

St Clement's House, 27-28 Clement's Lane, London EC4N 7AE
Tel: +44(0)20 3207 9380 Fax: +44 (0)20 3207 9134 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk



Workplace pensions: challenging times

Final Report of the ACA's 2011 Pension trends survey

Conducted by the Association of Consulting Actuaries

PUBLISHED – 3 January 2012

Chairman's comment: ACA 2011 Pension trends survey



This final report outlines the full results of our *2011 Pension trends survey*, a survey we have conducted on a biennial basis for nearly a decade now. The overall picture, as we outlined in our interim report, is alarming in that 'good' private sector workplace provision seems to be under threat almost everywhere we look. Employers are examining their present and future pension costs and employee opt-outs are rising, no doubt driven by pressures on pockets and, in some cases, disillusionment with anticipated retirement outcomes, particularly from defined contribution plans.

Yes, it is good news that auto-enrolment, beginning in late 2012, should widen pension coverage, particularly where no pensions are offered at present, but the fact that the Government has had to delay its introduction for smaller employers, because of the deteriorating economic climate, is discouraging. It is welcome that the Government is at last waking up to the reality of how 'low' morale is in the private sector pensions world and is looking to produce a paper in the New Year examining how workplace pensions can be 'reinvigorated'. The preparedness of some employers to share risks, echoed by this and other recent surveys, and the endorsement of this approach by the recent *Workplace Retirement Income Commission*, needs to be followed up with some urgency as part of this reinvigoration agenda. However, it is very difficult to see what can be done to turn the tide in the near-term given the austerity backcloth, coupled with the economic woes we face for a number of years to come. Inevitably any fresh initiative to boost pension savings will require both an easing in regulatory controls and, in all probability, new incentives to encourage employers and employees to take up the challenge and opportunities.

The survey results point to a rising trend amongst private sector employers of all sizes to review existing pension arrangements and, given the economic climate, for a goodly number to seek ways to reduce their pension costs. It appears the austerity message has been grasped by many employers as they begin to focus on the potential extra costs of pension reforms from 2012 onwards. This is understandable but, with only just over a third of private sector employees now in pension arrangements and with many of these set to deliver very modest retirement incomes, the survey findings are disappointing in terms of the need to boost rather than diminish retirement incomes into the future. With contribution rates into many defined contribution schemes failing to keep pace with the pension costs of longer life-spans, and with employers expecting (and in some cases relying upon for budgetary purposes) high anticipated levels of pension opting-out, warning bells are ringing.

And following the closure of most defined benefit schemes, the survey findings point to a quarter of employers now looking to take the next steps beyond closure to new and existing members by 'buying-out' or 'buying-in' liabilities within the next five years, with also a rising trend to manage liabilities over the next few years by way of offering enhanced transfer values to existing members.

Indeed, these are very challenging times for pension provision whether by individuals, private sector employers, public sector employers or nation states.

For those wanting to digest the survey results quickly we have provided both 'highlights' (see page 3) and an 'executive summary' on pages 4-6. However, for those who want greater detail, a separate *Statistical Supplement* is available on our website at www.aca.org.uk (go to 'Research' page).

Finally, I would like to thank all those firms that responded to the online questionnaire for their help in providing the information for this survey report.

Stuart M Southall
Chairman

3 January 2012

Summary results: ACA 2011 Pension trends survey

Survey background

The survey was conducted by the Association of Consulting Actuaries (ACA) in the summer of 2011 for online completion and was circulated to UK employers of all sizes, selected on a random basis. Responses were received from 468 employers running over 560 schemes. This survey report follows on from our interim report published in September and examines general workplace pension trends, including contribution levels by private sector employers and members, views on auto-enrolment and other pension reforms.

Survey highlights

- Overall, a fifth of employers are looking to decrease their pension spend, balanced by 14% aiming to increase spend. A third of larger employers say they are looking to decrease their spending on pensions.
- Over the last three years, 21% of employers report that member opt-outs from workplace pension schemes have increased.
- Employers responding to the survey report average contributions into defined contribution schemes have changed very little over the last decade – contribution rates are generally failing to keep pace with the pension costs of longer life-spans and lower investment returns.
- Despite a near doubling in employer contributions over the last decade, close to a third of employers (31%) expect to take over ten years to remove their defined benefit scheme deficits.
- A quarter of employers with defined benefit liabilities are looking to buy-out or buy-in all these liabilities within the next five years, with this rising to 4 out of 10 within ten years. Within 5 years, over four out of ten are looking to partial buy-outs or buy-ins.
- Over a third of employers expect to manage their defined benefit scheme liabilities over the next three years by offering enhanced transfer values (28%) or pension increase exchanges (8%).
- Only just over a quarter of employers (26%) say they have budgeted for the costs of auto-enrolment, with this falling to one in seven amongst employers with 49 or fewer employees. On average, budgets are based on estimates of 25% of employees opting-out of workplace pensions following auto-enrolment, but with smaller employers estimating between 30-40% of employees will decide to opt-out.
- 73% of employers say they are likely to auto-enrol all employees into an existing pension scheme and 27% of employers say they are likely to review their existing scheme benefits to mitigate the cost of higher scheme membership as a result of auto-enrolment, with this rising to over a third (35%) amongst the largest employers.
- Over a half of smaller employers (with 249 employees or less) presently do not agree with the Government and the Pensions Regulator encouraging employers with small defined contribution schemes to merge these into larger multi-employer arrangements.
- Whereas, at present, over nine out of ten employers say their employees retire at age 65 or younger, in under a decade close to four out of ten expect the typical retirement age to be 67 or later. One in six employers expect typical retirement ages to move out to between age 68 to 70 by 2020.
- Upwards of eight out of ten private sector employers support the recommendations made by Lord Hutton that public service pensions should be scaled back (85%), that member contributions should increase (79%) and that the pension age in such schemes should increase to the State Pension Age (91%).

Executive Summary

Today's pension provision and trends

- The predominant types of scheme provided by employers responding to the survey are Group Personal Pensions, Stakeholder and Trust based defined contribution schemes.
- Where final salary schemes are provided, 91% are closed to new entrants with 37% of these also now closed to future accrual of benefits (of these 21% closed to future accrual in the last 12 months).
- Membership participation in workplace pensions varies between 45% - 70% of employees, with Stakeholder pension participation lowest at, on average, 45% of eligible employees. Over the last 3 years, 21% of employers report that employee opt-outs from schemes have increased.
- In the last year, a fifth of defined benefit schemes have closed to future accrual for existing members and a similar number have switched from RPI to CPI benefits indexation. One in ten have amended early retirement terms, reduced benefit accrual rates or have increased their normal retirement age.
- Whereas, at present, over nine out of ten employers say their employees retire at age 65 or younger, in under a decade close to four out of ten expect the typical retirement age to be 67 or later. One in six employers expect typical retirement ages to move out to between age 68 to 70 by 2020.
- 30% of employers are either presently reviewing their pension arrangements or will do so in the year ahead, with a further 19% having completed a review in the previous year.

Pension spend and contributions

- 47% of employers do not have a target for their pension costs, but 43% are targeting employer pension costs of 4% of payroll or more. However, amongst employers with 49 or fewer employees – where the bulk of private sector firms are found – only just over a quarter (28%) are looking to a pension spend at or above this 4% level.
- Overall, 19% of employers are looking to decrease their pension spend, balanced by 14% aiming to increase their spending on pensions. A third of larger employers say they are looking to decrease their spending on pensions.
- Employers responding to the survey report average combined employer and employee contributions into defined contribution schemes ranging between 7½% and 13% of earnings. Average combined employer and employee contributions into defined benefit schemes remain at over double these levels at 27% of earnings.

Defined contribution schemes

- 83% of defined contribution schemes offer a default investment strategy and six out of ten offer 11 or more fund options.
- Six out of ten employers offer assistance to retirees purchasing an annuity, predominantly making broking services available.

- Over a half of smaller employers (with 249 employees or less) presently do not agree with the Government and the Pensions Regulator encouraging employers with small schemes to merge these into larger multi-employer arrangements.

Defined benefit schemes: funding and the future

- The defined benefit schemes in the survey sample reported that their funding level was on average 77% as a percentage of liabilities at the last actuarial assessment, slightly lower than two years ago.
- 31% of employers said they expected the removal of their scheme deficits to take 11 years or more.
- Three-quarters of employers said that their relationship with the Pensions Regulator had become 'more difficult' or 'challenging' as monitoring had become more active.
- A quarter of employers are looking to buy-out or buy-in all of their defined benefit liabilities within the next 5 years, with this rising to four out of ten within 10 years. Within 5 years, over four out of ten are looking to partial buy-outs or buy-ins.
- Over a third of employers expect to manage their defined benefit scheme liabilities over the next three years by offering enhanced transfer values (28% of employers) or pension increase exchanges (8% of employers).
- Over the last year, schemes say they have on average reduced their investment in UK and overseas equities, property, derivatives and hedge funds, whilst increasing their exposure to gilts, corporate bonds and emerging markets.
- One in ten schemes presently utilise delegated investment management, with a similar number presently considering such an approach.

Auto-enrolment and NEST

- 22% of employers currently auto-enrol employees into at least one of their schemes, although this figure drops to one in ten amongst employers with 249 or fewer employees.
- 72% of employers said they are aware of the date when they must auto-enrol 'eligible jobholders' into a qualifying scheme between 2012 and 2016 (but this has now been thrown open, with staging dates for those employing fewer than 3,000 employees now subject to review).
- Just over a quarter of employers (26%) say they have budgeted for the costs of auto-enrolment, with this falling to one in seven amongst employers with 49 or fewer employees. On average, employers' budgets are based on estimates of 25% of employees opting-out of the workplace pensions into which they have been auto-enrolled, but smaller employers are estimating higher opt-out rates of between 30-40% of employees.
- 73% of employers say they are likely to auto-enrol all employees into their existing workplace pension scheme(s), with 21% saying they are likely to enrol all employees into a new scheme. A fifth may restrict entry into their existing scheme and auto-enrol the balance of employees into NEST. Between 5% - 7% are likely to close their scheme and auto-enrol all employees into NEST, or will use NEST as a foundation scheme.

- 27% of employers say they are likely to review their existing pension scheme benefits to mitigate the cost of higher scheme membership as a result of auto-enrolment, with this rising to over a third (35%) amongst the largest employers.

Other pension reforms

Risk sharing

- In all three areas of investment, longevity and inflation risk, at least half of the employers responding to the survey say that employers should share or take on a majority of these pension risks.

Changes to Pension ages

- 56% of employers support the proposal that further increases in State Pension Age should be linked automatically to average increases in life-spans as reported on by an independent body, although the majority of larger employers would prefer that any recommendations be made subject to a final decision by Government.
- 64% of employers say they want a statutory override that would enable them to adjust their scheme pension age automatically as life-spans extend. The ability to move automatically in line with State Pension Age is the most popular approach (39%).

Defined benefit contracting-out and indexation

- 14% of employers running a defined benefit scheme said the abolition of contracting-out would bring forward a decision to close the scheme to future accrual, with a further 25% saying 'it might'.
- Just over a half of employers said that sponsors should have a statutory over-ride to change scheme indexation rules to overcome problems with current scheme rules, with 58% saying sponsors should also have discretion to hold back indexation where a defined benefit scheme is in deficit.

Public service pensions

- Upwards of eight out of ten employers support the recommendations made by Lord Hutton that public service pensions should be scaled back (85%), that member contributions should increase (79%) and that the pension age in such schemes should increase to the State Pension Age (91%). Over half (56%) support the continuation of defined benefit provision for public service employees but, of these, only 16% support the continuation of existing – in the main – final salary schemes.

