Lessons from Britain’s national ‘NEST’ egg program

By Kerry Pechter *Sun, Sep 29, 2024*

NEST is the U.K.'s experiment with a government-sponsored, portable defined contribution plan for low- and middle-income workers at small companies. Most NEST participants are still far from retirement, but NEST's leaders envision them hedging their longevity risk with late-life annuities.

Aimed at helping workers in low-pay, high-turnover jobs save for retirement, Britain’s national defined contribution plan, known as **NEST**, is barely a dozen years old. Most of its participants are young and have small accounts. It’s too soon to say how they’ll “draw down” their “pension pots” in retirement.

But Will Sandbrook, director of **NEST Insight**, the program’s in-house research group, expects that retired NEST participants will take systematic withdrawals from their accounts for the first 10 or 15 years of retirement, then switch to a late-life deferred income annuity.

Will Sandbrook

Sandbrook spoke at a September 18 webinar sponsored by the National Institute for Retirement Security (**NIRS**) in Washington and entitled “What the U.S. Can Learn from the U.K.’s National Employment Savings Trust.” (That’s NEST’s full name.) He was interviewed by Tyler Bond, research director of NIRS.

“In the future, we think the best default income process will be a hybrid approach, with ‘drawdown’ [systematic withdrawal] in the first part of retirement and a guaranteed solution in the later part,” Sandbrook said. Today, he added, “most of the people in NEST who are reaching retirement today have small pension pots [accumulations] that they take as cash.”

Annuities for 'long-tail' risks

While NEST faces no immediate pressure to design a decumulation strategy for its participants, corporate sponsors of large 401(k) plans in the U.S. are. Asset managers and life/annuity companies have begun dunning them with a variety of proprietary draw-down products.

Those products and processes come in a variety of shapes and sizes, with a few that fit the model that NEST imagines its members using in the future. Principal Financial currently offers a program that lets 401(k) participants lock-in credits toward a qualified longevity annuity contract (QLAC) during the accumulation period. They decide at retirement whether to commit to it or not. T. Rowe Price is preparing to roll out a strategy where the participants decide at retirement whether to allocate money to a QLAC or not.

NEST envisions its members waiting until age 75 or so before they move part of their NEST assets into a late-life annuity, Sandbrook said. Five or ten years later, they would start receiving annuity payments that will last as long as they (or their spouses) are living.

"Annuities were never designed to be 30-year products," he said. "Better to have draw-down and then an annuity to deal with the larger long-tail risks." Income annuities cost least, any actuary can tell you, when payouts start in advanced old age. That's when you're both least likely to be still alive and most likely to have run out of money. To make that strategy work, you just have to make sure that your liquid savings don't hit zero before your monthly annuity checks start arriving.

There's also behavioral drawback to buying an "immediate" life annuity that starts producing income at the beginning of retirement, Sandbrook said. NEST may want to "put some conditionality in the draw-down"—that is, "encourage people to tighten their belts in some years" rather than, say, liquidate depressed assets during a market downturn and lock in a permanent loss. But with a "30-year immediate annuity you take away some of that discretion."

Interestingly, the type of decumulation strategy favored by NEST, Principal, and T. Rowe Price resembles the one that Jason S. Scott of Financial Engines prophesied in a 2007 research **paper**.

Partly because interest rates were so low for so long, these late-life annuities, also known as deferred income annuities (DIAs), have not offered payout rates high enough to be popular. They accounted for only 1.2% of U.S. annuity sales in the first half of 2024, at $2.5 billion.

But DIA sales were up 30% in first-half 2024 over first-half 2023, apparently benefiting from the higher bond yields that lifted sales of most fixed annuities.

Replacing pre-retirement income

Inaugurated in 2012 with start-up funding from the U.K. government, NEST now has about 13 million members. It was designed for people previously not well-served by the pensions sector, including those on low-to-moderate incomes, working for smaller employers, or with higher likelihood of job turnover. NEST also draws members from large employers in sectors with lower income levels and higher job turnover.

Sandbrook estimated that a stunning 25 million people in the U.K., or more than a third of the U.K.’s population of 67 million, live in households where at least one source of income is “volatile.”

The U.K. has a “flat-rate” state pension that equals about 30% of the average pre-retirement earnings of a median worker starting at age 66, Sandbrook said. NEST started out with the stated goal of enabling lifelong participants in the program to eventually replace an additional 15% of pre-retirement income, with retirees relying on personal savings for the rest of their retirement income.

NEST participants contribute a minimum of 8% of pay to their accounts—the current default minimum contribution rate for all employers/pension plans under the auto-enrollment regulations in Britain. Since 2012, U.K. law has required all employers in the U.K. to offer access to an auto-enrolled retirement savings plan. NEST makes it easy for small employers to fulfill that obligation.

The U.K. state pension contrasts with that of the U.S., where Social Security benefits are based on payroll tax contributions, up to a salary cap. Benefits in the U.S. are “progressive” rather than flat. As percentages of pre-retirement income, they’re higher for low-income workers than for high-income workers.

Financial whack-a-mole

Sandbrook’s job—his title is executive director of NEST Insight—gives the Oxford-educated social scientist a window into the financial lives of low- and middle-income couples. A survey of 50 families showed them constantly moving money between checking, savings, and credit accounts to try and pay bills on time and avoid penalties. One couple made 150 transfers in a single month. “They were just moving money from one account to another,” he said via

Zoom from London.

Tyler Bond

This modern, smartphone-enabled game of financial whack-a-mole doesn't leave much money for retirement saving or much time for retirement planning. "It creates a massive focus on *today*," Sandbrook said. "Low-income people are capable money managers in the short-term. But it exhausts their capacity for long-term planning. Imagine the cognitive load that that uses."

"People try to save. Some households belong to savings circles, where five households might contribute to a fund, and each household receives the whole pot every fifth month. The degree of innovation that people go through to make ends meet is amazing," the NEST research director said.

That evidence was furnished by the Real Accounts project, a long-term study by NEST Insights of U.K. households' financial lives. The project, according to its **website**, "uses first hand stories and digital transaction tracking to build an in-depth, in-the-moment understanding of households' income, spending and money management strategies over time."

The Real Accounts project was inspired by the **U.S. Financial Diaries** project, a joint venture of the Financial Access Initiative at the NYU Wagner Graduate School of Public Service, The Center for Financial Services Innovation (now the Financial Health Network), and Bankable Frontier Associates.

One of the lingering questions about auto-enrolling low-income workers in retirement plans is whether or not nudging them to make salary deferrals every month might backfire and drive up their use of credit cards. NEST has gathered enough data on that issue to reach a tentative answer.

“We saw a small increase in debt for those auto-enrolled,” Sandbrook said. “We can hypothesize about the mechanism for this, that if you live day-to-day, and someone takes a bit of money out of your pay check, you just run out of money a bit sooner and adjust through credit.”

“It’s easy to see how pushing on one part of the household balance sheet affects another part, without them having any real choice. But they didn’t opt out of NEST. Those who design pension plans need to know this about people.”