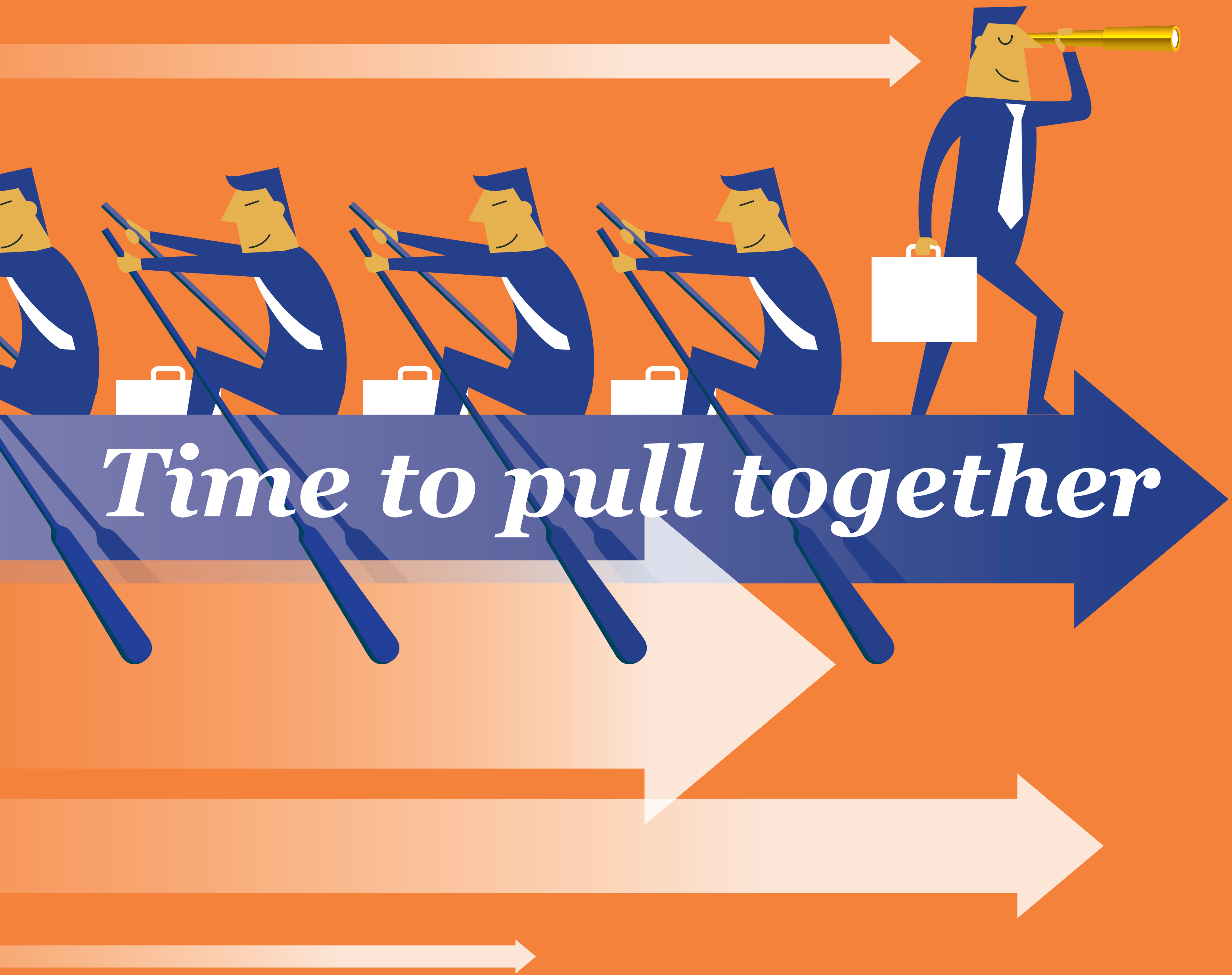
Final Report of the ACA 2015/16
Pension trends survey



Time to pull together

Survey finds little enthusiasm for pension tax reforms.

More joined-up thinking needed to boost pension contributions as next wave of defined benefit scheme closures approaches.

Survey conducted by the Association of Consulting Actuaries

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Chairman's Introduction

Final Report of ACA 2015/16 Pensions trends survey

"We must have the ambition to convince employers and employees alike to save more to improve retirement incomes."

In this Final Report of our 2015 /16 Pension trends survey we focus on employers' views on the further reform of pension taxation and how this might impact on pension coverage. We also explore how employers appear to be reacting to the end of defined benefit contracting-out from April of this year. Our findings suggest that this will trigger a further wave of defined benefit closures to future accrual, exacerbating the worrying drift downwards in median pension contributions reported in our initial survey report, published in October 2015.

We have been very supportive of the Government's 'freedom and choice' reforms, but we do feel that to the Government should ensure that any further reforms to pension taxation are workable and that they work supportively alongside the auto-enrolment policy, which itself needs to be carefully monitored as it impacts on small firms. In that regard, employee opt-out rates have been lower than many expected and as a result the number of UK employees in workplace pensions – so long in reverse – has recovered to the levels of coverage we had in the 1960s, but generally at very low levels of contributions.

Need joined-up strategy

Other findings we report on here show strong support for merging smaller DC arrangements into larger schemes, support for encouraging large collective schemes and a huge majority – 85% – supporting the establishment of an Independent Pensions Commission to advise on policy going forwards.

As we noted in our initial report, in assessing the challenges ahead, we believe the Government needs to have a joined-up strategy ready to address the potential danger of rising opt-outs as employers – particularly small and micro-employers – and their employees react to the increase in minimum contributions in now April 2018 and 2019. For the majority of employers this is still shortly after their staging date for auto-enrolment and lands in the middle of sizeable projected increases in the 'living wage'. And, importantly, as this report points out, there needs to be a great deal of care taken before further pension tax changes are made – any reform must genuinely simplify the regime for both employers and employees and, above all, must genuinely incentivise pension saving as opposed to simply raising tax revenues.

"Pull together to boost retirement incomes."

Whilst much of the recent debate about pensions has dwelt on legitimate desires to drive down charges and to free-up pension monies by way of the popular 'freedom and choice' reforms, our survey points to the greater need that looks to a gradual, but essential increase in minimum pension contributions. This is needed to ensure that many more retirees save sufficient amounts for both a comfortable retirement income and one where they have real choices to spend some of their accumulated savings as they approach or reach retirement. We must have the ambition to 'pull together' to convince employers and employees alike to save more to improve retirement incomes, particularly for those in receipt of lower workplace incomes, with the Government reviewing in a joined-up way its pension strategy, spending plans, tax policies and incentives to help make this happen.

I would like to thank all those employers who responded to the survey questionnaire for the time this involved.

David Fairs
Chairman
Association of Consulting Actuaries

Survey covers 477 employers sponsoring 620 pension schemes.

Final Report findings

The survey was conducted by the Association of Consulting Actuaries (ACA) in the summer of 2015 for online completion and was circulated to UK employers of all sizes, selected on a random basis. Responses were received from 477 employers sponsoring over 620 pension schemes. This final survey report considers employers' views on further pension tax reforms and the implications of the ending of defined benefit contracting-out. The initial survey report published in October 2015 examined general workplace pension trends focusing particularly on changes driven by auto-enrolment.

Key Final Report findings: *Time to pull together*

81% of employers are concerned at the level of pension spending they are incurring with 43% looking to target 6% or less of payroll on pensions.

31% of employers say the reduction in tax relief and complexities of the regime have caused employees on higher incomes to leave their schemes(s).

13% of employers say that if pensions were taxed like ISAs, with a top-up from Government during accumulation, that this would boost pension saving.

20% of employers running defined benefit schemes at present open to future accrual say they will close their scheme following contracting-out ending in April 2016.

82% of employers expect that by 2020 – just 4 years away – the typical retirement age of employees to be age 66-67. By 2028, over a third expect the typical age to rise to age 68-69.

