Aspects of U.K.'s NEST in MyRA

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MarketWatch Blog by Alicia H. Munnell

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We were looking at the **United Kingdom's ambitious retirement saving initiative** when the President announced Treasury's **MyRA proposal** last month. The UK initiative shares two key attributes with the MyRA – namely, safe investments for the new saver and a separate mechanism to administer small accounts. And it's an interesting plan.

The initiative was introduced to counteract projected declines in government old-age pensions, particularly for average- and low-wage workers. Following on the heels of the failed "stakeholder" initiative, which required employers only to *offer* a plan, the new initiative requires all employers (without a better plan) to "auto-enroll" their workers into a retirement savings plan. Since financial services companies find small accounts with small employers supremely unprofitable, the government also created a new non-profit entity, the National Employment Savings Trust (NEST), to provide such employers with high-quality, low-cost plans.

Parliament enacted the new plan in 2008 and, when fully phased in by 2018, workers will contribute 4 percent of after-tax earnings, the employer will provide a 3-percent match, and the government will add 1 percent as "tax relief." Participants cannot access their savings before age 55; by age 75 they must use at least 75 percent to buy an annuity, and can withdraw up to 25 percent tax-free.

The Pensions Commission, which designed the new plan, recognized that for any meaningful accumulations to occur, costs had to be kept low. The Commission targeted a 0.3 percent fee, typically found only in large plans with high-paid workers. To meet this target, the government: 1) created a low-cost national payment collection system (NEST); 2) built investment options from low-cost funds; 3) allowed accounts to follow workers; and 4) eliminated the "stakeholder" requirement to provide participants with financial advice.

NEST is meant to be self-financing but, until the program matures, costs will far exceed revenues. So the government is providing a start-up loan, with interest equal to the government's cost of funds. To cover the interest costs, NEST is charging an additional 1.8 percent fee on contributions, bringing NEST costs for early participants to roughly 0.5 percent of assets under management.

Target Date Funds are the default investment option. These funds differ from the U.S. version in two ways. First, they invest the savings of workers in their 20s in relatively low-risk investments. When researching their investment options, NEST heard many young workers say they could stop saving if they saw their account value fall. So NEST adopted an investment strategy designed to produce rising nominal balances for workers just starting out. Second, the NEST Target Date Funds move to a very low-risk portfolio after retirement since participants have to buy annuities at 75.

To prevent NEST from competing with private sector providers, the government initially capped contributions and prohibited transfers between NEST accounts and accounts in other plans. The findings of a review committee however, resulted in these restrictions being rescinded when NEST is fully phased in. The committee feared that the cap would create the need for two plans, adding cost and administrative complexity, and that workers could view the cap as a ceiling for how much they need to save. The committee objected to the prohibition on asset transfers, because it would create multiple pots of money, making it difficult for workers to understand how much they have and how it is invested.

Lots of questions remain. Will NEST expand beyond its target market and compete with private sector providers? Will its low fees put pressure on more expensive providers? Will NEST's system for collecting contributions, maintaining worker accounts, and making payments – tasks with large economies of scale – take on a larger role? In Sweden, whose mandatory retirement saving program served as a model for NEST, a public infrastructure handles transactions and bookkeeping, which significantly cuts costs and allows financial services firms to focus on investing retirement savings.

What is clear is that NEST has already served as a valuable model for MyRA. Too bad we couldn't go all the way and have auto-enrollment. But for that, the administration needs Congress.