Pensions and the UK economy

The UK economy comprises around 1.2 million private sector employers, of which over 99% engage fewer than 250 employees. This means there are slightly fewer than 6,000 UK private sector enterprises employing 250 or more employees, albeit these large businesses employ altogether nearly half of the UK private sector labour-force. Slightly fewer than 19 million people work in the private sector and latest ONS statistics indicate only 3 million are active members of occupational schemes (down from 8 million in 1967), as opposed to 5.3 million active members in public sector schemes (4.1 million in 1967). Of the 3 million active private sector scheme members still two-thirds are members of defined benefit schemes.

With mounting evidence that the percentage of employees in the private sector with access to workplace pensions is continuing to fall, particularly due to the closure of many defined benefit final salary schemes, the last Labour government passed legislation requiring all organisations with one or more employees to auto-enrol all their 'eligible jobholders' into 'qualifying workplace schemes', meeting certain minimum standards, beginning in 2012.

The challenge now to both the Pensions Regulator and NEST (the default qualifying workplace scheme) will be to capture data on over 1 million private sector employers (the majority with fewer than 5 employees). This will encompass being able to cope with the dynamic changes in business numbers each year (more than 1,170 firms closed and over 1,000 opened **every working day** last year), the movements of employees from employer to employer and changes in opt-out decisions, and – of course – pension investment decisions and individual employees' changes thereto. The task in the first stages during 2012 and 2013, to ensure auto-enrolment is implemented by larger employers, should be manageable, provided the chosen administrative systems and providers prove robust.

However, there will be a considerable challenge all round in ensuring the huge number of smaller employers come 'on stream' during the later periods of the staging timetable and hence the delay in the timetable for smaller employers, announced in November 2011 by the Pensions Minister in the light of ongoing economic woes, may prove helpful all round. Aside from their awareness of when they must auto-enrol (which now will need to be re-visited), this survey found few smaller employers understand key basics about auto-enrolment requirements.

Figure 1: UK private sector: number of enterprises and employment by size of firms

UK private sector firms	Number of enterprises	Employees (thousands)	Average number of employees per enterprise
No employees (see note below)	3,290,570	3,532	-
1 – 49 employees	1,160,255	7,080	6
50 – 249 employees	27,770	2,703	97
250 or more employees	5,940	9,198	1,548
Total: all private sector employers	1,193,965	18,981	16

Data Source: Dept for Business Innovation and Skills, Enterprise Directorate Analytical Unit, 2010 figures, published 24 May 2011.

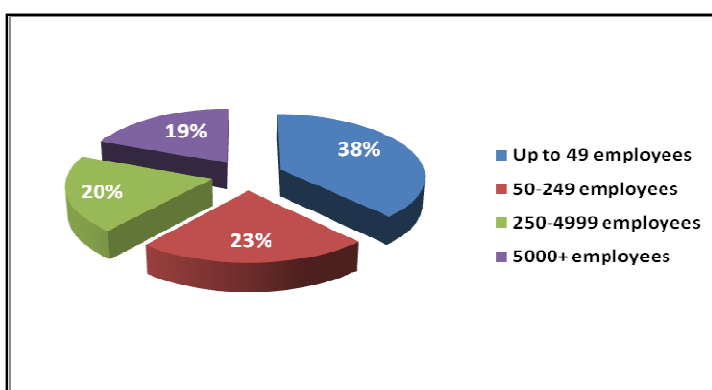
Note: 'No employees' comprises sole proprietorships and partnerships comprising only the self-employed owner-manager and companies comprising only an employee director).

Employers responding to the survey

Of the 468 employers, running over 560 pension schemes, that responded to the survey questionnaire, some 61% employ 249 or fewer staff, with the balance employing 250 or more employees. This sample does not represent a 'mirror image' of UK private sector employers. If it did, then around 98% of the sample would be drawn from firms with just 50 or fewer employees¹.

Equally, with only 16% of respondents indicating they do not run a workplace pension scheme, the sample is not typical of employers as a whole in that it over represents the proportion of employers offering pension arrangements. **Around two-thirds of the UK's private sector employers provide no workplace pensions albeit it is estimated around a further 5% make contributions into employees' personal pensions².**

Figure 2: Breakdown of employers responding to the survey
(Data Source: ACA 2011 Statistical Supplement, Table 1)

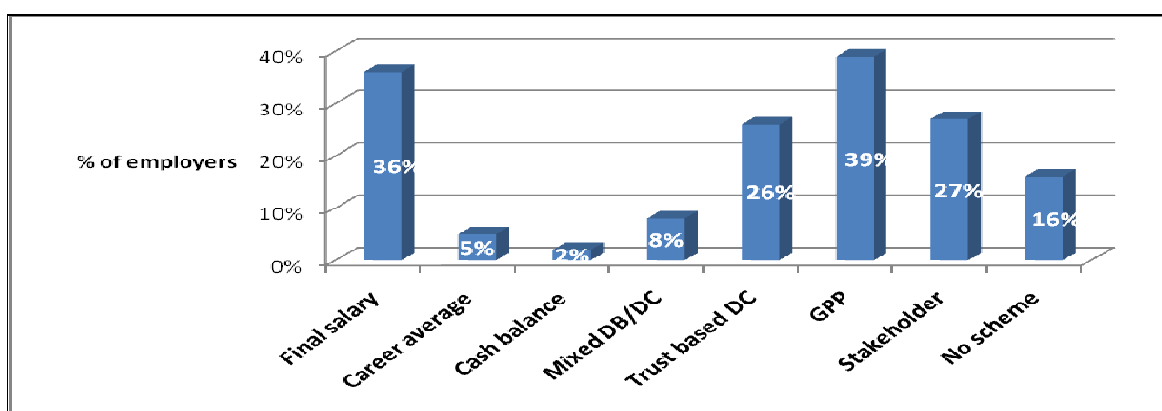


Types of schemes run by employers responding to the survey

The predominant types of workplace pension schemes being run by employers responding to the survey are defined contribution in nature – contract-based Group Personal Pension Schemes (GPPs), Stakeholder plans and Trust based schemes. Approaching half, mainly larger employers, run some kind of

defined benefit scheme, but the majority of these are reported closed to either new employees or, increasingly, to both new employees and future accruals.

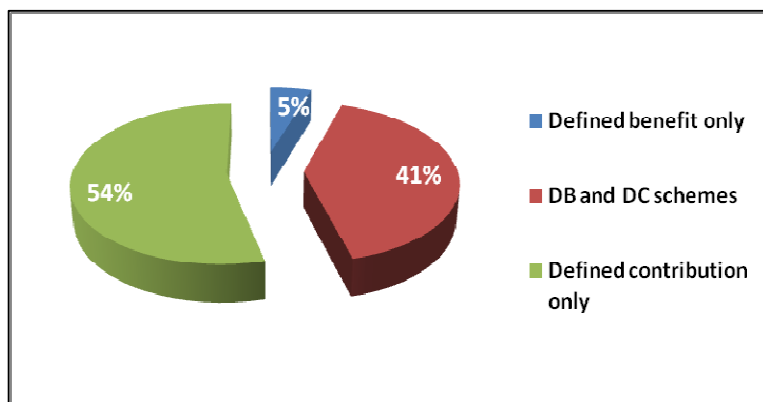
Figure 3: Schemes run by employers responding to the survey
(Data Source: ACA 2011 Statistical Supplement, Table 2A)



¹ Source: ONS Inter-Departmental Business Register 2010

² Source: DWP Research Report No.683, *Employers' attitudes and likely reactions to workplace pension reforms 2009*

Figure 4: Schemes designs run by employers: by regulatory type
(Data Source: ACA 2011 Statistical Supplement, Table 2B)

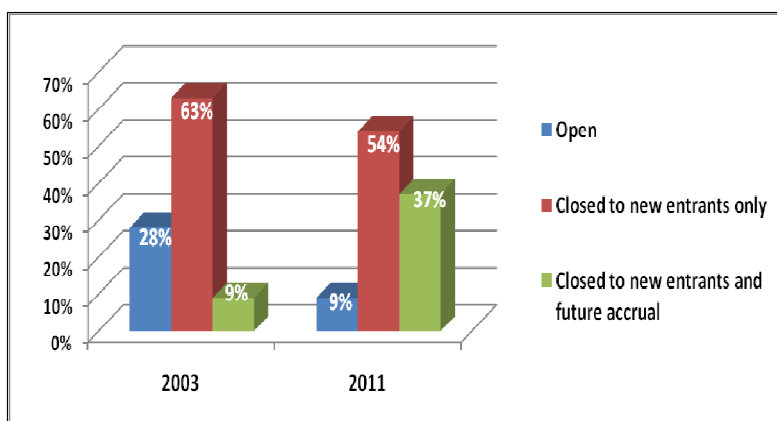


Of those employers running schemes, over a half provide just a defined contribution scheme and 5% offer only a defined benefit scheme.

Of the final salary schemes run by employers, 91% are closed to new entrants and, of these, 37% are also now closed to future accruals by existing employees. To a limited degree lower-cost defined benefit

schemes – career average, cash balance and mixed DB/DC schemes are being offered as final salary arrangements are closed, but they are still relatively thin on the ground. When this series of biennial surveys into pension scheme trends began in 2003, 72% of final salary schemes were already closed to new entrants. In under a decade, a further 19% of schemes have closed their doors to new employees, with closures to future accrual by existing members quadrupling to 37% of schemes (as opposed to just 9% in 2003).

Figure 5: Defined benefit scheme closures 2003 – 2011
(Data Source: ACA 2011 Statistical Supplement, Table 2A and 2003 Pension trends survey)



Closures of trust based defined contribution schemes mount

Reflecting a move away from trust based in favour of contract based defined contribution schemes, the survey found 31% of trust based defined contribution schemes are closed to new entrants, with just under a third of these also closed to new contributions from existing

employees. The majority of firms reporting such a closure now offer either contract-based GPPs or Stakeholder schemes.

Recent trends in benefit provision

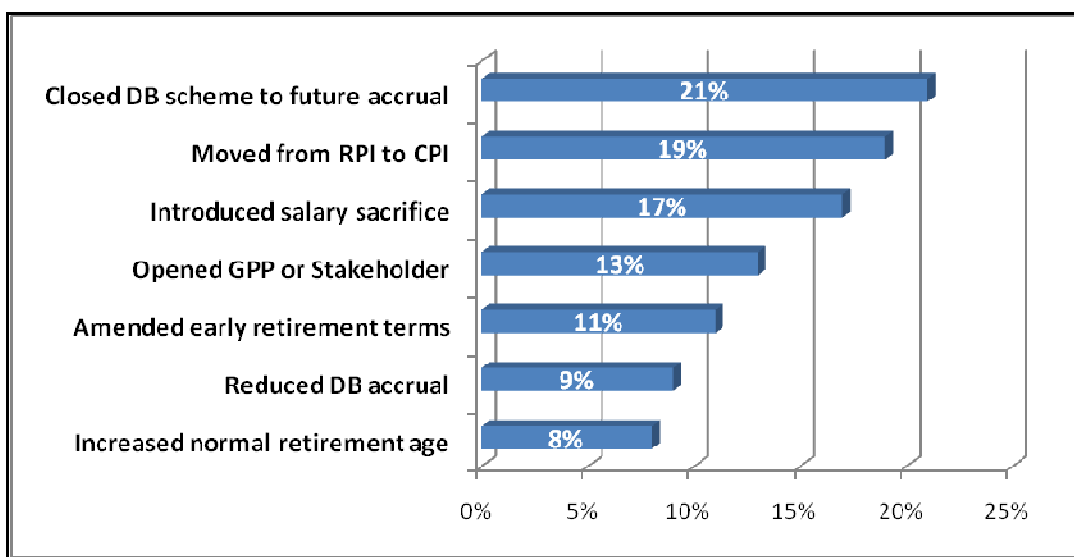
In the last year, a fifth of private sector defined benefit schemes have closed to future accrual for existing members. As employers look to cap their costs and pension liabilities it seems likely this trend will move at some pace, particularly given the present economic woes. Additionally, many employers who are

beginning to look at their benefits package across-the-board in an auto-enrolment environment are seemingly taking the view that it is probably unsustainable to maintain very different pension arrangements for existing as opposed to newer employees. Inevitably, this will tend to lead to many moving all of their employees into open ongoing schemes, in the main these being defined contribution in nature.