85% of employers say the Government should set up an Independent Pensions Commission to make periodic recommendations on pension policies to ensure these are cost effective and sustainable for employers, members and Government.

Other findings

78% of employers would support the Government considering legislation that would make it simpler to automatically convert accrued pension benefits so they can be rationalised and crystallised into a consolidated 'new' scheme benefit at 'fair value'.

70% of employers either support or see value in the Government encouraging employers with small defined contribution arrangements to merge into larger multi-employer schemes.

69% say the Government should facilitate and encourage the development of large collective schemes where investment, inflation and longevity risks might be shared between members and employers.

49% of employers, if given the option, would consider in the next five years providing a pension scheme that capped costs but offered greater certainty of pension income for employees than most current defined contribution schemes.

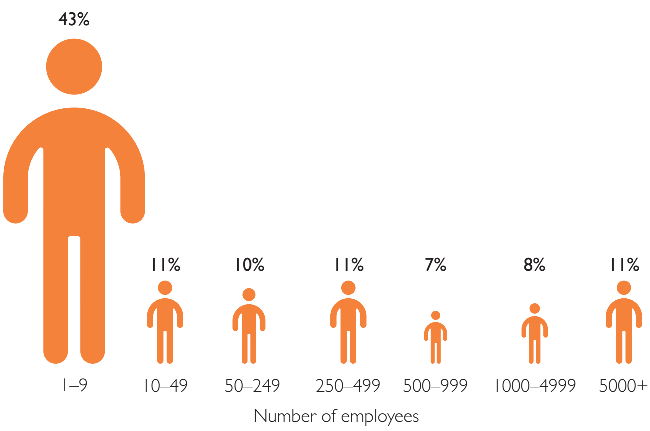
Section 1
Survey respondents and workplace pension provision

Our 2015/16 survey report, following a questionnaire broadcast in the summer of 2015, received responses from 477 employers sponsoring over 620 pension schemes covering every size of business.

Two-thirds of the responses came from smaller firms employing fewer than 250 employees, with a tenth replying from organisations with 5,000 employees or more (see *Figure 1*). The sample does not represent a 'mirror image' of UK employers broken down by size. If it did, over 95% of the sample (rather than 54%) would be drawn from firms with fewer than 50 employees[1], but it provides a good indication of trends across all types of enterprises with a higher proportion of smaller employers responding than in previous biennial surveys dating back to 1997.

With 29% of respondents indicating they do not run a pension scheme, the sample also over-represents the proportion of firms presently offering pension arrangements. At present, some 30% of the UK's employers provide workplace pension schemes with around a further 7% making contributions into employees' personal pensions[2]. However, this is a picture that will change markedly over the next three years as the Government's pension auto-enrolment policy[3] impacts on over 1.8 million small and micro-employers.

Figure 1: Organisations responding to the survey



(Source: ACA 2015/16 Pension trends survey, Table 1, page 16)

Of the employers responding to the survey as at 31 July 2015 **46% had already reached their staging date for enrolling employees into a qualifying auto-enrolment scheme, with the balance set to reach their staging date within a matter of months or not scheduled to stage until well into 2017/18** (see *Table 2*, page 16).

The principal types of open pension schemes run by the employers responding to the survey are defined contribution in structure with over eight out of ten of those employers that have staged for auto-enrolment offering NEST or another multi-employer scheme as their auto-enrolment scheme.

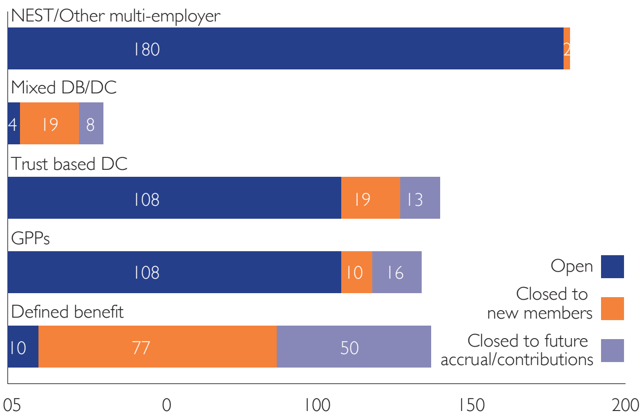
It is clear that very many of those employers who have passed their staging date for auto-enrolling employees into a qualifying scheme have turned to NEST or another of the multi-employer scheme providers to establish their first pension arrangement or to enrol previous non joiners of established schemes and new entrants (see Figure 2 and Table 3, page 16). It also seems likely that a number of employers have taken the opportunity to close established trust-based and GPPs in favour of (probably) lower-cost multi-employer schemes. The survey found **around a fifth of trust-based DC schemes and GPPs were now reported closed** to either new entrants and/or further contributions. However, this year the survey did not test the extent of any levelling-down of pension provision for existing employees.

Over a quarter of employers responding to the survey still sponsor a defined benefit scheme, but only 7% of these are open to new and existing employees, with the balance either closed to new members (56%) or closed to future accrual (37%).

Of the employers that have not reached their staging date for auto-enrolment (54% of the sample), coincidentally 54% of these (29% of all employers responding) operate no pension arrangements at all as at 31 July 2015.

Of those that have not staged but do run a scheme – all employers with fewer than 49 employees – six out of ten of these provide access to a GPP arrangement and around one-fifth provide a trust-based DC scheme. A smattering also say that they offer NEST or a multi-employer scheme. Given the mounting pressures on providers and the dangers of providers' capacity falling short of demands upon them, particularly in 2016/18, it would seem wise for more small and micro employers to act sooner rather than later in establishing pension arrangements that meet the minimum auto-enrolment standards.

Figure 2: Number, types and status of pension schemes provided by employers responding to survey



(Source: ACA 2015/16 Pension trends survey, Table 3, page 16)

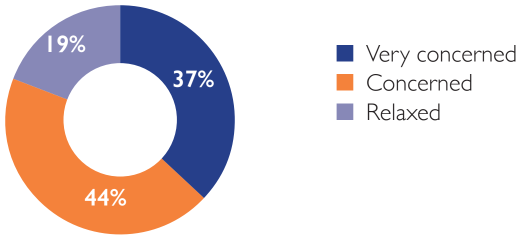
All footnotes in this Report are featured on page 15.

Section 2
Little enthusiasm for pension tax reforms and extra cash for pensions

The survey found across employers of all sizes, but particularly amongst smaller firms, a high degree of concern over the cost and prospective cost of pensions. This was also apparent where employers still sponsor open defined benefit schemes – where employer contributions often exceed 15% of earnings – and across a swathe of smaller employers, where current contributions into money purchase type schemes are often around 3% of earnings or less (see the summary of our earlier report, pages 10-12, which reports on pension contribution trends). Our survey found

81% **of employers are concerned at the level of pension spending they are incurring, with 37% saying they are 'very concerned'**

Figure 3: Employers' concern at board level over spend on pensions

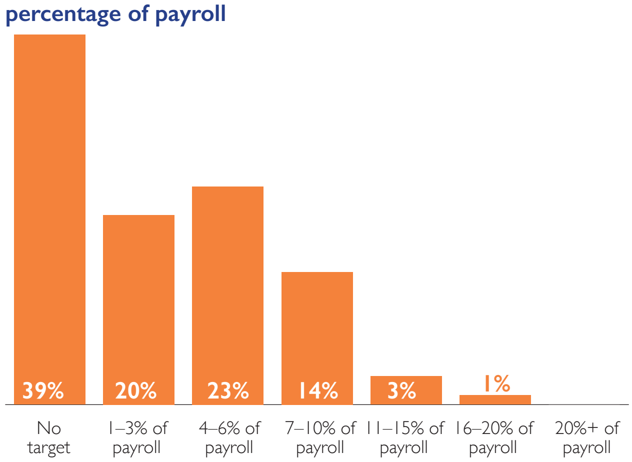


(Source: ACA 2015/16 Pension trends survey, Table 4, page 16)

Many employers say they do not have a target for spending on pensions, particularly smaller employers many of which have yet to auto-enrol employees into pensions for the first time. Of the remainder,

43% **(i.e. 70% of those with a target) are looking to a target of 6% or less of payroll to be spent on pensions**

Figure 4: Employers' target for spending on pensions as a percentage of payroll



(Source: ACA 2015/16 Pension trends survey, Table 5, page 17)

Significantly, given the employers' median cost of defined benefit schemes was reported to the survey at between 16-20%, it is noteworthy that just 1% of employers (and 8% of the largest employers in the sample) are looking to their pension costs in the longer-term exceeding 16% of payroll.

