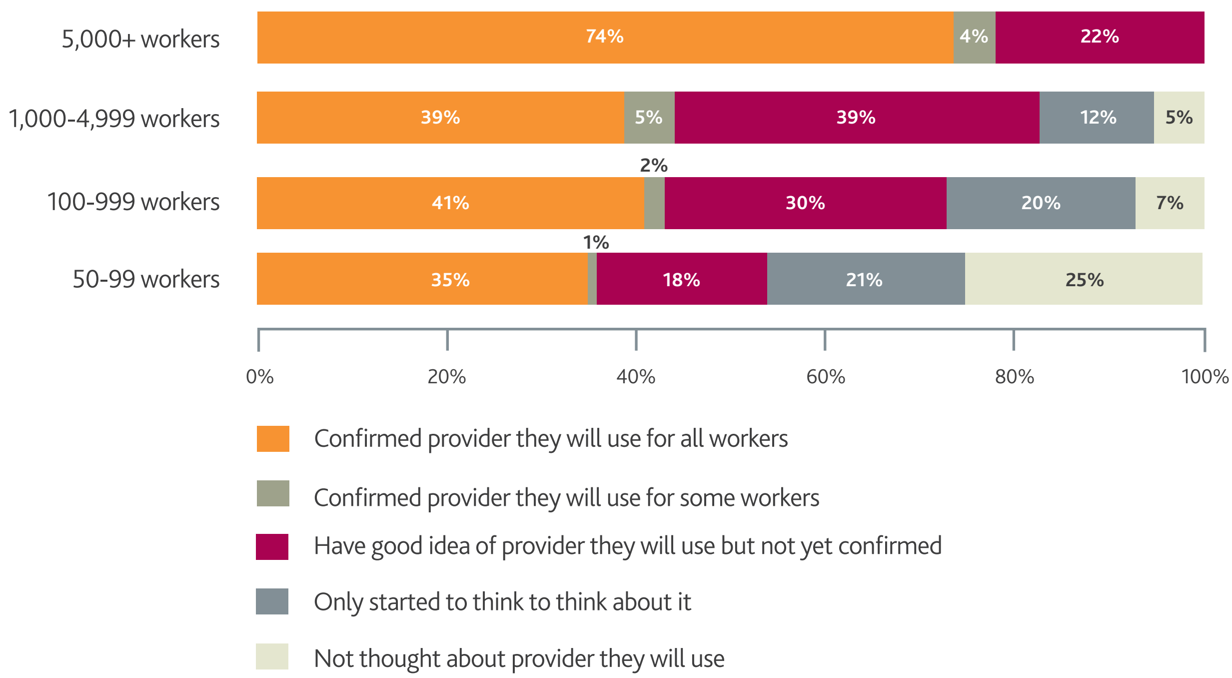
Many employers are yet to confirm their scheme choice

- 74 per cent of the largest employers have confirmed a provider for all their workers.
- A significant proportion of employers whose staging date comes after October 2013 say they have only just started to think about which provider they might use.
- Just under half of the largest employers who say they're ready to comply have spent between 10 and 18 months preparing.
- The experience of the largest employers suggests that employers of all sizes should make sure they give themselves plenty of time to get ready.

In the last 12 months, an increasing proportion of the largest businesses have confirmed the providers they'll use to comply with their new duties. Our latest tracking study found that 74 per cent of the largest employers now say that they've confirmed a provider for all their workers.

The number of employers who believe they've got a provider in place for their workers decreases significantly as employer size decreases. 39 per cent of employers with 1,000-4,999 workers, 41 per cent of employers with 100-999 workers and 35 per cent of employers with 50-99 workers believe they've confirmed their provider for all their workers.