Following on from the Government's lead, another major change in the last year has been a **switch from RPI to CPI indexation of benefits**, the objective being to help reduce the ongoing cost of running schemes into the future. Other cost saving initiatives that will help to hold costs down in both the short and longer-term are revealed by the survey. **One in ten employers have amended early retirement terms, or reduced benefit accrual rates, or have increased their normal retirement age.**

As well as more employers opening contract-based defined contribution schemes (generally to replace defined benefit or in some cases trust based defined contribution schemes), there has been a continued trend towards more employers introducing salary sacrifice arrangements. Here employees give up rights to future cash remuneration in return for the employer contributions into a registered pension scheme or employees give up a right to future cash remuneration in return for a benefit in kind.

Figure 6: Main structural changes in benefits made by employers in last 12 months
(Data Source: ACA 2011 Statistical Supplement, Table 3)

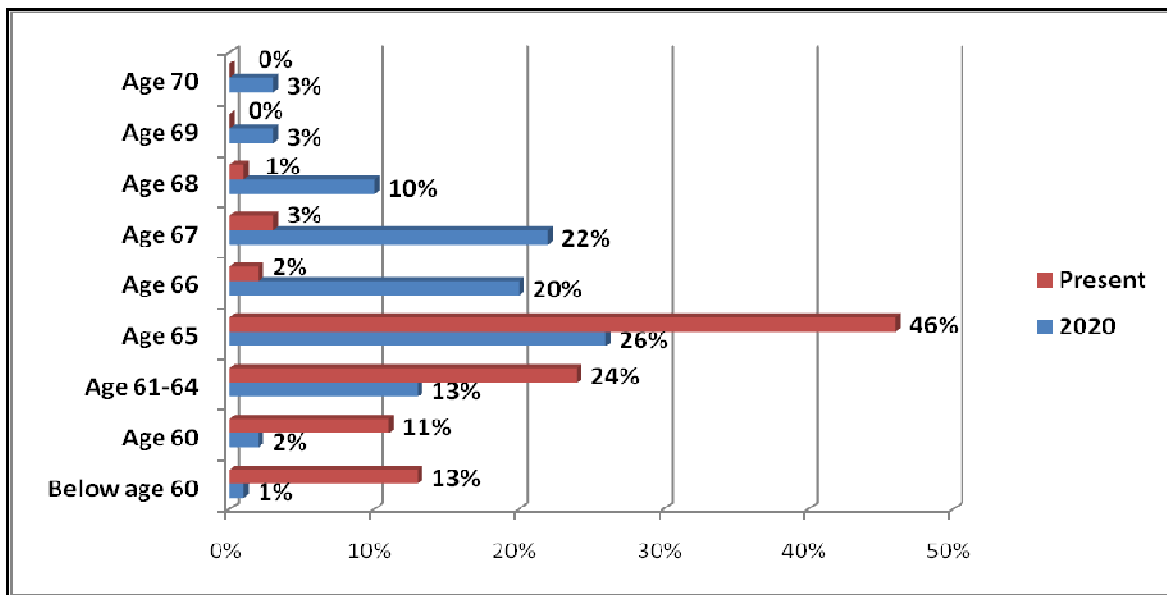


Rapid change in retirement ages expected

Looking to the future, and no doubt again in the light of the Government's decision to bring forward the move to a State Retirement Age at age 66 from 2020 as opposed to 2026 (and, more recently, its decision to then advance the move to age 67 to between 2026 to 2028 (around eight years earlier than current legislation), private sector employers are expecting to see 'typical' retirement ages from work to change quite markedly in under a decade. Whereas, at present, over nine out of ten employers say their employees retire at age 65 or younger, **in under a decade close to four out of ten expect the typical**

retirement age to be 67 or later. One in six employers expect typical retirement ages to move out to between age 68 to 70 by 2020.

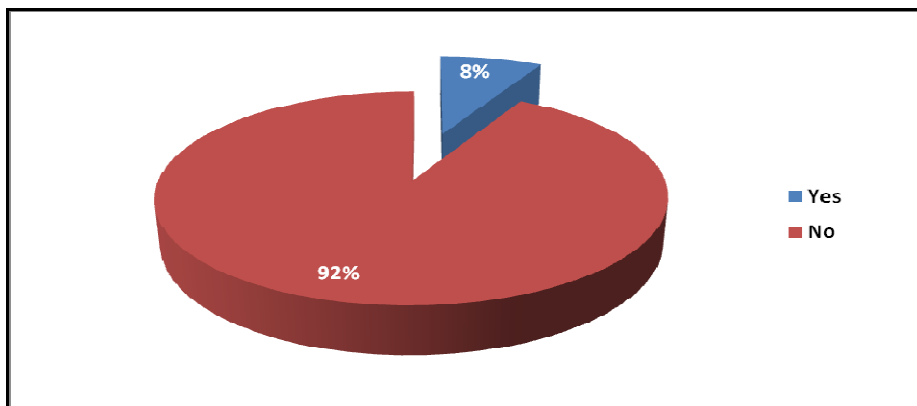
Figure 7: Typical current retirement age at organisations and expected change by 2020
(Data Source: ACA 2011 Statistical Supplement, Table 4)



Some people have argued that the removal of the Default Retirement Age from this year will mean more employers will consider improving their retirement package, so they have some ‘incentive’ available to encourage older workers to retire. The results of our survey do not suggest that this is a strongly held view amongst employers, with fewer than one in ten saying that employers will respond in this way.

That said, these are early days and it will be interesting to see over the next few years whether this answer will change as employers grapple with ageing workforces and later voluntary decisions to retire brought about by inadequate pension and other savings.

Figure 8: Will the removal of the Default Retirement Age lead to employers offering better pension schemes as a means to ‘encourage’ older employers not to work on?
(Data Source: ACA 2011 Statistical Supplement, Table 5)

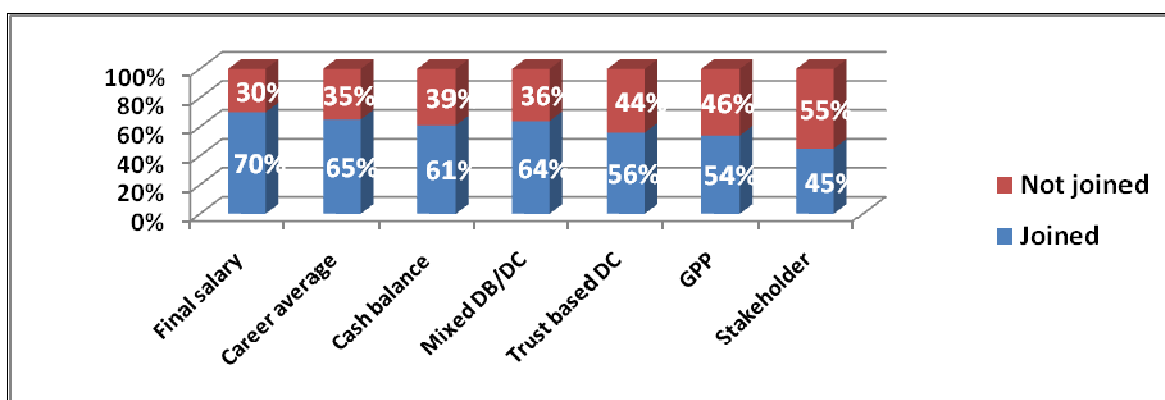


Scheme membership

Average participation rates amongst those eligible to join workplace pension schemes vary between 45% in Stakeholder schemes through to 70% in final salary arrangements.

With generally over 35% of employees not participating in workplace schemes (with this rising to 100% for the 16% of respondents who provide no scheme), there are clear cost implications for many employers when they have to auto-enrol employees into either their own qualifying schemes or into NEST under the Government's staging and phasing schedule between 2012 and 2017 (this latter date may now change). The degree of those cost increases will hinge upon whether any scheme is offered at present, the level of employee opt-outs and the levels of employer contributions into the future for existing members and new joiners.

Figure 9: Scheme participation by eligible employees
(Data Source: ACA 2011 Statistical Supplement, Table 2A)



Why are so many employees not in workplace pension schemes?

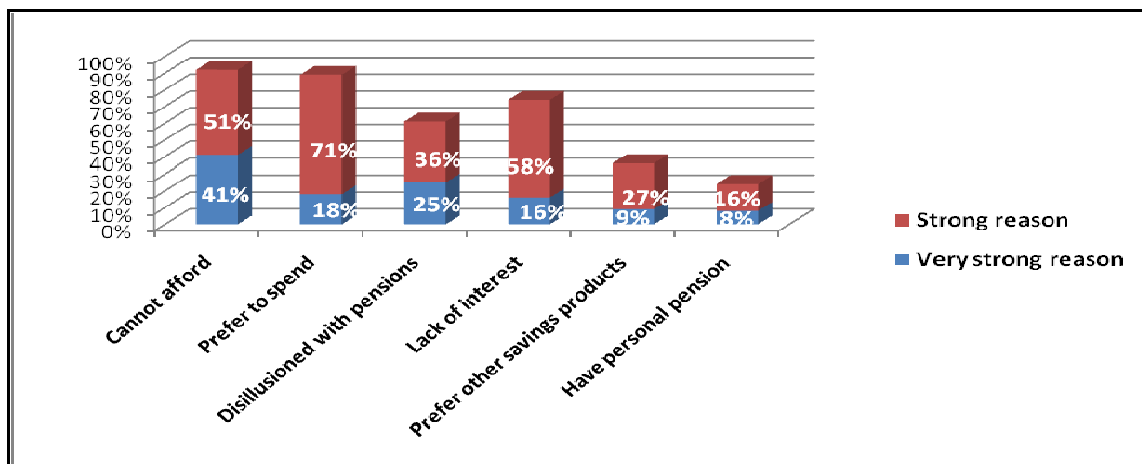
Employers are very clear on why they feel so many employees have not joined existing workplace pension schemes. 92% of firms say employees 'cannot afford the cost' (although, 89% also say employees prefer to 'spend their income'). Whilst amongst lower income groups, ONS figures suggest there is little or no room for private savings given current spending patterns and credit commitments, it is less clear this is the case for those around and above average earnings. However, in the current economic climate where price increases are running well ahead of earnings and where credit commitments remain worryingly high, the number of employees genuinely unable to meet the cost of existing and prospective pension contributions is likely to grow. Our survey found 21% of employers saying the proportion of existing employees leaving their schemes has increased over the last 3 years³.