Whilst our first report noted that four out of ten employers were prepared to see the auto-enrolment minimum contributions rise to 4% from employers from 2020, it is clear there is very little enthusiasm from employers to pay contribution rates that historically have delivered the levels of pension presently enjoyed by many private and public sector retirees.

Pension tax reform: are we heading for more complexity?

Shortly before our survey questionnaire was published, the Chancellor announced in his Summer Budget the implementation of the Conservatives' manifesto commitment to reduce relief for those on higher incomes (yet again) and a review of the pension tax regime[4]. Whilst professing no particular preference for the future, the Chancellor mentioned in his statement how an ISA-type pension tax regime might work.

The review initiative was one we at the ACA had called for in March 2015[5] ahead of the General Election on the basis that in our view the present regime had been so corrupted by endless complex changes designed to reduce the relief given that a fundamental review was needed, ideally attracting cross-party support.

In our March paper, we noted:

"Constant chipping away of tax relief undermines faith in the system and erodes the belief that saving for old age is appropriate. It is inconsistent with the Pension Schemes Act which is intended to be the foundation structure for future pension savings.

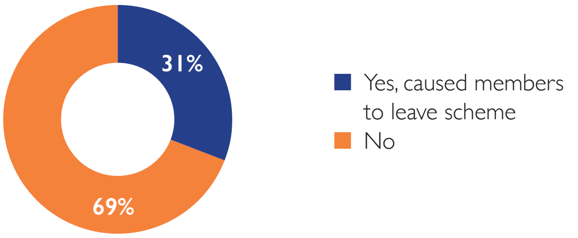
Furthermore, the ACA has been concerned for some time about the complexity of the current system and believes that very few people, even those working in the pensions industry, fully understand the many nuances of the pension tax system.

This complexity results in individuals being put off saving for retirement, employers are deterred from establishing and maintaining pension schemes beyond the minimum enforced by auto-enrolment; and, for individuals who do save diligently (and for employers supporting this), the costs of ensuring compliance with current tax law means ultimately that there is less money available for retirement savings."

Echoing these concerns, our survey found that

31% **of employers say the reduction in tax relief and increasing complexities of the regime have caused employees on higher incomes to leave their schemes(s).**

Figure 5: Has the reduction in pension tax relief and/or the complexities of the regime for those on higher incomes in recent years caused members on these higher incomes to leave pension scheme(s)?



(Source: ACA 2015/16 Pension trends survey, Table 6, page 17)

Across larger employers, over half have experienced employees leaving their scheme(s) on this basis (see *Figure 5* and *Table 6*, page 17). This finding is a reflection of the persistent meddling with reliefs that should offer a long-term basis upon which employers and individuals set aside monies for later life.

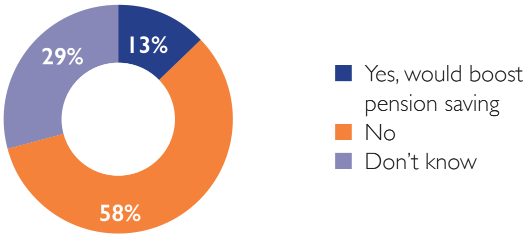
The great attraction for the Government in moving to an ISA-type pension tax regime is that it offers – in theory – a very significant increase in the up-front tax take offering the potential of reducing the budget deficit 'at a stroke' at a time when the Government may be having some difficulty achieving its targets.

However, it is unclear what the impact would be on pension savings given the Chancellor has said that any change should boost savings. There are huge difficulties in making such a change for those in the private sector and, more particularly, for far more employees in the public sector who enjoy defined benefit pension arrangements. One compromise, a separate tax regime for defined benefit schemes would be difficult to operate given that many current retirees are likely to have both defined benefit and defined contribution arrangements and indeed some are members of hybrid arrangements. With defined contribution being most prevalent in the private sector and defined benefit in the public sector a different tax regime for defined contribution and defined benefit may be politically hard to justify. And, of course, many also wonder whether a regime that offers tax-relieved pension saving is at all sustainable, depriving as it would future Chancellors of tax revenues from an ever growing proportion of the population.

Our survey found that just

13% **of employers say that if pensions were taxed like ISAs, with a top-up from Government during accumulation, that this would boost pension saving.**

Figure 6: One possibility for the future is that pensions could be taxed like ISAs – you pay in from taxed income and the pension is tax free when you take it out. And in between the pension receives a top-up from Government. Do employers feel such an approach would boost pension saving?



(Source: ACA 2015/16 Pension trends survey, Table 7, page 17)

As some change seems likely to be announced in the Spring 2016 Budget, we hope the Chancellor and his advisers will follow the 'guiding principles' we outlined in our March 2015 paper[6]:

- ✔ **the new regime should incentivise individuals explicitly to save for retirement while they are working and encourage employers to make suitable arrangements;**
- ✔ **the new regime should replace the current regime and not require, for example, creation of two separate regimes to run in parallel dealing with past and future savings;**
- ✔ **the new regime should, ideally, be simpler to understand and operate than the existing regime; where it cannot be simpler it should at least be fairer and intuitive, with anomalies and perverse outcomes eliminated;**
- ✔ **the new regime should be capable of targeting tax relief in line with the Government's intentions; and**
- ✔ **opportunities to manipulate the system should be minimised.**

The survey findings when combined with employers' clear concerns over the rising cost of pensions and – more recently – further new additional costs falling on many employers in terms of the living wage and apprentice levy make it essential that the Government does not hit employers with further disincentives to provide pension arrangements above the statutory minimum.

In particular, a reduction in or abandonment of relief from national insurance contributions made in respect of employer pension contributions would in our view be a disastrous move unless replaced by an equal employer incentive as it would seriously undermine employer commitment towards offering pensions above minimum standards and thereby the income security of millions of people into the future.

Section 3
Further defined benefit closures signposted

Much of the debate in recent months has focused on the new State Pension being introduced in April 2016 and, more particularly, 'who loses out'. Whilst for those reaching State Pension age after April, the new State Pension may offer some greater income than for those retired ahead of that date, the impact of the end of defined benefit contracting-out has only attracted peripheral attention. However, in simple terms the change means that both employers and employees will see their national insurance costs increase as they lose their current rebates and start paying the standard rate (Class 1) NI contributions. In money terms, this means an employee on £30,000pa will see their NI contributions increase by £338 with the employer paying £822 more in NI. An employer with over 1,000 employees could well see their NI costs rise by over £1 million next year.

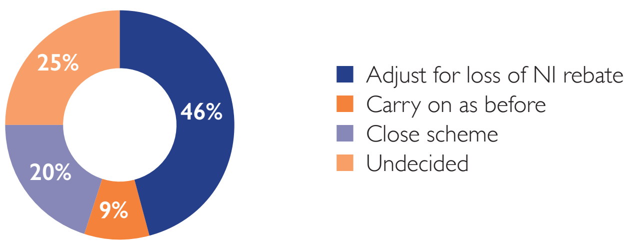
Whilst the Government has passed legislation allowing private sector employers[7] (via a statutory override) to make adjustments to their defined benefit schemes to mitigate the increase in NI costs, our survey found a surprising number of employers (25%) were still undecided on what to do, with only 30% certain to use the statutory override. Whilst there will have been some movement in these figures towards the year end, ACA members report that many employers with defined benefit schemes open to future accrual have not yet acted. One reason given by many is that with an announcement on pension tax reform expected in the Spring Budget it is impossible to make a sensible decision on the future of their defined benefit scheme(s) without first considering these tax implications.