Figure 8: Extent to which employers have confirmed provider



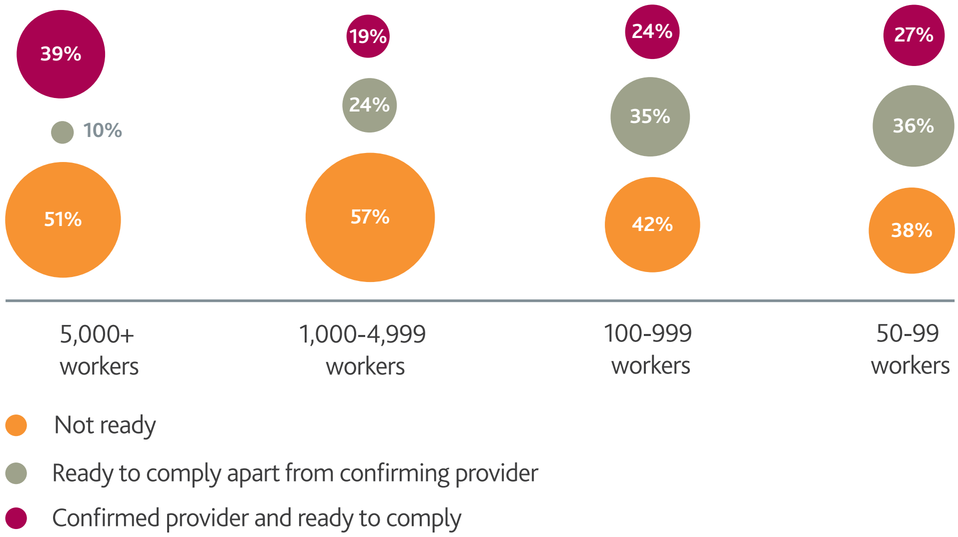
Source: NEST employer readiness research, 2012

A significant proportion of employers whose staging date comes after October 2013 say they have at best only just started to think about which provider they might use - 27 per cent of those with 100-999 workers and 46 per cent of those with 50-99 workers. 17 per cent of employers with between 1,000 and 4,999 workers say they have only just started to think about the provider they'll use or haven't thought about it at all.

We also asked employers whether they believe they've done everything they need to do to be ready to comply. 39 per cent of the largest employers have confirmed their provider and believe they've done everything they need to. A further 10 per cent believe they're ready, apart from confirming the provider they'll use. A similar picture is apparent among organisations with 1,000 to 4,999 workers, although fewer who believe they're ready have confirmed their provider. More organisations with fewer than 1,000 workers believe they're ready than the largest employers.

The complexity of challenges that the largest employers face might mean they're more cautious about saying they're fully ready to comply. It also suggests that some smaller organisations may be underestimating what they need to do to get ready to comply, whereas larger organisations that are closer to the staging date are more conscious of what preparing for the new duties entails.

Figure 9: Whether employers believe they have done everything they need to do in order to comply



Source: NEST employer readiness research, 2012

Our experience of working with large employers planning to use NEST and our research suggests that getting ready to comply with the reforms can take a significant amount of time. Just under half of the largest employers that say they're ready to comply have spent between 10 and 18 months preparing. Of course the exact amount of time each employer needs to prepare will vary, and smaller employers may need less time. However, the experience of the largest employers suggests that employers of all sizes should make sure they give themselves plenty of time to get ready.

What does good look like in 2013?

The last two chapters of this report looked at how the reforms are seen by our customers - workers and employers. In this section we've asked for views on how automatic enrolment will ideally roll out from some of those helping to deliver automatic enrolment. These include scheme providers, advisers, payroll organisations and those with a wider policy perspective. By recording these views in this first *NEST insight* report we'll be able to see how closely the actual situation matches these aspirations over time.

Steve Webb MP, Minister for Pensions, DWP

The introduction of automatic enrolment, which rolls out over six years, represents a major behavioural change. During 2013, the first full year of implementation, I look forward to more and more employers successfully providing workplace pensions and helping us move closer to our target of 6 to 9 million people saving for the first time or saving more into a workplace pension by 2018. For many, this is the first time they will have access to workplace pension saving, and a contribution from their employer.

However, automatic enrolment alone does not address all the barriers to pension saving. We have published our intention for State Pension reforms in *The single-tier pension: a simple foundation for saving*, which is available from our website. These reforms will underpin the rollout of automatic enrolment, enabling people to make decisions about saving for retirement based on a clear understanding of what they can expect from the state.

We have also published a reinvigoration strategy which you can read at **dwp.gov.uk/reinvigorating-workplace-pensions**. This focuses on creating a future private pensions landscape that gives consumers high-quality schemes to save in and creates trust and confidence in pensions.