³ Data Source: ACA 2011 Statistical Supplement, Table 6

A disturbing finding is that 61% of employers believe employees are ‘disillusioned with pensions’, no doubt in the wake of events over the last decade or so. Disappointing growth in defined contribution pension pots as investment returns have reduced, adverse publicity over pension charges, lower retirement incomes from annuities and, for some, experiences of scheme closures, ‘lost’ pensions and levelling-down will all have played a part in this disillusionment. The prospect of later retirement ages may also be deterring an increasing number of younger and middle-aged employees from pension saving – other nearer-term spending priorities may appear much more relevant and vital. This is a situation which may have some way to run given the huge uncertainty about the pace of any economic recovery over the next few years.

These results underscore that whilst auto-enrolment into workplace pension schemes may indeed increase the numbers making pension savings from 2012, there remain major financial and communication challenges to be addressed if we are not to see the emergence of both more levelling-down and high opt-out rates by employees from workplace pensions. The economic shocks since this survey was conducted in the summer of 2011 suggest the challenges ahead, and the policy response, may need to be re-addressed again in the period ahead of the first auto-enrolments later in 2012.

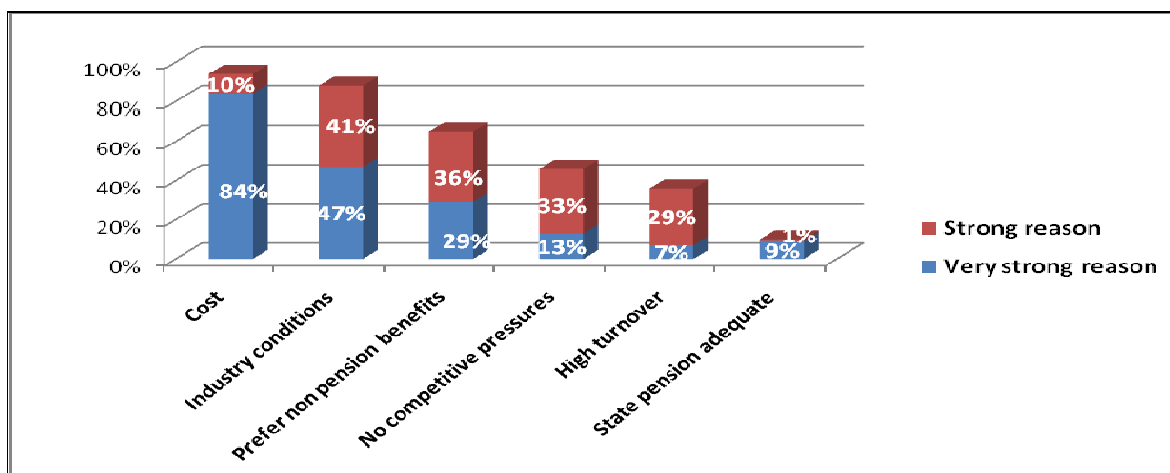
Figure 10: Why do employers think employees do not join your pension scheme?
(Data Source: ACA 2011 Statistical Supplement, Table 7)



Why do employers not offer pension arrangements?

Almost all (94%) of the employers who responded to the survey who do not offer pension schemes say ‘cost’ is the main reason why they do not provide a workplace pension. This view, they say, is compounded by present economic conditions in their respective industries. High levels of staff turnover are also cited as a further disincentive to offering a workplace pension.

Figure 11: Why employers do not offer a pension scheme
(Data Source: ACA 2011 Statistical Supplement, Table 8)



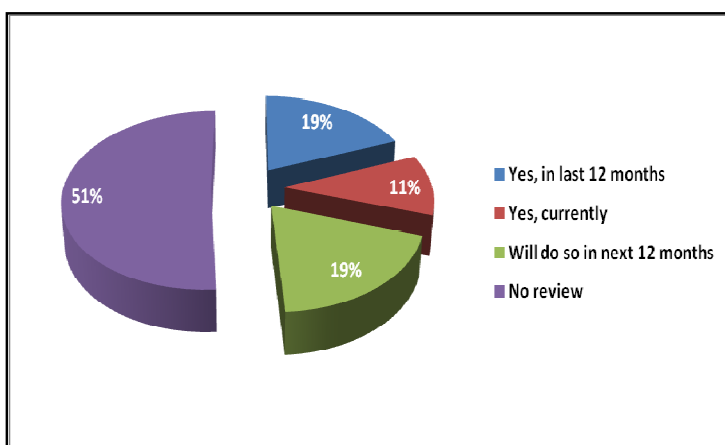
Scheme reviews

30% of employers are either presently reviewing their pension arrangements or will do so in the year ahead. This high level is likely to be the result of a number of factors, including the stream of regulatory measures impacting on existing arrangements in recent years, the approach of auto-enrolment, or because of financial reasons in a generally very difficult economic climate for many businesses, with uncertainty mounting.

The high incidence of scheme reviews by larger employers, found by the survey, may reflect the closer prospect of having to implement auto-enrolment, coupled with nearer-term priorities including capping the cost of defined benefit arrangements, which are of course more prevalent at this size of employer.

Given the approach of auto-enrolment, it is perhaps surprising that half the employers responding to the survey have no current intention to review their existing scheme.

Figure 12: Reviews of current workplace pension arrangements
(Data Source: ACA 2011 Statistical Supplement, Table 9)



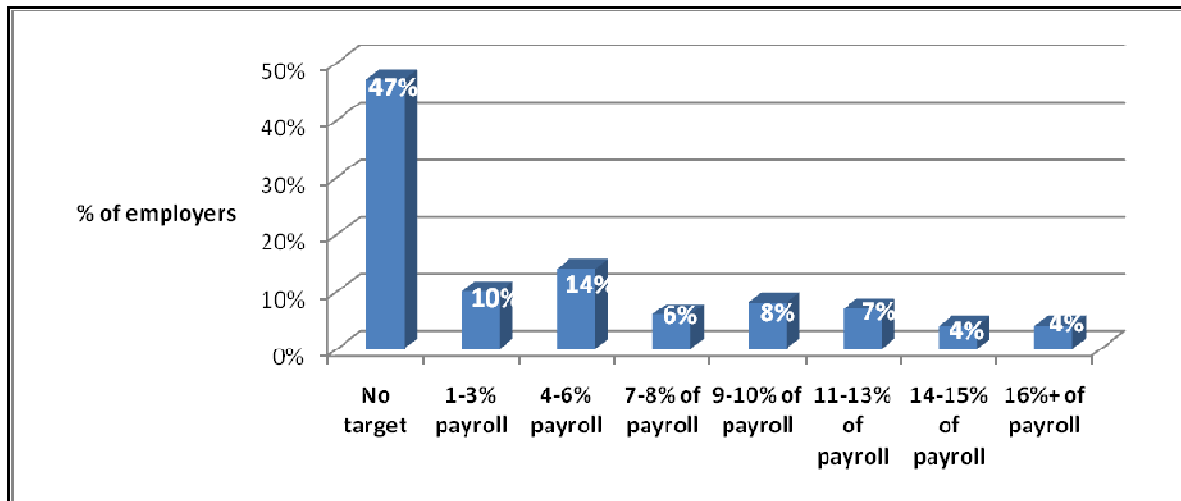
Targets for pension costs

Whilst close to half of the employers responding to the survey do not have a target for their total pension costs (which seems surprising), it is encouraging that over 4 in 10 are targeting employer pension costs of 4% of payroll or more (i.e. broadly in excess of the minimum employer contribution levels that will come into full force presently from October 2017 for

employees in membership of 'qualifying workplace schemes' or NEST).

Figure 13: Do employers have a target as to what their business will spend on pensions as a percentage of payroll?

(Data Source: ACA 2011 Statistical Supplement, Table 10)



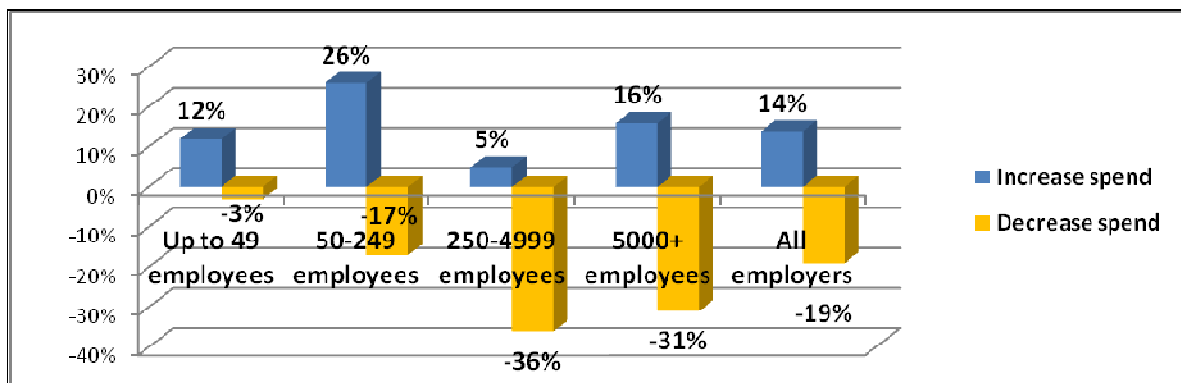
However, whilst those looking to reduce pension spend (19%) only modestly outnumber those looking to increase spend (14%), with the majority of employers holding to their current spending on pensions, this overall picture disguises some alarming replies from the larger employers replying to the survey.

Amongst larger employers (those with 250 or more employees), a third are looking to reduce their overall spend on pensions. This is one of the more disturbing findings of this year's survey and must surely reflect the financial pressures falling upon them and the potential extra costs that auto-enrolment may bring with higher levels of scheme participation, especially where pension costs per head are presently well above the new statutory minimum standards. Again, given the adverse economic trends since the survey was conducted in the summer of 2011, it may be that there has been some worsening in this position in recent months.

Certainly, given the lobbying on behalf of smaller firms that led to the Government's decision in November to delay auto-enrolment staging for smaller businesses, it would appear many smaller employers feel attempts to increase spend on pensions are moving away from them at the moment.

Figure 14: Overall, is your business trying to increase or decrease its' spend on pensions?

(Data Source: ACA 2011 Statistical Supplement, Table 11)



Pension contributions

Employer contributions into defined contribution schemes across our sample are averaging between 4 to 8% of earnings, with employee contributions hovering between 3½% and 5% of earnings.

Contribution levels reflect both the type of arrangement provided and the size of employer. **In the main, trust based defined contribution schemes are attracting higher levels of contributions than both GPPs and Stakeholder schemes but, as we report elsewhere, closures of these arrangements are on the increase.** Larger employers are also generally making higher contributions into their defined contribution schemes, as are their employees.

What these figures indicate is that as auto-enrolment moves ahead, there continues to appear to be limited scope at most smaller firms for significant levelling-down of existing pension contributions/benefits to mitigate the potential cost of enrolling employees into schemes. The absence of pension provision at most small employers compounds this. As we reported in our 2010 surveys of both large and small firms⁴, levelling-down is much more likely to be a feature in larger organisations where current employer contribution levels tend to be much higher than the minimum levels required under the new legislation.