Our survey found that whilst close to a half of employers with schemes open to future accrual were likely to make adjustments to mitigate the extra NI costs,

20% **of employers running defined benefit schemes at present open to future accrual say they will close their scheme following contracting-out ending in April 2016.**

This would suggest that the slowing in closures recently reported by the Pensions Regulator[8] may be short-lived. Reform of the tax regime in the Spring budget might also mean the closures would rise above this figure.

Figure 7: In April 2016 the ability to contract-out of the State second pension scheme will end for DB schemes and their members. How do employers expect to respond if their scheme is presently open to future accrual?



(Source: ACA 2015/16 Pension trends survey, Table 8, page 17)

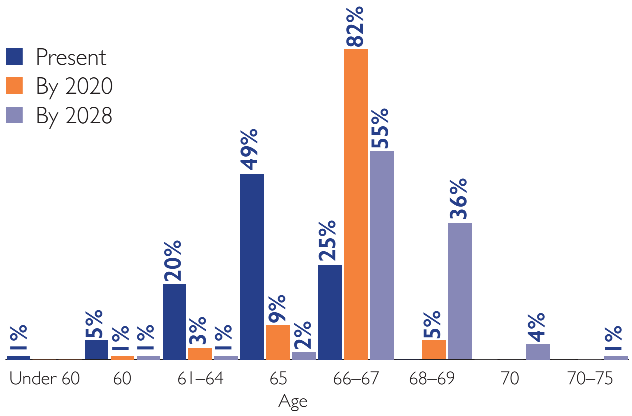
Greying working population

Much has also been written in recent times about older employees working beyond the present State Pension age. Whilst it is clear more are staying on and that an increasing number of those approaching retirement are looking to stay on either full or part-time by inclination or to boost incomes that may be falling below expectations, it still remains the case that only just over 60% of UK workers in the 55-64 year old category are still working[9].

However, our survey found that **by 2020 – just 4 years away –**

82% **of employers expect the typical retirement age of employees to be age 66-67. And by 2028, over a third expect the typical age to rise to age 68-69.**

Figure 8: Typical current retirement ages and how employers expect this to change by 2020 (when SPA reaches age 66) and by 2028 (when SPA reaches age 67)



(Source: ACA 2015/16 Pension trends survey, Table 9, page 18)

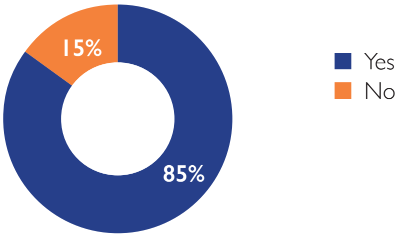
Big 'yes' to Independent Pensions Commission

The ACA alongside many other bodies has called on this and previous Governments to establish an Independent Pensions Commission to make periodic recommendations on the future path of pension policies, ideally seeking cross-party support for those recommendations. It is notable that the work of the Pensions Commission under Lord Turner has largely stood the test of time and its outcome has been supported by successive Labour, Coalition and Conservative governments. This is surely a powerful indication that it is possible to achieve reform in the pension arena by means of a consensus approach, rather than policies being substantially reversed as the political tide drifts this way and that.

Our survey found that

85% **of employers say the Government should set up an Independent Pensions Commission to make periodic recommendations on pension policies to ensure these are cost effective and sustainable for employers, members and Government.**

Figure 9: Should the Government set up an Independent Pensions Commission with a remit to make periodic recommendations on pension policies to ensure these are cost effective and sustainable for employers, members and Government?



(Source: ACA 2015/16 Pension trends survey, Table 10, page 18)

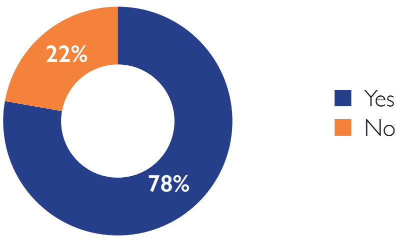
Other survey findings

The survey also tested employers' views in a number of other areas of possible reform.

Reflecting calls made by employers during the various consultations on the establishment of a new 'Defined Ambition' pension regime, there remains a strong desire that employers have a greater ability to rationalise legacy pension arrangements built up over many years.

78% **of employers would support the Government considering legislation that would make it simpler to automatically convert accrued pension benefits so they can be rationalised and crystallised into a consolidated 'new' scheme benefit at 'fair value'**

Figure 10: Would you support the government considering legislation that made it simpler to automatically convert accrued pension benefits so they can be rationalised and crystallised into a consolidated 'new' scheme benefit at 'fair value'?

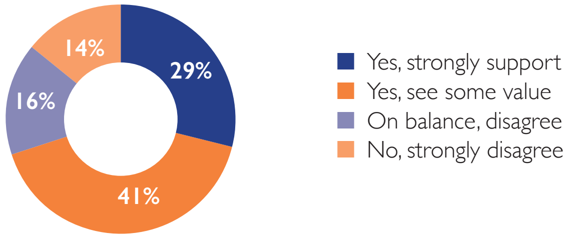


(Source: ACA 2015/16 Pension trends survey, Table 11, page 18)

Echoing views made periodically by both the Government and the Pensions Regulator in respect of both governance and ongoing charges,

70% **of employers either support or see value in the Government encouraging employers with small defined contribution arrangements to merge into larger multi-employer schemes.**

Figure 11: Should the Government encourage businesses with small DC arrangements to merge these schemes into larger multi-employer arrangements?



(Source: ACA 2015/16 Pension trends survey, Table 12, page 18)

The survey found a similar number,

69% **say the Government should facilitate and encourage the development of large collective schemes where investment, inflation and longevity risks might be shared between members and employers.**

It is noteworthy that the legislation to enable such schemes to be more easily established has been passed, but the Pensions Minister has announced a delay in the regulations needed to support this legislation until later in the Parliament, once the new State Pension and auto-enrolment stages and phases have been completed. This delay is unfortunate as it removes the option for employers to set up such arrangements during the auto-enrolment of millions of employees new to pensions and for employers considering pension changes ahead of re-enrolling those who opted-out first time round. The delay in the 'Defined Ambition' regulations also means new options for employers and their employees in provision will stall.

Our survey found, given the option,

49% **of employers would consider in the next five years providing a pension scheme that capped costs but offered greater certainty of pension income for employees than most current defined contribution schemes.**

Finally, the survey found that

19% **of employers say the Government should establish a 'star rating' system for pension schemes covering, for instance, charges, governance and transparency.**

A further 36% supported such a move if it is established on a voluntary basis only.

Section 4: Summary of First Report

The changing pensions scene and contribution rates

The first report of this survey, *Time to get real*, published in October 2015, focused on the findings in respect of the national policy of auto-enrolling employees in stages into workplace pensions and trends in pension contributions. The full report is available free of charge at www.aca.org.uk (see 'publications' or 'research' pages).

A summary of some of the key findings in that report can be found below and over the next few pages.