With so many more people newly saving into a pension, quality is key. The introduction of NEST has already driven down charges and spurred on innovation in pension provision. We will examine issues such as charges and whether large scale pension schemes might provide greater value for money. We will also continue to explore the development of defined ambition pensions to give members more certainty about the pension they can expect to receive in retirement.

I welcome this report by NEST which demonstrates its continued commitment to understanding the factors that influence employers' and individuals' behaviours towards pensions and automatic enrolment.

Association of British Insurers (ABI)

After many years in the making, 2012 finally saw the start of automatic enrolment – a policy which will over time transform peoples' lives after work, providing much greater financial security for our ever-increasing lifespans. Considering that in 2066 there will be at least half a million people aged 100 or over, this is absolutely critical.

Looking ahead to 2013, what does good look like in terms of introducing automatic enrolment successfully and creating a savings culture in the UK?

We believe there are three key elements to this. First, we need as many people as possible staying in their pension scheme once automatically enrolled. Given the power of inertia, there is a good chance many will remain in their new schemes. It is also incumbent on the pension community not to engage in public self-flagellation and doom-mongering, as this will only turn the public off pension saving, increasing the potential for opt-outs.

Secondly, a vibrant market. Competition for pension schemes is fierce, as evidenced by reports of recent deals with annual management charges of 0.32 per cent for large schemes. This is great news for employers and workers, and shows the market is working.

Thirdly, engagement. 2013 will only see larger employers starting with automatic enrolment. However, this year TPR will also be writing to employers with less than 100 staff to alert them to their new duties. They are less likely to be engaged with pensions, and may even be new to pensions. So we need to do everything we can to help them and indeed their workers engage with pensions.

The recent *Joint Industry Code of Conduct* on explaining pension charges and services will support employers in their choices. But workers will also need more help understanding their pension, to make informed decisions. Transparency of charges and costs is an important part of this, and we will shortly publish our *Agreement on Charges*, which will enhance transparency both when people join a pension scheme and during their savings journey.

Ultimately, we all have to recognise that given our increasing lifespans we must make more provision for our later life. The pensions industry has a critical role to enable this – by continuing to improve its standards on transparency, value and member engagement.

Dr Yvonne Braun, head of savings, retirement and social care, ABI

The Chartered Institute of Payroll Professionals (CIPP)

Good would be most or all payroll software products having functionality to assist employers with their automatic enrolment obligations, whether directly included in the software, or the capability to interact with others. Good would be all employers with a staging date before the end of 2014 being aware of the legislation and having a prepared project plan for a smooth implementation. Good would be a pensions communication campaign to encourage workers to save for their retirement. And finally the silver lining for the employer would be them having a joined-up payroll, human resources, pensions and finance team all working together to ensure the automatic enrolment obligations are met.

Karen Thomson FCIPP MSc, associate director of policy, research, and strategic visibility, CIPP

The Confederation of British Industry (CBI)

As life expectancy increases, it is clear people will need to save more to achieve a good income in retirement. The UK is sitting on a demographic ticking time bomb with birth rates having fallen by almost 30 per cent over the past 40 years. At the same time, those born in the 21st century can now expect to live 30 years longer than someone born a century ago. Compared to today, the number of people over 65 will be half as many again in 2030, and will have doubled by 2060.

Automatic enrolment will go some way to addressing this demographic challenge by boosting private savings. But to make the system work well in the long term, we need to achieve two things at the outset. First, we need to ensure employers are able to set up workplace pension schemes that are affordable for them and suitable for the needs and demands of their workforce. And second, we need to ensure that people take responsibility for their retirement and take ownership of the tools that will allow them to save adequately for a pension.

To do this, the CBI believes 2013 would be a good year for automatic enrolment if the following things happen.

- The government and TPR continue to raise awareness of the changes so all employers understand the need to prepare early. It takes on average 18 months for a business to get ready.

- As smaller employers with little experience of providing pensions begin to prepare, the government and TPR provide accessible information and assistance to them so they are ready to comply when their staging date arrives.
- TPR and the FSA work together to better coordinate the governance landscape of the regime for both trust-based and contract-based schemes so both employers and providers are clear on duties.
- The pensions industry continues its efforts to make charges more transparent, helping employers choose the scheme that would deliver value for money for them and their employees.
- We continue to stick to the plan. Automatic enrolment is a long-term reform which will work through economic cycles. While opt-out rates initially might be higher than forecast, take up will improve as the economy picks up. It is therefore important that we do not introduce short-term fixes, and instead provide employers and employees with certainty about what to expect so they can plan ahead.