Figure 15: Average contributions into defined contribution workplace pensions (as a percentage of earnings): broken down by employer sizes (Data Source: ACA 2011 Statistical Supplement, Table 12)

Average employer contributions	Up to 49 employees	50-249 employees	250-4999 employees	5000 employees +	All Employers
Trust based defined contribution	5.0%	6.0%	6.6%	7.8%	6.9%
Group Personal Pension	4.9%	5.5%	6.1%	6.9%	5.8%
Stakeholder scheme*	4.0%	4.4%	4.3%	5.0%	4.3%

Average employee contributions	Up to 49 employees	50-249 employees	250-4999 employees	5000 employees +	All Employers
Trust based defined contribution	3.7%	4.3%	4.6%	4.8%	4.5%
Group Personal Pension	3.6%	4.1%	4.5%	4.7%	4.4%
Stakeholder scheme*	3.5%	4.0%	4.1%	4.0 %	3.8 %

Average combined contributions	Up to 49 employees	50-249 employees	250-4999 employees	5000 employees +	All Employers
Trust based defined contribution	8.7%	10.3%	11.2%	12.6%	11.4 %
Group Personal Pension	8.5 %	9.6 %	10.6%	11.6%	10.2%
Stakeholder scheme*	7.5 %	8.4 %	8.4%	9.0%	8.1 %

Note: *Stakeholder figures exclude 28% of schemes with 'nil' employer contributions

⁴ ACA Survey Report, *Auto-enrolment and NEST in larger organisations*, published 31 August 2010 and ACA Survey Report, *Auto-enrolment in smaller firms*, published 27 September 2010 (see: www.aca.org.uk – publications)

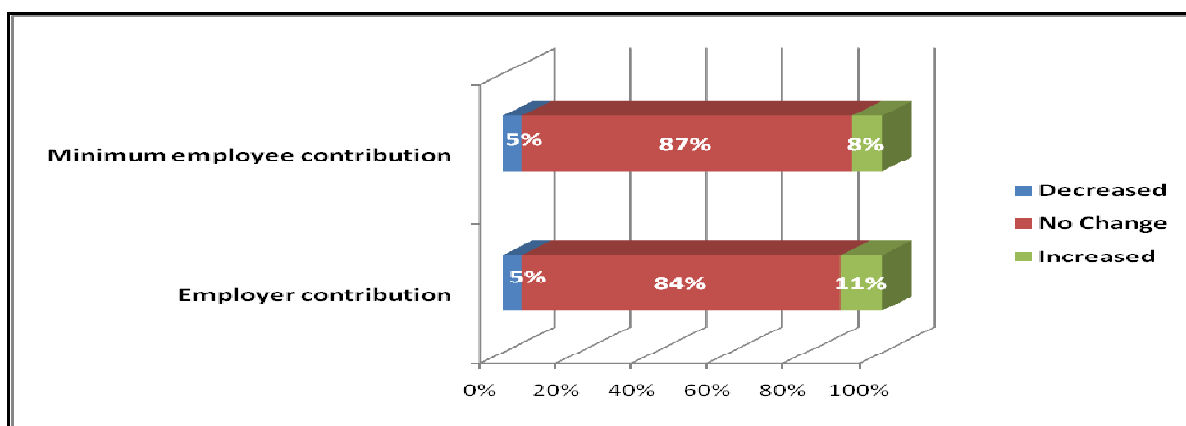
Average combined employer and employee contributions into defined benefit arrangements are running at more than double the above levels at just over 27% of earnings (see Figure 17, page 18). Higher defined benefit contributions reflect the increasing cost of delivering targeted pension benefits as life-spans extend and economic and regulatory factors change.

Whilst over the last 8 years we have been monitoring trends there has been a gradual, if small, increase in average employer and employee contribution levels into defined contribution arrangements, it is clear from this year's research and our 2010 survey⁵ that this has been driven primarily by an increase in contributions by larger employers. This is likely to have been due to the movement in recent years of an increasing number of employees in larger employers out of generous defined benefit arrangements into reasonably generous (although not as costly) defined contribution schemes.

This process aside, over the last 5 years, only 11% of employers report any, and mostly modest, increases in their contribution levels (and 8% any increase in the minimum employee contributions) into their defined contribution schemes/plans.

Figure 16: Over the last five years, have employer or minimum employee contributions into defined contribution schemes changed?

(Data Source: ACA 2011 Statistical Supplement, Table 13)



However, where contributions from employers have advanced most over the last nine years – into trust based schemes – is where there have also been most defined contribution scheme closures. A recent tPR paper⁶ found there has been a 15% reduction in trust-based defined contribution scheme numbers across all employers in the last year monitored. Whether tighter governance arrangements of defined contribution schemes generally will reverse, stem or hasten this trend is as yet unclear. To date, however, many employers have seen the lighter governance associated with contract-based schemes as welcome in a world, where otherwise, mounting regulatory requirements have weakened employer enthusiasm for generous voluntary workplace pensions.

⁵ ACA Final Report, *Survey of smaller firms' pensions*, published 4 January 2011 (see: www.aca.org.uk – publications)

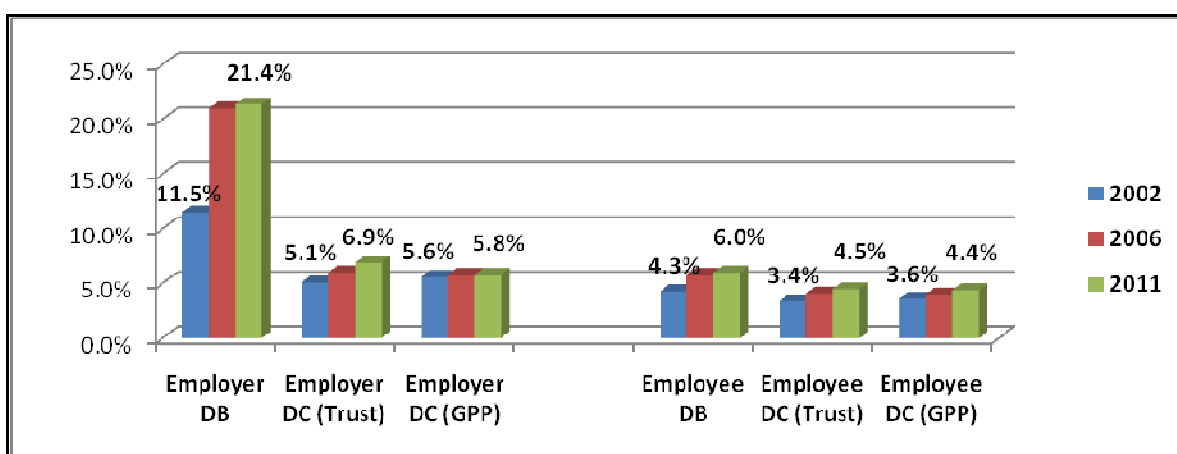
⁶ *DC Trust: A presentation of scheme return data*, published by the Pensions Regulator on 28 October 2010

With annuities presently delivering lower pension incomes due to low gilt yields, coupled with the longer-term impact of lengthening life-spans, **the need for increases in pension contributions (or other savings) is absolutely essential if we are not to see in the future many old people living for an increasing number of years in very reduced circumstances in retirement.** For some, and alarmingly this may be a very sizeable and growing group given current economic circumstances, pension saving may remain a distant prospect.

Clearing costly debt and sheer 'wherewithal' may prevent many from looking to pension savings now and, unfortunately, long into the future.

However, beyond this group (which presently may be enlarging quite rapidly due to economic woes), persuading the wider public with wherewithal, who could save more, to think again about their spending and savings priorities is a major public policy challenge. This is an essential next step if we are to reduce significantly the proportion of those living on low incomes for increasingly longer periods, as lives extend.

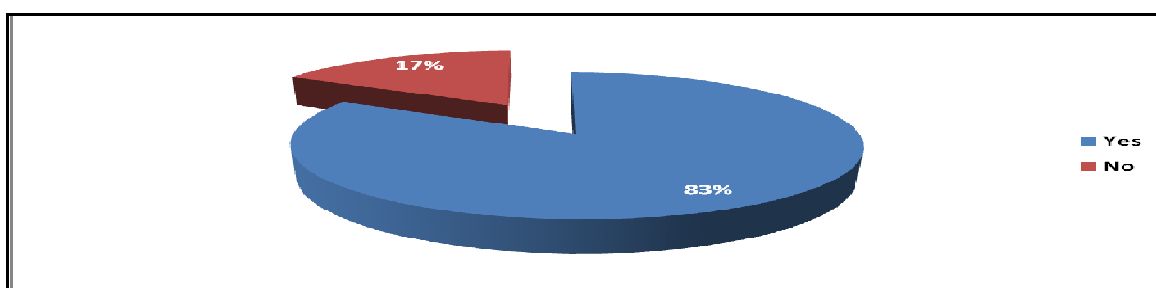
Figure 17: Comparison of average employer and employee pension contributions (as a percentage of earnings) 2002 – 2011
(Data Source: ACA 2011 Statistical Supplement, Table 14)



Defined contribution scheme trends

Over eight out of ten of the defined contribution schemes covered by the survey offer a default investment strategy and, of these, again over eight out of ten offer this in the form of a lifestyle fund where, in the main, members can choose their own retirement age. Whilst default investment funds

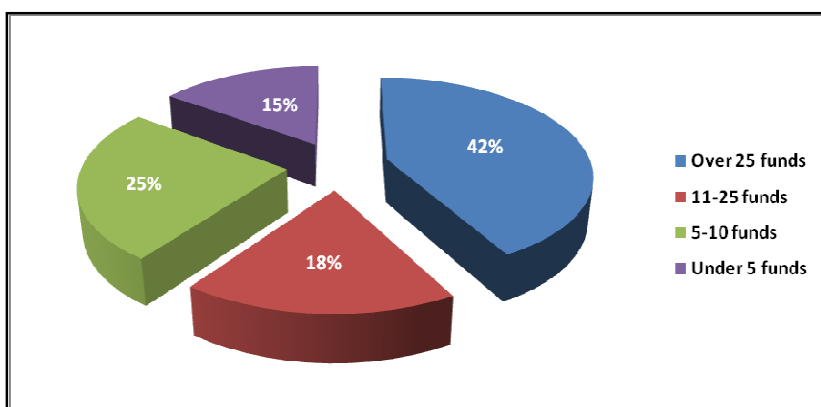
Figure 18: Percentage of defined contribution schemes offering a default investment strategy
(Data Source: ACA 2011 Statistical Supplement, Table 16)



take the pressure of individual members in terms of investment selection, there remains considerable evidence that many default funds are irregularly reviewed to check their performance and their asset mix may be inappropriate for many scheme members in terms of the risk approach being adopted.

Six out of ten defined contribution schemes responding to the survey offer upwards of eleven fund options, which is very much the same proportion as we found two years ago.

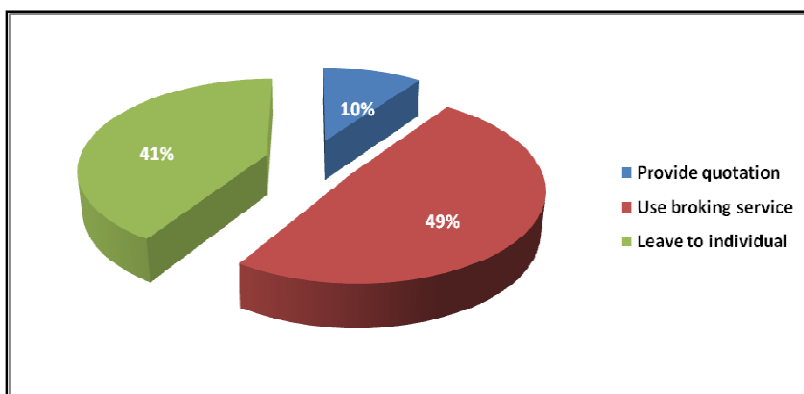
Figure19: Percentage of defined contribution schemes offering different number of fund options
(Data Source: ACA 2011 Statistical Supplement, Table 17)



Whilst generally more schemes now offer over ten fund managers (21% as opposed to 14% two years ago), the number only offering one fund manager has also increased (from 38% to 43% this year). It is difficult to explain the pull in opposite directions, but it may in part be reflective at one end of the market of the increasing

prevalence of contract-based schemes, where fewer managers may be offered. This could also reflect a move to platform systems whereby managers can offer access to funds from other managers.