Key findings of First Report: Time to get real

- **For smaller employers, the forecast employee opt-out rate by smaller employers from workplace pensions is down on the figure reported two years ago, but the median band of eligible employees is in the range between**

16%–20%

- **Whilst the majority of survey respondents wanted both the minimum auto-enrolment employer and employee contributions to stay at the 2018 levels (respectively 3% and 4% of qualifying earnings), over four out of ten were prepared to see minimum contributions rise in 2020 to 4% from employers and 5% from employees, or higher.**

- **Whilst our 2013 survey found a higher level of interest in auto-escalation, this year's survey still found slightly over a quarter of employers prepared to support the idea whereby employees are encouraged to auto-escalate pension contributions at a future date when wages/salaries increase.**

- **Of those employers (46%) that have reached their staging date for auto-enrolling employees into a qualifying scheme, a fifth have enrolled all their employees into an existing or new employer's scheme. One third have enrolled all their employees into NEST or one of the other multi-employer schemes, whilst close to four out of ten have restricted entry into an existing scheme and have auto-enrolled previous non joiners and new entrants into NEST or a multi-employer alternative.**

- **Of those smaller employers who have not as yet reached their staging date, a third have not made a decision on what they will do. Of those that have, close to a quarter will enrol all employers into NEST or another multi-employer scheme, with three out of ten enrolling previous non joiners and new entrants into NEST or another multi-employer arrangement. Just one in ten will enrol all employees into an existing scheme.**

Presently, the auto-enrolment policy in terms of employers that have staged is still at an early stage of implementation. Auto-enrolment of eligible jobholders[10] into schemes has been required of around 73,000 employers as at the end of November 2015, with 5.6 million workers auto-enrolled since October 2012[11]. Because those who have auto-enrolled to date are the UK's larger firms, the number of active members of schemes has increased to around 70%[12] of all employees compared to 42% in 2012.

Huge task ahead

Over the next three years it would seem around a further 1.8 million employers will be required to auto-enrol eligible jobholders. This is a huge increase in employers subject to auto-enrolment duties compared with those to date, with the number of employers being required to auto-enrol increasing to between 100,000 and 350,000 per quarter. We have questioned in previous survey reports and in our evidence to the auto-enrolment review in 2010 whether it would not be wise to have a pause in staging ahead of micro employers[13] being subject to auto-enrolment duties whilst providers, advisers and the Pensions Regulator take a breather. What occurs over the next few months – given the sizeable increase in quarterly staging of employers henceforth – may clarify whether this is essential, advisable or not needed!

Our survey found that the scale of change in workplace pension arrangements as a result of auto-enrolment has been and will continue to be significant. It is concerning how many small employers have yet to make a decision on their pension choices. Inevitably, this will mean a torrent of employers will be approaching NEST and other multi-employer scheme providers from now onwards, with this peaking from late 2016 through to 2018. NEST has acknowledged that there is a risk of failing to keep pace with demand[14] and this is all the more likely as other providers without a statutory requirement to make available a scheme step back on grounds of both cost and their ability to service more employers as demand peaks.

Capacity challenge

The scale of the benefit design changes over the next few years will present both employers and the pensions industry with major challenges and opportunities. This will come on top of the even larger job of coping with the majority of firms which at present offer no pension scheme at all. There are suggestions that the capacity of the industry to handle the number of firms staging is limited, albeit that innovative initiatives have been and are being developed by The Pensions Regulator, providers and advisers.

Budgeting for auto-enrolment and employee opt-out rates

Amongst those that have not reached their staging date for auto-enrolment we found only just over

36% **of small and micro-employers are budgeting for the likely increase in costs arising from auto-enrolment.**

Given the generally low level of pension provision and participation in pension arrangements at smaller employers, this is troubling, although it is between one to three years before the compulsory requirement to auto-enrol applies to the one million plus micro-employers.

It means many more employers over the next three years will wake up to the potential costs involved and may feel they need to take mitigating actions. This may be challenging as micro-employers and their employees will be expected to move up to the full 8% contribution on band earnings over a much shorter time-scale than larger employers. With moves over this period to also boost the minimum living wage (from effectively £6.50 per hour to £9 by 2020), the combined impact of both policies on small and micro-employers could be challenging, at best.

> *"Across those organisations that have budgeted for extra costs, the estimated member opt-out rate by smaller employers from workplace pensions is down on the figure reported two years ago, but still falls in the range between 16% and 20% of eligible employees."*

Indeed, close to half of the small employers who have not staged expect opt-outs to exceed 26%. **This is much higher than large and mid-sized employers who have auto-enrolled, where median opt-out rates are reported in the 8-9% band** (see *Figures 12* and *13* below and *First Report, Table 7*, page 20).

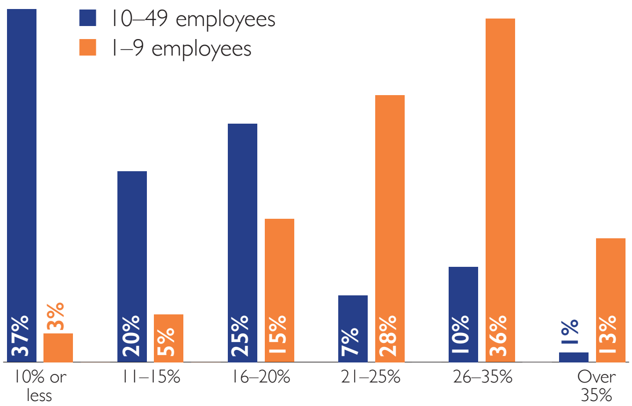
Whilst it is to be hoped that opt-out rates do keep to the low levels reported to date so that pension provision is extended to some nine million[15] employees, there has to be some expectation that rates may be higher amongst employers with much more limited resources to communicate the project effectively. Another factor that may in a sense disguise the number of employees who are not auto-enrolled is the high number of employees who do not meet the eligibility criteria. Amongst larger employers this already totals over 5.6 million employees[16] and it may be the sizeable increase in part-time and self-employed working[17] will mean the number of those ineligible for auto-enrolment climbs higher than originally expected. And, in simple mathematical terms, each employee opting out in a small firm can equate to a high percentage (one employee opting out at a four person micro-employer equates to a 25% opt out).

Figure 12: Median employee opt-out rates reported by employers that have already auto-enrolled and the rates forecast by employers yet to reach their staging date

Employers status	Actual	Forecast	
Already staged	8–9%		
Not staged (10–49 employees)		11–15%	
Not staged (1–9 employees)			21–25%
All not staged		16–20%	

(Source: ACA 2015 Pension trends survey, First Report, Table 7, page 20)

Figure 13: Range of employee opt-out rates forecast by employers yet to reach auto-enrolment staging date



(Source: ACA 2015 Pension trends survey, First Report)

Contribution rates

Median employer contributions into GPPs and defined contribution pension schemes across our sample are respectively in the 4% and 5% band of earnings (see *Figure 14* below and *First Report, Table 8*, page 21). **Median employee contributions into GPPs and defined contribution schemes are respectively 3% and 4% of earnings[18].**

Contributions into NEST and other multi-employer arrangements are reported at a much lower level, with many employers and employees contributing at the minimum initial auto-enrolment level, which is below 1% of total earnings .

Combined employer and employee contributions into defined benefit arrangements at between 22–26% of earnings are running at many times more than those going into defined contribution and particularly NEST and many other multi-employer arrangements . Higher defined benefit contributions reflect the cost of delivering salary related pensions in the years ahead as longevity extends and in a low interest rate environment.

Figure 14: Median contribution rates into pension arrangements provided by responding employers (figures in brackets are 2013 mean figures from ACA 2013 Pension trends survey report)

	Employer		Employee
Group Personal Pension	4% (5.8%)		3% (4.2%)
Trust based DC	5% (6.9%)		4% (4.5%)
NEST	1% (NA)		1% (NA)
Other multi-employer schemes	3% (NA)		1% (NA)
Mixed DB/DC	11–15% (NA)		5% (NA)
Defined benefit	16–20% (21.9%)		6% (6.1%)

(Source: ACA 2015 Pension trends survey, First Report, Table 8, page 21 and ACA 2013 Pension trends survey, Second Report, page 25)

Auto-enrolment reverses DC contributions trend

Over the last decade there has been a gradual, if small, increase in median employer and employee contribution levels into defined contribution arrangements. However, it is clear from this year's research that this trend has reversed due to the much lower minimum contributions paid by both employers and employees for many on auto-enrolment. This is highlighted by comparing this year's findings with those reported in the *ACA 2013 Pension trends survey*[19] (see *Figure 14*, above).