Mario Lopez Areu, senior policy adviser, labour market and pensions policy, CBI

The National Association of Pension Funds (NAPF)

The introduction of automatic enrolment last year was a pivotal moment in the history of UK pensions saving. But implementation will be a gradual process and getting people to start saving into a pension scheme is only part of the answer. We also need to ensure they are saving in the right schemes.

The vast majority of the new savers will be in defined contribution schemes. In the trust space we have a large legacy of very small schemes that do not reap the benefits of providing pensions at scale, while the contract-based space suffers from a lack of appropriate governance. This is not a debate about the merits or otherwise of trust versus contract, it is about developing a pensions system that puts the member at its heart – a system that protects the consumer and delivers good member outcomes.

The key challenge for 2013 is getting the regulatory framework right. TPR's work on defined contribution schemes is a good starting point, but it is disappointing that the proposed code only applies to trust-based pensions and not contract-based schemes. This means that around three million people are saving into a type of pension that is overlooked by this effort. All types of pension need to meet high standards, and we need a joined-up regulatory approach. The FSA and TPR need to work together much more effectively than they currently do.

Our regulatory system needs to create alignment between the provider and saver through strong governance and by delivering value for money through scale. Only then will our industry be able to start improving confidence and really delivering for members.

Helen Forrest, head of policy and advocacy, NAPF

NEST

We're at the start of a long journey. Automatic enrolment will take six years to introduce fully and 2013 is the year in which we and the industry as a whole will begin to really get going. Almost 6,000 employers are expected to have their staging dates this year.

Making a success of that scale of activity is a formidable challenge in itself and it's where we at NEST will be focused throughout the year. 'Good' in 2013 is a market with the following features.

- Employers understand how to meet their automatic enrolment duties and, working with schemes and intermediaries, they comply on time.
- The schemes into which workers are enrolled are focused on their outcomes. TPR's principles and features for well-governed schemes will be a valuable guide here, as will the extension of the Pensions Quality Mark to multi-employer schemes.
- Participation in workplace pensions increases. This year, when most staging employers already have workplace provision, we think it will be particularly important to focus on overall participation rates and not just the opt-out rates among the proportion of workers who are newly enrolled.

This market would be good for both the savers enrolled in 2013 and those who follow. Crucially, it would mark the beginning of the long journey towards rebuilding trust in pension saving. It's the solid foundation of getting people into the saving habit in high-quality schemes which will enable us to turn to member outcomes as the key marker of success for automatic enrolment in future.

Tim Jones, chief executive officer, NEST

The Personal Finance Society

Automatic enrolment has the potential to bring an estimated 10 million people into saving for their retirement for the first time. Many of these workers work for small and medium-sized businesses (SMEs), mainly micro or small firms who employ 30 per cent of the UK's workforce. These firms face more of a challenge than larger, better-resourced firms in both understanding the requirements and setting up a compliant scheme. The actions taken by small firms will be crucial to the successful implementation of automatic enrolment. Employers in this sector need to not only be aware of their responsibilities but buy into the long-term objectives.

SMEs often have to deal with a range of regulatory developments such as the national minimum wage, default retirement age and constant reforms to statutory benefits and taxation. Automatic enrolment adds a further complexity and implementation will need to be made as simple as possible. The development of payroll systems that facilitate contribution deduction will be central to success.

It is in everyone's interest that automatic enrolment succeeds and research undertaken by the Chartered Insurance Institute in June last year shows that many small and micro firms may benefit from receiving professional help in making the right decision regarding the selection and setting up of an appropriate pension scheme. Of the small proportion (13 per cent) of firms in the research that had sought external advice on automatic enrolment, nearly half had consulted a financial adviser. 81 per cent of these firms were either very or fairly satisfied with the advice received.

Professional advice will not be necessary for all firms and many will rely on the information provided by the government and NEST. But success is not just having a scheme in place. It will be measured by the take-up and buy-in of both workers and workers and if professional advisers can help alleviate some of the burden to employers and promote the value of long-term savings to employees, automatic enrolment will be a win-win for all.