Figure 20: Percentage of employers offering assistance to retirees in purchasing an annuity
(Data Source: ACA 2011 Statistical Supplement, Table 18)



Annuity purchase

Over the last few years as annuity rates have declined, increasing attention has been focused on both the open market options available to defined contribution members on retirement and the need for advice to be taken by most members at this time.

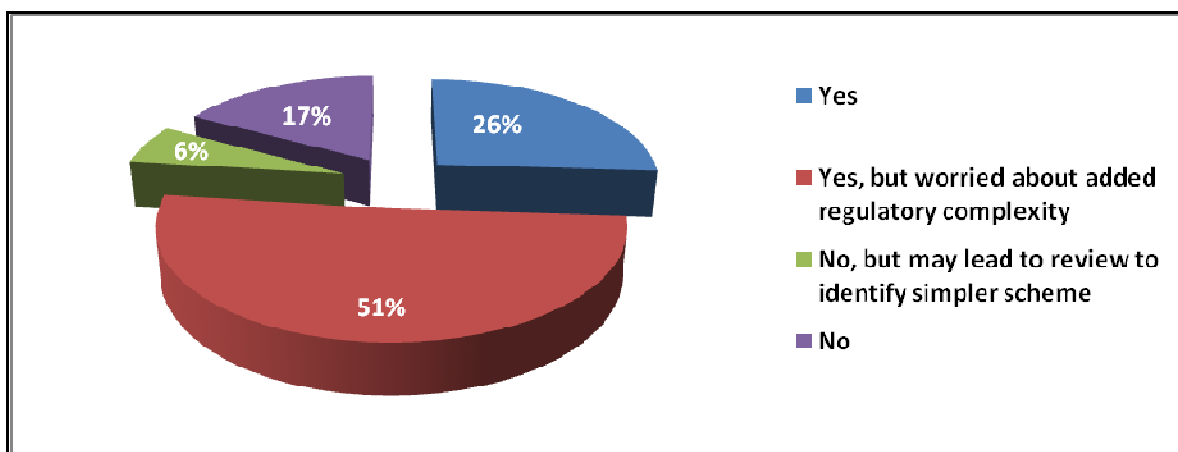
Our survey found that six out of ten employers offering a scheme do provide annuity quotations for members (10%) or, more often, offer a broking service to members (49%). The concern must be, however, that 41% leave the decision to the individual and, from the statistics available to date, this is most likely to mean that these members do not take advantage of either advice or an open market option, which may then result in a poor value-for-money annuity being chosen. Government and industry policy developments over the months ahead may, however, begin to address this concern.

More recently, the role of the Pensions Regulator, in engaging with the pensions sector to improve standards of defined contribution provision and to ensure that the sector is ready for auto-enrolment, has become clear. To that end, six principles for good design and governance of schemes have recently been proposed which, if followed, the Regulator believes will deliver the six elements necessary for members to receive good outcomes, namely:

- Appropriate decisions with regard to pension contributions
- Appropriate investment decisions
- Efficient and effective administration of schemes
- Protection of scheme assets
- Value for money
- Appropriate decisions on converting pension savings into a retirement income.

Encouragingly, three-quarters of employers with defined contribution schemes are supportive of the Pensions Regulator’s greater involvement in the sector, although two-thirds of these are worried about the added regulatory complexity that this may involve.

Figure 21: Do employers welcome the Pensions Regulator taking greater interest in the governance of defined contribution schemes alongside its compliance responsibilities in respect of auto-enrolment?
(Data Source: ACA 2011 Statistical Supplement, Table 19)



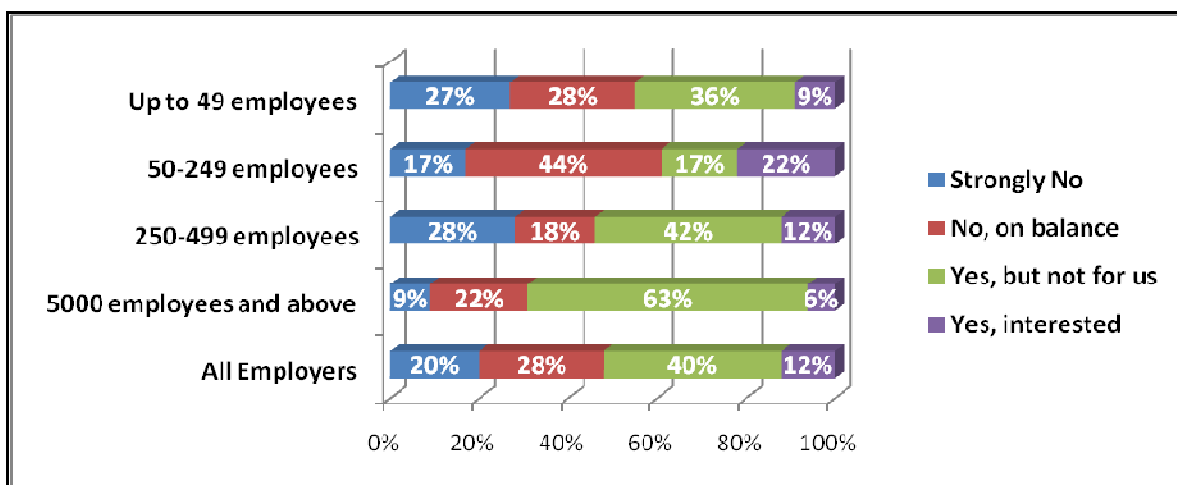
Where, however, there is likely to be some conflict is if the Pensions Regulator, egged on by the Government and others, endeavours to ‘encourage’, by one means or another, small defined contribution arrangements to merge into larger multi-employer schemes. **Close to half of employers do not agree with such a move, with those most opposed being the smallest schemes.**

Whilst there is a logic that larger multi-employer schemes should offer lower costs and potentially higher standards of governance, and it may be that this will be accepted by those not presently running schemes, those that have established schemes may feel that having their own ‘bespoke’ scheme does present them with a competitive advantage over other employers in their locality or industry. The number of employers saying that larger multi-employer schemes should be encouraged, ‘but not for us’, seems to confirm this

conclusion. If nothing else, this would seem to suggest that there will need to be a significant educational campaign if it is judged that this consolidation of schemes should be progressed as public policy.

Importantly, the cost-advantages of multi-employer schemes will need to be clearly detailed (as the Government Actuary's Department did with their commentary on the possible additional pension accruing through Collective Defined Contribution arrangements⁷) and the case well argued as to how a trust-based governance structure of a multi-employer scheme would better a similar trust structure in a small scheme or, increasingly more relevant, a contract-based governance structure.

Figure 22: On grounds of administrative costs and perceived improvements in governance, do employers believe Government or the Pensions Regulator should encourage employers with small defined contribution arrangements to merge these into larger multi-employer arrangements?
(Data Source: ACA 2011 Statistical Supplement, Table 20)



Defined benefit schemes: funding and the future

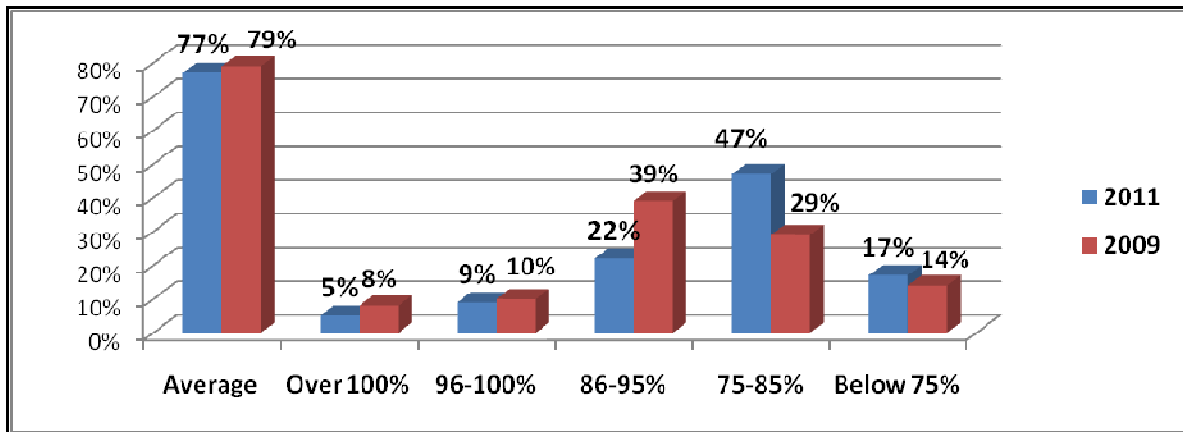
Defined benefit scheme funding remains an immense problem for private sector employers, both in terms of mapping out how pension benefits are to be met as they fall due long into the future, plus the accounting reporting issues, which arguably make it more difficult for many companies to persuade investors to stick with open defined benefit arrangements.

Employers responding to the survey in the summer of 2011 reported that funding levels were on average 77% as a percentage of liabilities at their last actuarial assessment. This is a slightly weaker position than our findings of two years ago, and the position of most schemes since mid-summer is likely to have deteriorated in funding terms.

⁷ The report said that a Collective Defined Contribution scheme was expected to produce a pension pot around 25% higher than a conventional defined contribution pension, see *Modelling Collective Defined Contribution Schemes*, DWP summary of GAD modelling, page 8, ISBN 978-1-84947-182-4.

Figure 23: Defined benefit scheme funding levels as a percentage of liabilities at the last actuarial assessment

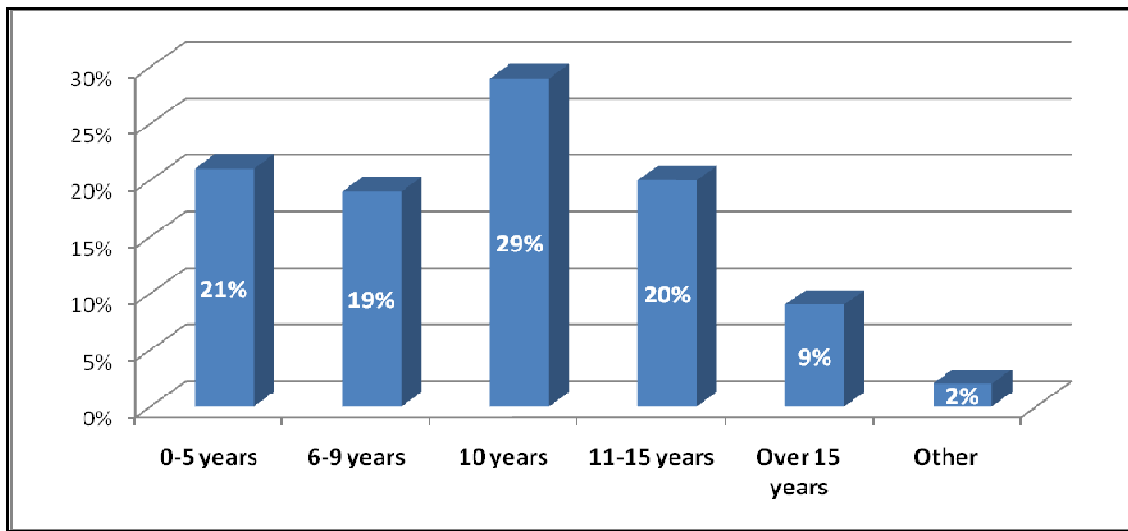
(Data Source: ACA 2011 Statistical Supplement, Table 21A)



Close to a third of these defined benefit schemes said that they expected the removal of their funding deficit would take 11 years or more. Whilst this might reflect the timescale advised to the Pensions Regulator in any recovery plan, it might also reflect the timescale that employers now consider as realistic encompassing post-assessment changes in economic conditions.