We must expect over the next two to three years until phasing is completed in April 2019 that average and median contributions into all types of defined contribution schemes (including multi-employer schemes) will decline or remain very low as many more employees are auto-enrolled into pension schemes for the first time[20]. However, set against this, many more employees are now saving something into pensions, which they were not prior to 2012.

It would appear from the survey results, confirmed by later DWP[21] and ONS reports, that as more mid-sized and smaller employers have met their staging dates, they too have auto-enrolled at very modest contribution levels, which are below the median contribution rates our survey found from the minority of employers who already provided schemes ahead of auto-enrolment[22].

However, it has to be expected that modest progress in increasing contribution levels amongst hundreds of thousands of firms who presently offer no workplace scheme is unlikely ahead of 2019. There are existing ways that more employers could build on initiatives like the Pension Quality Mark[23] by fostering a trend towards higher member pension contributions or by adopting auto-escalation (see below) as a feature of their approach to pensions.

Will employers support higher minimum auto-enrolment contributions from 2020?

Our survey tested whether there was any appetite from employers to support increases in the minimum level of auto-enrolment contributions from, say, 2020. By then, unless there are any late changes, employers will be contributing 3% on qualifying earnings and employees 4% (with tax relief adding a further 1%). The Government has said that it will review how auto-enrolment has worked in 2017, and – given that it is generally recognised that for many the 8% minimum contribution on qualifying earnings is not adequate to fund a comfortable retirement when combined with the State pension – it seems possible (although by no means certain) that there will be some consideration given to raising minimum contributions, possibly in phases, in the years ahead and/or broadening the band of qualifying earnings.

Whilst the majority of survey respondents wanted both the minimum employer and employee contributions to stay at the 2018 levels, namely respectively 3% and 4% of qualifying earnings,

46% **were prepared to see minimum contributions rise to 4% from employers and 5% from employees, or higher from 2020.**

(see *First Report, Table 9,* page 21). Of course, the unknown in all of this is the degree to which opt-outs may rise as minimum employee contributions climb in 2018 and 2019 and how this might then colour any further increases in minimum levels.

One in four support auto-escalation of employee contributions

One possible way of building up employee contributions into pensions is via 'auto-escalation'. Auto-escalation encourages people to commit to increasing their pension contributions at a future date, often in line with wage increases. The idea is one that the DWP has said is worthy of further examination[24] as, much like auto-enrolment, it plays on inertia. Once signed up, an individual no longer has to take active decisions to increase their contributions – that happens automatically. By synchronising the point of increase in contributions with an increase in wages, individuals not only defer to a later date the loss of immediate income that an increase in contributions represents, but also know that when it comes, it will be tempered by their overall income increase.

A clear economic pre-condition is, however, that earnings are generally increasing year by year. It may be that the UK economy is entering a phase where year on year wage increases will begin to re-emerge enabling auto-escalation to take hold, and in this event it is likely that larger employers will be the first to consider such an approach in the UK, but it seems likely that for the initiative to take-off there may be a need for the Government to incentivise employers to offer such an option.

One concern that many employers may have is that if the Government backs auto-escalation, will they also attach an obligation on employers to in some way match increases in employee contributions?

Section 5:
The 'Next Steps' in the reform strategy

Growing workplace pension contributions

Whilst auto-enrolment is extending workplace pension coverage to millions more employees, it is vitally important that the schemes which employees join are designed and developed to be fit for purpose. By this we mean that the pensions delivered are robust enough to provide millions more retirees with incomes that allow for a comfortable retirement, without dependency on State welfare benefits. Workplace schemes should also offer their members similar flexibilities so that 'freedom and choice' is not just confined to a minority approaching retirement.

This survey has underscored that whilst auto-enrolment is introducing many more employees to pension saving, supported by their employer contribution and tax relief, big hurdles lie ahead in terms of auto-enrolling employees in 1.8 million smaller firms at much the same time as minimum contributions climb quite sharply. And now, of course, many employers will be expected to boost their employees' earnings via phased increases in the minimum living wage, set to reach £9 an hour in 2020.

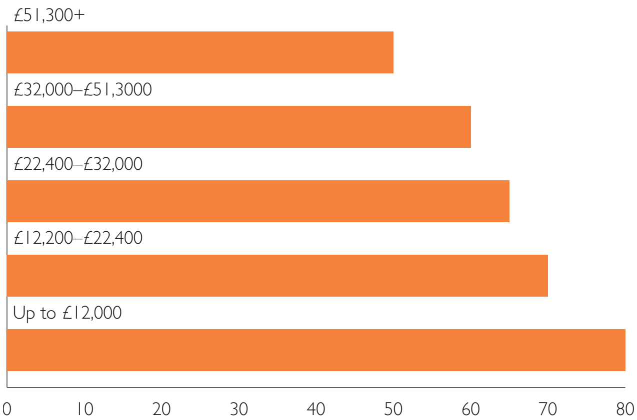
We believe that the oft-quoted 'success' of auto-enrolment has yet to be proven with so many new pension savers as identified by this and other report making minimal pension savings, especially as 'affordability' has been reported as the principal reason why individuals to date have opted-out[25]. What occurs in 2018 and 2019 when minimum contributions rise quite steeply will determine the true scale of the policy's success in extending pension coverage.

However, even if the high rates of participation are maintained, the eventual 2019 minimum 8% contribution, when phasing is completed, is unlikely to generate for very many the retirement income that will lead onto a comfortable retirement. **Assuming 40 years of contributions at 8%, with 3% real return on investment, a person on average earnings is likely to fall markedly short of the Pension Commission's targeted replacement income[26] of two-thirds of pre-retirement income.** Indeed, a contribution rate of between 14-16% would probably be needed to reach this benchmark. Variable earnings over a lifetime and shorter periods of savings make the argument for higher than 8% contributions all the more powerful, especially given the forward pressures in funding State pensions due to a rapidly ageing society.

A PPI study[27] has broadly confirmed these findings. Whilst a low-earner contributing 8% would have a 63% probability of achieving the Pension Commission's target replacement income (including the single tier State pension) on retirement, an average earner has a 49% probability and a high earner a 40% probability. However, these probabilities decline sharply with career breaks or if pension saving starts at a later age.

"A contribution rate of 14–16% is probably needed to reach targeted replacement income."

Figure 15: Pension Commission: target replacement ratios by income



(Source: Framework for the analysis of future pension incomes, DWP, September 2013))

We view it as vital that ahead of 2017 a 'next step' strategy is developed to secure the progress to date of auto-enrolment and – depending on the success of the UK economy – plans are made to boost minimum pension contributions from 2020 onwards.

We believe that the Government will have to be prepared to offer incentives to secure the ongoing success of the auto-enrolment programme and ahead of the 2017 review should consider the following next steps:

Minimum pension contributions: the future

- **Serve notice that in 2018 the Government will reduce the lower band on earnings eligible for auto-enrolment and lower the auto-enrolment earnings threshold to extend provision to more women and low earners.**
- **Serve notice that in 2018 the Government will allow employers to phase-in minimum employee contributions for new employees and those reaching age 22 so they are not encouraged to opt-out because of the higher initial minimum contribution rates.**
- **Serve notice that the Government will increase the minimum auto-enrolment contributions by 1% every two years after 2020 until they have reached a combined contribution of 16%. The Government's contributions will take account of the outcome of the current tax relief consultation.**
- **Serve notice that the Government will assist employers and employees over the period of these increases in pension contributions by way of planned reductions in NI and further increases in tax free allowances and the Employment Allowance.**
- **Serve notice that these increases in contributions and tax adjustments may be implemented subject to the performance of the economy, particularly in terms of earnings growth and growth in earnings net of tax.**

Other ‘next step’ policy recommendations

Establish a standing Independent Retirement Income Commission

charged with promoting the active extension and betterment of private retirement income provision and making recommendations on the future of State and public sector retirement provision.

