

## Save More Tomorrow and Smart schemes

### Introduction

Smart pension schemes were pioneered in the US. Those credited with inventing the idea, Richard H Thaler and Shlomo Bernartzi, referred in their original paper to a plan called Save More Tomorrow or the SMarT plan. Possibly due to this term subsequently being trademarked (SMarT™), their later paper refers instead to Save More Tomorrow or the SMT plan. The essence of the plan is to get employees to commit in advance to allocate part of their future salary increases toward retirement saving.

Smart schemes have, however, developed in a different guise as a straight salary sacrifice scheme designed solely to save employees and employers from National Insurance contributions (NICs) without increasing savings. The DWP refer to 'Save More Tomorrow' plans as 'Smart' schemes, while HMRC use the term 'Smart scheme' to mean a straight salary sacrifice scheme to save NICs.

### SMT schemes

Save More Tomorrow schemes are designed to tackle the problem of undersaving by those already in, or with access to, a pension scheme. They work by getting employees to pre-commit to increasing their contributions with each pay rise, while at the same time not reducing take home pay.

#### How does SMT work?

The plan is designed to help employees who would like to save more but lack the willpower to act on this desire. The key features are:

- Employees are approached about increasing their contribution rate in good time before their scheduled pay rise.
- If employees agree to join, their contribution to the plan is increased beginning with the first payslip after a raise. This is to mitigate the perceived loss of salary.
- The contribution rate continues to increase on each scheduled raise until the contribution rate reaches a preset maximum. In this way, the employee does not have to make positive decisions in order to increase their pension saving.
- To make people more comfortable about joining, employees can opt out of the plan at any time.

#### SMT in practice

The first implementation in the United States, in 1998, was in a medium-sized manufacturing company with low participation and saving rates. In order to increase these rates, the company offered all employees the services of an

investment consultant. Most agreed to meet the consultant and get his advice, but only 28% of these were willing to accept his advice on how much they should contribute. The others were offered a SMT plan under which they agreed to increase their contributions by 3% each year beginning with the next pay rise (pay rises only averaged just over 3%).

Over half the employees joined the SMT plan, and 80% of these stayed with the plan over three pay rises. The effect was to increase saving for these employees from 3.5% to 11.6%. Interestingly, for those employees who accepted the consultant's recommendations, savings rates increased from 4.4% to only 8.7% over the same period.

#### Why does SMT work?

The creators of SMT attribute its success to the power of inertia. Most people are willing to save, but often require a helping hand to put this desire into practice. Once people enrol into the plan, few will get around to opting out. The plan takes the same behavioural tendency that induces people to under-save in the first place, and puts it to use.

#### SMT in the UK

Encouraging results from the US have prompted the DWP to investigate the effectiveness of SMT. The DWP is therefore piloting two case studies with employers to see if this initiative could work in the UK under the name 'Pension Increase Pledge'.

In one such study, over 2,000 employees were asked to sign a pledge to start contributing to the company pension scheme from July 2006. It was aimed at both those contributing nothing and those contributing very little. Contributions (matched by the employer) start at 1% and increase by 1% a year, up to 5%. Results will be published in 2011, although it is to be hoped that the DWP acts before then.

If successful, the DWP will consider how to promote it more widely. Of course, such schemes do depend on employees receiving pay increases that they can sacrifice. They may also place demands on the employer's payroll system, and may not be appropriate where there is high staff turnover.

#### Smart schemes

Rather than encourage employees to make extra savings, the Smart Pensions Scheme is purely a device to save on employer and employee NICs where the employer already operates a pension scheme. A summary of how it works is on the HMRC site

(<http://www.hmrc.gov.uk/manuals/nimmanual/NIM02331.htm>)

In brief, the Smart Pensions Scheme operates in the following way:

- The employee gives up an amount of cash salary equivalent to the contributions they are making to the company's registered pension scheme.
- The employer agrees to increase employer contributions to the pension scheme by an equivalent amount.
- Employees are notified that the new arrangements will apply automatically from a particular date unless they opt out in advance.
- If they do not opt out at the start, employees cannot opt out again until the first anniversary of the commencement of the scheme, unless they experience a "lifestyle change" (marriage, birth of a child, separation or divorce, death of a partner or child, change from full-time work to part-time).
- The employee's previous gross salary ("base salary") remains the yardstick for other issues (e.g. the calculation of overtime pay, annual salary increases or salary-related benefits).

If the Smart Pensions Scheme is effective, salary on which NICs are calculated will reduce and NICs will therefore reduce for both the employer and the employee.

According to HMRC, employees do not have to consent specifically before being included in the scheme. As long as the terms are made known to all employees before the scheme is introduced, employees are deemed to have accepted the variation to their contract of employment by not opting-out. This is negative affirmation. It is not clear whether this interpretation refers only to occupational pension schemes using the Smart scheme device.

If HMRC are also referring to using Smart schemes with a GPP/Stakeholder, then the DWP guide to automatic enrolment suggests that there are issues with negative affirmation. Under contract law, there can be a valid pension contract between the employee and the provider without the employee giving written consent to enter into the contract, but only if the employee has authorised the employer to act as their agent to enrol them.

There may also be issues with employment law (no deductions can be made from an employee's pay without their written agreement), and the Data Protection Act (an employer should obtain consent before sharing details of employees with a pension provider). For more information, see [Pension Pointers Issue 3](#).

Faced with HMRC's apparent enthusiasm for Smart schemes, a number of employers have adopted it, including BT, Tesco and Sainsbury's.

## Conclusions

The SMT plan makes use of behavioural economics to tackle the problem of undersaving, and from studies conducted thus far, seems to be effective. It will be interesting to see the results of the DWP's research, to discover whether such practices work as well in the UK.

As with all new plans such as this, caution must be taken. Even where positive results were found for SMT, this success was over a relatively short period of time, and longevity of saving is of course key to pension provision. The impact of SMT may also vary for employers of different sizes or type.

So far as Smart schemes are concerned, these do not increase pension saving, and it is surprising that HMRC appears to be positively encouraging employers to use them to save on their NICs payments.

## Friends Provident's Stance

We have recently launched an initiative 'Helping employees plan for tomorrow'. This is based on SMT and asks employees to commit to future payment increases, to coincide with annual pay increases. For more information, see our [sales leaflet](#).

**This summary is based on our understanding of the rules and regulations in place at the time it was written and should not be treated or relied upon as a statement of law. Proper legal or tax advice should be sought on any particular aspect.**