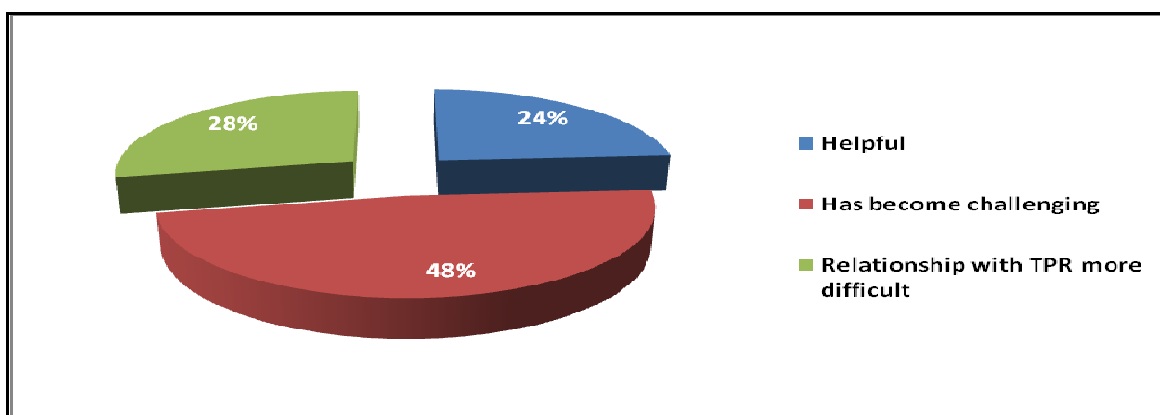
Figure 24: Recovery period over which employers say scheme deficits are expected to be removed

(Data Source: ACA 2011 Statistical Supplement, Table 21B)



The perceived more active role being taken by the Pensions Regulator in respect of scheme recovery plans has clearly been noticed by employers. Only a quarter of employers are prepared to regard this scrutiny as 'helpful', with the remainder either finding the Regulator's role 'challenging' (48%) or 'making relationships more difficult' (28%). Whilst the Regulator's approach is quite understandable given the organisation's objectives, it could prove unhelpful in supporting ongoing provision if employer sponsors feel they are increasingly under the cosh.

Figure 25: What are employers' reactions to a more active monitoring role by the Pensions Regulator?
(Data Source: ACA 2011 Statistical Supplement, Table 22)



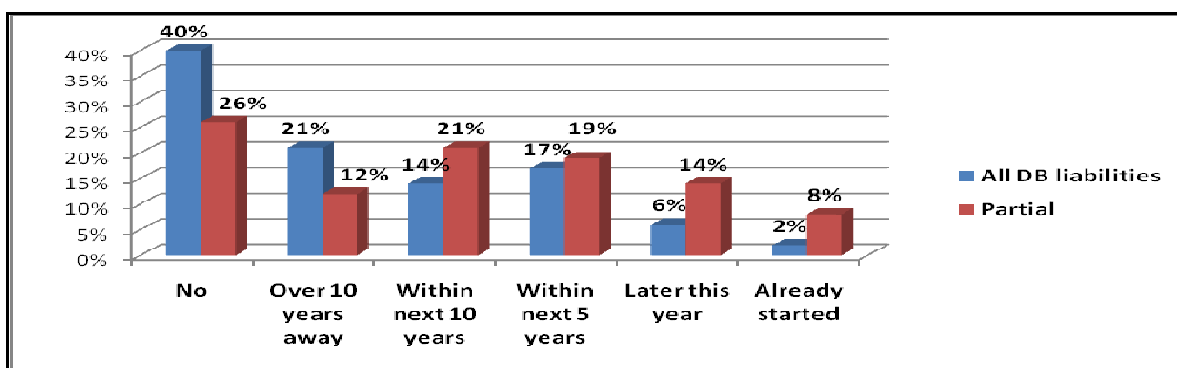
Looking to the future, it is clear many employers are looking beyond the closure of their defined benefit schemes to both new entrants and future accrual and are now seriously plotting either the partial or complete buy-out or buy-in⁸ of their defined benefit scheme liabilities, within relatively near-term timescales.

25% are looking to buy-out or buy-in all defined benefit liabilities within 5 years, increasing to 4 out of ten schemes within a decade. Over 60% are looking to partial buy-outs or buy-ins also within a decade.

Whether markets can provide adequate capacity on attractive enough terms, of course, remains uncertain and maybe unlikely on the scale employers would like, but the intent is clear. The scale of demand certainly would seem to undermine the widespread maintenance or re-emergence of defined benefit provision in the private sector, unless its costs can be capped into the future without fear of regulatory and legislative creep from 'do good' governments.

Figure 26: What percentage of employers is planning to buy-out or buy-in defined benefit scheme liabilities over the near and longer-term?

(Data Source: ACA 2011 Statistical Supplement, Table 23)



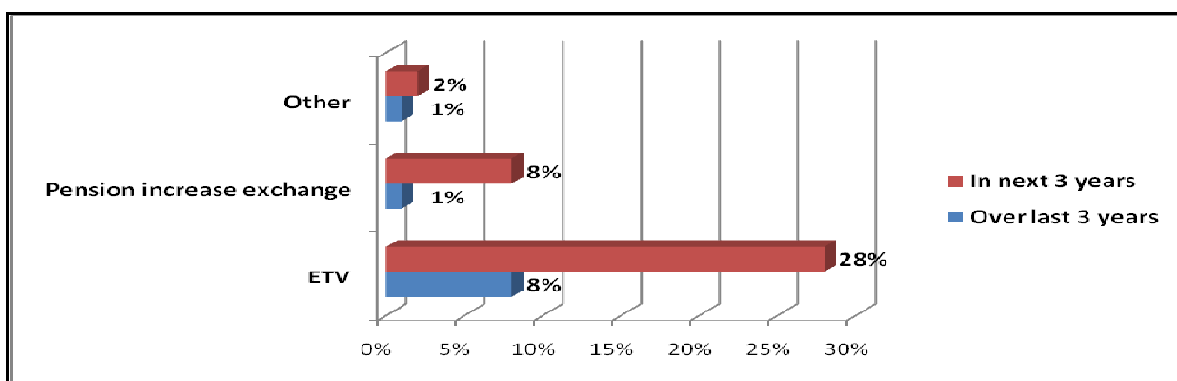
⁸ A Buy-out usually involves the transfer of scheme assets and liabilities to a regulated insurer. A Buy-in is where trustees continue to manage the scheme, with effectively an insurance policy covering benefits for a selection of pensioners.

Supporting employers desire to crystallise their defined benefit liabilities on the best terms available, over a third of employers are looking to manage their liabilities over the next three years by offering members enhanced transfer values to leave schemes (28%) or pension increase exchanges (8%), offers that run ahead of the reported incidence seen over the last three years.

The Pensions Minister, Steve Webb, has expressed some alarm at evidence he says DWP has about 'bad practice' particular in the use of cash incentives to encourage members to leave schemes. As a result, Ministers have agreed recently to work with industry groups to develop a Code of Practice to cover all forms of transfers that have not been inspired by the member, with a view that the Code be endorsed across the industry by April 2012. Whether this approach will slow down the anticipated increase in liability management offers is as yet unclear.

Figure 27: What 'liability management' offers have been made to defined benefit scheme members over the last 3 years and what might be offered over the next 3 years?

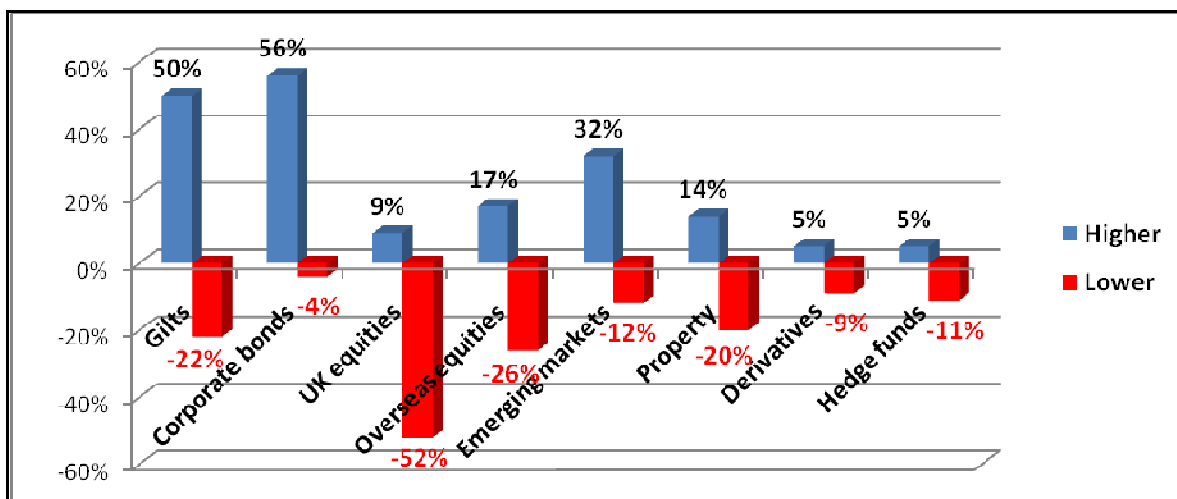
(Data Source: ACA 2011 Statistical Supplement, Table 24)



Over the last year, schemes say they have on average reduced their net investments in UK and overseas equities, property, derivatives and hedge funds, whilst increasing their exposure to gilts, corporate bonds and emerging markets.

Figure 28: Over the last year, what changes have there been in defined benefit schemes' investment strategy

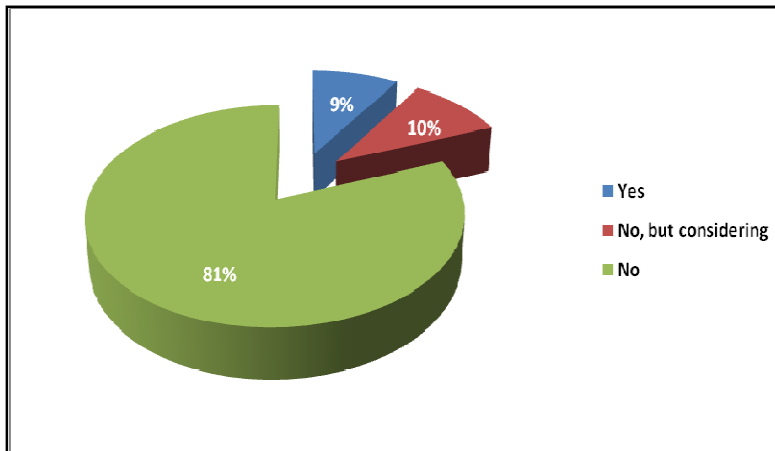
(Data Source: ACA 2011 Statistical Supplement, Table 25)



On average, a half of scheme assets are now passively managed, as against 44% two years ago and 9% of schemes are now utilising delegated investment management, with a further 10% considering using this approach. Recent market turbulence has accelerated the adoption of delegated investment management with an increasing number of schemes opting for this approach to enable swifter actions in response to volatile markets and the complexity of today's investment landscape.