The proposed Commission would make recommendations to Government and others – sponsors, providers and regulators – within 12 months of its establishment and periodically thereafter. The priority would be to encourage improving pension provision for all including higher levels of pension savings. The Commission could, for example, make recommendations on how auto-escalation in pension contributions might be encouraged or how a ‘pensions dashboard’ (a combined State and private pension statement) system might be implemented.

It might also review and make recommendations on tax incentives for long-term care products.

Amongst other responsibilities, the Commission would ensure the cost of public sector pensions is transparent, making recommendations to Government to ensure provision is sustainable and fair.

Additionally, the Commission should be charged with periodically reviewing the supervisory framework of the pensions sector with a remit to make recommendations to rationalise and simplify the structure over time.

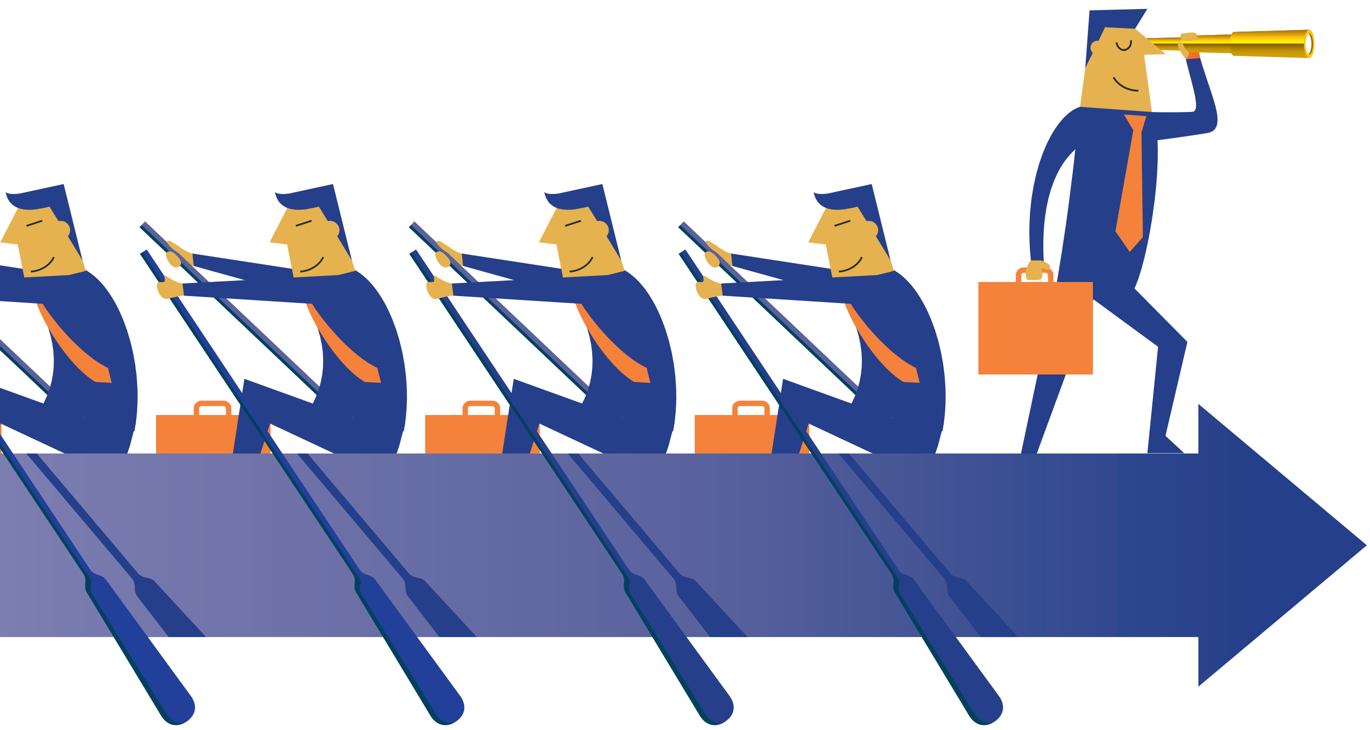
Employers to be given tax breaks to incentivise the provision of savings and retirement advice.

Building on *Pension Wise* guidance, we believe there is also a role for formal regulated financial advice to be provided via the workplace. We would urge the Government, funded through tax concessions granted to the employer, to consider encouraging formal regulated advice to be made available from age 50, and that a sum of about £500 should be made available. A second session, valued at around £800, should be provided at the point of retirement, with this funding coming through adjustments to the employer’s tax liability. The present allowance of £150 is completely inadequate.

Provide greater incentives for lifetime savings by allowing early access after 10 years of pension savings to a proportion of their fund currently available only from age 55

to help fund house deposits and/or to meet life’s crises. This to be implemented at such time that the Pension Wise service can be extended to provide guidance on such withdrawals.

As the age when individuals can draw their retirement benefit becomes later, it is likely that younger people will find it increasingly difficult to prioritise and fund long-term savings. This is why the incentives for long-term savings should be meaningful and why a more holistic approach to savings – allowing individuals early access, on a restricted basis, to a proportion of their fund – should be considered by the Government.



Footnotes

[1] **Source:** BIS Business Population Estimates 2015

[2] **Source:** DWP Research Report *Employers' Pension Provision Survey 2011* figures, updated to reflect auto-enrolment to date (estimate)

[3] The Government's auto-enrolment policy requires all firms with one or more employees to auto-enrol eligible jobholders into a workplace pension scheme with certain minimum standards on a staged basis by late 2018.

[4] *Strengthening the incentive to save: a consultation on pension tax relief*, Cm 9102, published by HM Treasury, 8 July 2015.

[5] *Creating a Sustainable Pensions Tax Framework*, published by the ACA, 4 March 2015, available at www.aca.org.uk (publications page).

[6] *Creating a Sustainable Pensions Tax Framework*, published by the ACA, 4 March 2015, available at www.aca.org.uk (publications page).

[7] Most public sector employers will have to meet the extra NI costs because of commitments given to public sector unions during pay negotiations.

[8] *The Purple Book: DB Pensions Universe Risk Profile 2015*, published by the Pensions Regulator and the Pension Protection Fund, 3 December 2015.

[9] OECD *Labour Market Statistics*, Q2 2015.

[10] Eligible jobholders are those aged 22 or over and below State Pension Age with earnings above £10,000 per annum.

[11] *Automatic Enrolment Declaration of compliance report*, July 2012 – end November 2015, published by The Pensions Regulator in December 2015.

[12] *Official Statistic on workplace pension participation and saving trends of eligible employees: 2004-2014*, published by DWP, July 2015, page 6.

[13] Micro-employers employ 1-4 people and make up two-thirds of those employers left to stage.

[14] *NEST Annual Report & Accounts*, page 33.

[15] DWP forecast, updated 21 September 2015.

[16] *Automatic Enrolment Declaration of compliance report,* July 2012 – end November 2015, published by The Pensions Regulator in December 2015.

[17] ONS January-March 2015 figures report 4.5 million self-employed workers, up 39% on 2000 figures. Of these around 17% are saving for retirement (*Hansard, 21 September 2015*, PQ answer by DWP Minister, Justin Tomlinson MP). More recently, the Prudential says just 9% of the self-employed are saving for a private pension.

[18] As presently the first £5,824 of eligible jobholders' earnings and that above £42,385 is not subject to the minimum 1% contribution.

[19] *ACA 2013 Pension trends survey final report*, published January 2014, see www.aca.org.uk (research page).

[20] At present a minimum of 2% of qualifying earnings (split evenly between the employer and employee) is required on earnings between £5,824 and £42,385 (2015/16 levels) for eligible employees aged at least 22 and under SPA, who earn at least £10,000 per annum. From now April 2018 employers will be required to contribute a minimum of 2% on qualifying earnings as part of a total minimum contribution of 5%. The minimum employer contribution will rise to 3% in April 2019 supplemented by the jobholder's own 4% contribution and 1% in tax relief.