By **Fay Goddard**, chief executive, the Personal Finance Society

Which?

The objective of pension reform should be to ensure that all consumers have access to a high-quality workplace pension scheme that offers them good value for money. So the first step must be to establish defined quality standards to ensure that all schemes offer consumers a good deal. Which? is particularly concerned about the risk of excessive deductions being made from consumers' pensions under the pretence of 'consultancy charging'.

Setting quality standards will not be an easy task, but the alternative 'wait and see' approach risks damaging confidence in pensions and automatic enrolment.

Employers will have a significant role to play in choosing a scheme for their workforce. While we should do everything we can to help small firms choose a pension scheme, we need to recognise that many small businesses will not have the time or expertise to spend days and days choosing one. Establishing clearly defined quality standards will help send a clear message to employers that if they choose one of these schemes then it will offer their workers a good deal.

Alongside ensuring that all schemes are good quality we need to take steps to improve consumers' ability to engage with their pension scheme. Consumers should be provided with clear and jargon-free information at every step of their pension journey, from making contributions through investment and choosing a retirement income. They also need to be helped to determine how much they think they will need to live comfortably in retirement and be provided with regular updates about how far their existing pension scheme is from fulfilling their goals.

Dominic Lindley, financial services team leader, Which?

Appendix: sources

This report draws on information and insights from a number of different sources. It has been informed by a wide variety of published research papers, our own research and from analysis of data from a number of different surveys conducted by the DWP and other organisations.

Qualitative research

We've used our own qualitative research and qualitative research conducted by the DWP to explore individuals' and employers' reactions to NEST and automatic enrolment. We've also conducted qualitative research on the language used to talk about pensions and automatic enrolment.

Although we've looked at a wide range of research projects, the following qualitative studies were particularly instrumental in driving our thinking.

- *Consumer qualitative study*. 40 in-depth interviews that support and enrich findings from the *NEST consumer survey*, 2011/12.
- *Employer readiness survey*. Supplementary in-depth interviews that have helped to support our understanding of employers.
- *Investment communications research*. The overall purpose of this research was to explore how to talk to potential members about investment and in particular NEST's investment proposition. This project involved a combination of in-depth interviews and group discussions.
- *Understanding reactions to volatility and loss*. This study was set up to investigate unpensioned workers' concept of loss and their likely reactions to being automatically enrolled. In total 102 participants took part in individual interviews and focus groups.
- *Member evidence brief, 2011*. This key foundation document summarises the research we conducted into potential members that helped inform our investment approach.

Our published research reports are available at **nestpensions.org.uk/library**

Quantitative research

We conducted two quantitative surveys that feature extensively in this report.

- A consumer survey of 1,879 individuals who were eligible for automatic enrolment but were not currently saving in a workplace scheme.
- *Employer readiness survey*. A regular survey of employers that tracks their awareness, understanding and preparation for the reforms. Each survey has involved between 500 and 700 employers and has oversampled the largest employers.

Along with our own surveys, we've drawn on quantitative data outlining demographics and pension provision from the ONS and DWP. These include:

- *Annual Survey of Hours and Earnings*, ONS, 2011
- *Annual Survey of Hours and Earnings Provisional Results*, ONS, 2012
- *Annual Survey of Hours and Earnings*, ONS, 2012
- *Attitudes to Pensions: the 2012 Survey*, DWP, 2012
- *Employer Pension Provision Survey*, DWP, 2012
- *Family Resources Survey*, DWP, 2012
- *Overview of Workplace Pension Reform*, DWP, 2012
- *Pensions Commission: Interim Report*, DWP, 2004
- *Workplace Pension Reforms: Baseline Evaluation Report*, DWP, 2012.

These reports are available from **ons.gov.uk** and **dwp.gov.uk**

Other sources

This report also draws on research from other organisations.

- *Budget 2012 Statement, HM Treasury*, March 2012
- *Inter-Departmental Business Register*, ONS, 2011
- *Measuring the Effectiveness of Automatic Enrolment*, Nessmith, Utkus and Young, 2007
- *Survey of Persistency of Life and Pensions Policies*, FSA, 2009.

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