[21] 'In the private sector, there has been a marked decline in the amount saved per eligible saver in 2014. This is likely to be a result of the increased number of savers in the private sector, many of whom will be making contributions at the minimum level'. Extract from *Official Statistic on workplace pension participation and savings trends of eligible employees: 2004-2014*, published by DWP in July 2015, page 20.

[22] See also Official Statistic on workplace pension participation and savings trends of eligible employees: 2004-2014, published by DWP in July 2015, which found median occupational defined contributions by employers have reduced from 8% in 2012 to 3% in 2014 and by employees from 4% to 1%.

[23] Schemes can be awarded the Pension Quality Mark (PQM) where total pension contributions equal at least 10% of employees' pensionable salary (with a minimum of 6% from the employer) or PQM PLUS where total contributions equal at least 15%, with minimum employer contributions of 10%.

[24] DWP paper, *Reinvigorating workplace pensions*, November 2012, Cmnd 8476, pages 19-20.

[25] *NEST insight 2015: taking the temperature of auto-enrolment, page 18.*

[26] *Figure 15, page 17.*

[27] *What level of pension contribution is needed to obtain an adequate income?* Published by the Pension Policy Institute, October 2013.

Statistical Appendix
ACA 2015/16 Pension trends survey results

The survey was conducted by the Association of Consulting Actuaries (ACA) in the summer of 2015 for online completion and was circulated to UK employers of all sizes, selected on a random basis. Responses were received from 477 employers with over 620 pension schemes. This final survey report considers employers' views on further pension tax reforms and the implications of the ending of defined benefit contracting-out. The initial survey report published in October 2015 examined general workplace pension trends focusing particularly on changes driven by auto-enrolment.

Table 1
Breakdown of employers responding to survey (by number of employees)

1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +
43%	11%	10%	10%	7%	8%	11%

Table 2
Breakdown of employers responding to survey (by percentage of employers that have staged or not staged for auto-enrolment)

	1-9 employees	10-49 employees	50 employees +	Total
Reached staging date	–	19%	100%	46%
Not reached staging date	100%	81%	–	54%
Percentage of employers with no scheme at present	59%	35%	–	29%

Table 3
Number, types and status of pension schemes provided by employers responding to the survey

	Open schemes	Closed to new members	Closed to future accrual/contributions
Group Personal Pension (GPP)	108 (81%)	10 (7%)	16 (12%)
Trust based defined contribution	108 (77%)	19 (14%)	13 (9%)
NEST	77 (100%)	–	–
Other multi-employer scheme	103 (98%)	1 (1%)	1 (1%)
Defined benefit	10 (7%)	77 (56%)	50 (37%)
Mixed Defined benefit/Defined contribution	4 (13%)	19 (61%)	8 (26%)

Table 4
Employers' concern at board level over spend on pensions

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Very concerned	44%	33%	32%	28%	32%	33%	31%	37%
Concerned	50%	50%	42%	42%	29%	42%	28%	44%
Relaxed	6%	17%	26%	30%	39%	25%	41%	19%

Table 5
Employers' target for spending on pensions as a percentage of payroll

Percentage of payroll	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
No target	64%	52%	30%	15%	10%	6%	–	39%
1-3%	16%	33%	36%	28%	16%	11%	10%	20%
4-6%	17%	7%	21%	43%	35%	25%	35%	23%
7-10%	2%	6%	9%	11%	32%	50%	39%	14%
11-15%	1%	2%	4%	3%	7%	5%	8%	3%
16-20%	–	–	–	–	–	3%	8%	1%

Table 6
Has the reduction in pension tax relief and/or the complexities of the regime for those on higher incomes in recent years caused members on these higher incomes to leave pension scheme(s)?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	6%	16%	13%	13%	55%	56%	78%	31%
No	94%	84%	87%	87%	45%	44%	22%	69%

Table 7
One possibility for the future is that pensions could be taxed like ISAs – you pay in from taxed income and the pension is tax free when you take it out. And in between the pension receives a top-up from Government. Do employers feel such an approach would boost pension saving?

Percentage of payroll	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	12%	21%	15%	13%	19%	11%	6%	13%
No	53%	35%	60%	66%	58%	72%	80%	58%
Don't know	35%	44%	25%	21%	23%	17%	14%	29%

Table 8
In April 2016 the ability to contract-out of the State second pension scheme will end for DB schemes and their members. How do employers expect to respond if their scheme is presently open to future accrual?

Adjust for loss if NI rebate	46%
Carry on as before	9%
Undecided	25%
Close scheme	20%

Table 9
Typical current retirement ages and how employers expect this to change by 2020 (when SPA reaches age 66) and by 2028 (when SPA reaches age 67)

	Current	By 2020	By 2028
Under 60	1%	–	–
Age 60	5%	1%	1%
Age 61-64	20%	3%	1%
Age 65	49%	9%	2%
Age 66-67	25%	82%	55%
Age 68-69	–	5%	36%
Age 70	–	–	4%
Age 70-75	–	–	1%

Table 10
Should the Government set up an Independent Pensions Commission with a remit to make periodic recommendations on pension policies to ensure these are cost effective and sustainable for employers, members and Government?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	79%	83%	89%	91%	87%	89%	96%	85%
No	21%	17%	11%	9%	13%	11%	4%	15%

Table 11
Would you support the government considering legislation that made it simpler to automatically convert accrued pension benefits so they can be rationalised and crystallised into a consolidated 'new' scheme benefit at 'fair value'?

<table>
<tr><th></th><th>1-9 employees</th><th>10-49 employees</th><th>50-249 employees</th><th>250-499 employees</th><th>500-999 employees</th><th>1000-4999 employees</th><th>5000 employees +</th><th>Total</th></tr>
<tr><td>Yes</td><td colspan="2">76%</td><td>70%</td><td>81%</td><td>84%</td><td>86%</td><td>88%</td><td>78%</td></tr>
<tr><td>No</td><td colspan="2">24%</td><td>30%</td><td>19%</td><td>16%</td><td>14%</td><td>12%</td><td>22%</td></tr>
</table>

Table 12
Should the Government encourage businesses with small DC arrangements to merge these schemes into larger multi-employer arrangements?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Strongly support	27%	20%	22%	20%	37%	44%	46%	29%
See some value	37%	50%	42%	60%	33%	29%	40%	41%
Disagree	17%	14%	18%	13%	20%	18%	10%	16%
Strongly disagree	19%	16%	18%	7%	10%	9%	4%	14%

Table 13
Should government facilitate and encourage the development of large collective schemes where, for example, investment, inflation and longevity risks might be shared between members or between members and employers?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	68%	77%	77%	72%	70%	59%	60%	69%
No	32%	23%	23%	28%	30%	41%	40%	31%

Table 14
If you could offer a pension scheme to your employees that enabled you to cap pension costs, whilst also offering greater certainty of pension income for your employees than most current DC schemes offer, would you consider such an option in the next 5 years?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	10%	16%	13%	11%	13%	9%	10%	11%
Maybe	55%	41%	25%	20%	23%	21%	22%	38%
No	35%	43%	62%	69%	64%	70%	68%	51%

Table 15
Should the Government establish a 'star rating' system for pension schemes covering, for instance, charges, governance and transparency?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	22%	11%	13%	15%	20%	21%	20%	19%
Voluntary scheme	35%	34%	36%	31%	33%	35%	52%	36%
No	43%	55%	51%	54%	47%	44%	28%	45%

The Association of Consulting Actuaries (ACA) is the representative body for UK consulting actuaries and is the largest national grouping of consulting actuaries in the world and is a full member of the International Actuarial Association (IAA).

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code.

Report produced by
Association of Consulting Actuaries
Regis House, First Floor
45 King William Street
London EC4R 9AN
Tel: +44(0)20 3102 6761
EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

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