Figure 29: What percentage of defined benefit schemes utilise delegated investment management?

(Data Source: ACA 2011 Statistical Supplement, Table 26)

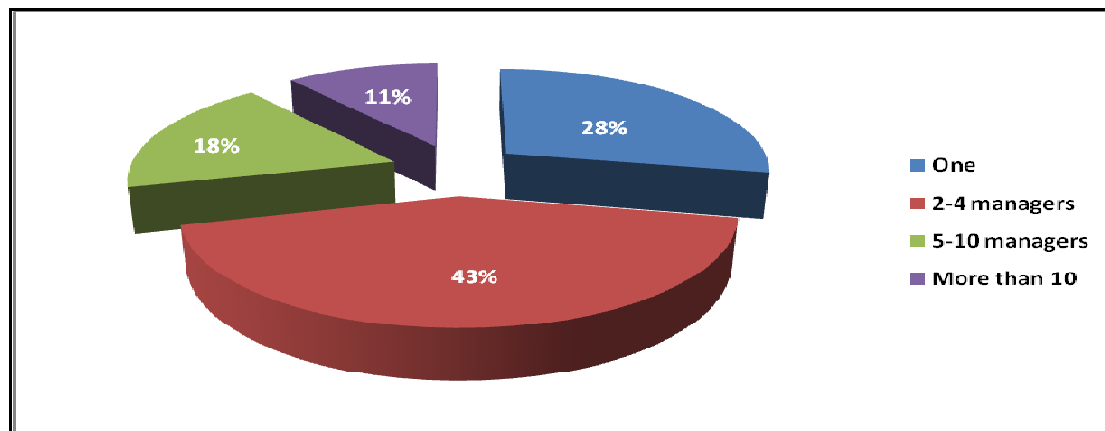


It may be as a result of these changes in management styles and in asset classes held generally by schemes over the last two years, but, fewer fund managers are on average being used by schemes.

Today, three out of ten use five or more fund managers as opposed to four out of ten two years ago.

Figure 30: How many fund managers do defined benefit schemes use?

(Data Source: ACA 2011 Statistical Supplement, Table 27)



Pension reform issues

Auto-enrolment and NEST

In 2010, we conducted two major surveys of both large and smaller firms on their views about the progress of auto-enrolment and NEST. This year's survey has looked again at a few of the key issues to assess whether attitudes and actions are changing as the staged auto-enrolment dates approach.

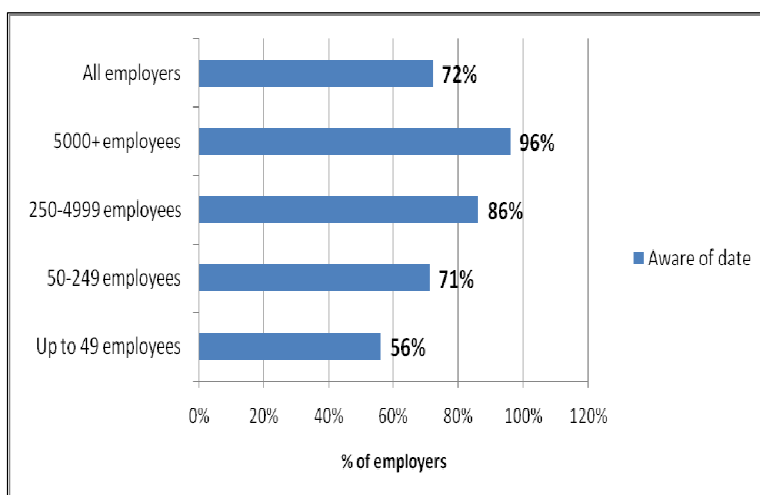
Are employers aware of the date when they must auto-enrol 'eligible jobholders' into a qualifying scheme?

Of those firms responding to the survey some 22% already auto-enrol at least some employees into a scheme, predominantly those employers with 250 or more employees⁹.

72% of all employers say they are aware of the dates from October 2012 onwards when they must auto-enrol eligible jobholders into either a 'qualifying' existing, or a new employer's scheme, or NEST. Even amongst smaller employers between 56-71% said they knew the date when the measure applies to them (54% a year ago). However, the government's recent announcement delaying staging for smaller employers with 50 or fewer employees, with further details due in January 2012, will have set this comprehension back (particularly as the staging dates for employers with fewer than 3,000 employees have also been 'withdrawn' pending the revised timetable due in January 2012).

Amongst larger employers, awareness is moving towards and beyond nine out of ten employers.

Figure 31: Awareness of auto-enrolment date by size of employer
(Data Source: ACA 2011 Statistical Supplement, Table 29)



In October 2012, the largest employers begin auto-enrolment with some starting earlier on a voluntary basis. **The challenging period for those running and monitoring auto-enrolment was to be in the period from March 2014.** Over what was a 4-month period, some 27,500 enterprises with between 50 and 249 employees were expected to begin auto-enrolment (unless they already do so). And then, the even bigger task,

in the next two years was due, when some 1.1 million enterprises with fewer than 50 employees were to be required to introduce auto-enrolment.

⁹ Data Source: ACA 2011 Statistical Supplement, Table 28

As we have outlined above, the full staging period is now to be made over a longer period, albeit this is not expected at this time to add more than a year to staging for the smallest of employers. The Government would be wise to retain some flexibility over any revised timetable to reflect how well the economy performs over the next few years. However, later staging is likely to mean a later date for the introduction of the full minimum contribution levels (hitherto due from October 2017), at least at the smaller employer end of the market.

Have employers budgeted for the likely increase in costs that could arise from higher scheme membership as a result of auto-enrolment?

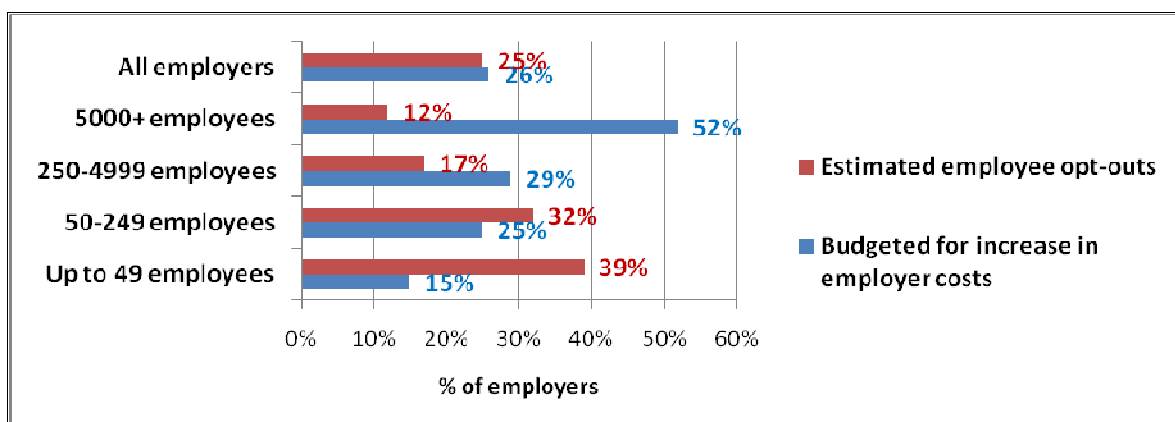
This year's survey found just over a quarter of employers (26%) are budgeting for the likely increase in costs arising from auto-enrolment, slightly more than our surveys found in 2010. However, amongst larger employers due to auto-enrol in 2012/2013, over half (52%) say they have now budgeted for the change. Last year, a little over a third of larger employers were in this position.

Amongst smaller firms with 249 or fewer employees, there appears to be no greater awareness than a year ago, with four out of five employers not yet counting the cost. Given the generally low level of pension provision and participation in pension arrangements, this is troubling, although it is three to five years now before the first compulsory requirement to auto-enrol applies to many smaller firms. **It means many more employers over the next three to four years or so will wake up to the potential costs involved and may feel they need to take mitigating actions.**

Of those organisations that have budgeted for extra costs, the average estimated member opt-out rate by smaller employers from workplace pensions is much the same as a year ago, ranging between 32% - 39%. This is much higher than larger employers are estimating, where opt-out rates averaging between 12% - 17% are being used for budgeting.

For many open schemes, this suggests auto-enrolment might lead to modest increases in membership through to very sizeable increases, where membership levels are low – potentially increasing employer pension contribution costs by high percentage amounts. Where no scheme is presently in place at all, the costs falling on employers, phased in over the period 2012 to 2017 (and maybe later), potentially will be greatest.

Figure 32: Have employers budgeted for auto-enrolment (including estimated opt-out rates)?
(Data Source: ACA 2011 Statistical Supplement, Table 30)



How will employers respond to auto-enrolment and NEST?

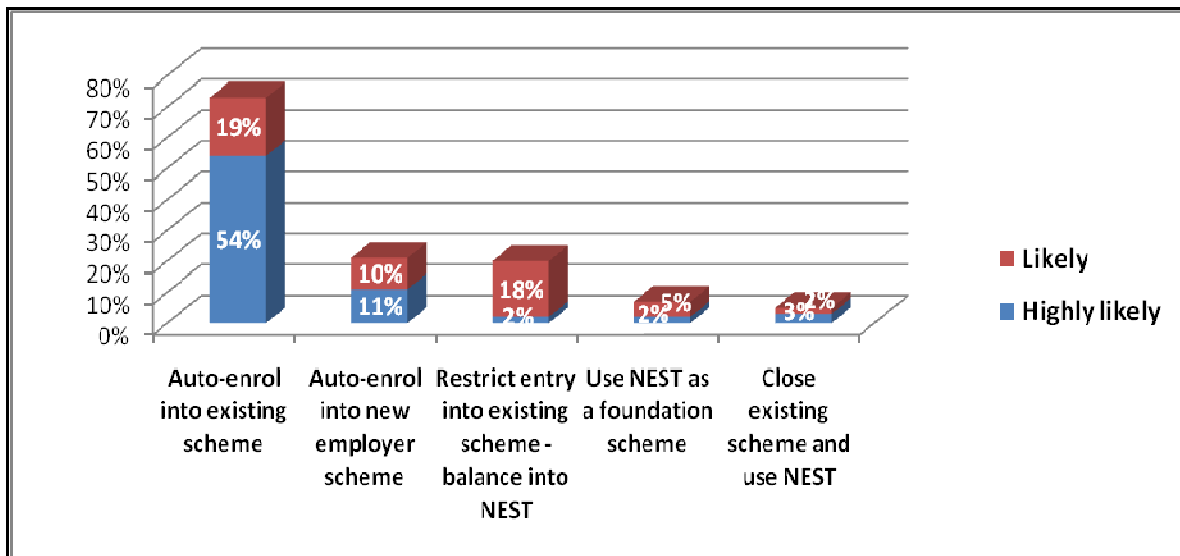
Employers with schemes at present: Encouragingly, the survey found that nearly three-quarters of employers (73%) are likely to auto-enrol present ‘non joiners’ into their existing pension scheme(s) – in the main into GPPs, Stakeholder and trust based DC schemes. There may be some levelling-down in contributions to mitigate costs (see *Figure 35, page 30*), where current employer contributions exceed the minimum applying from 2017 (3% of band earnings).

However, the results also suggest around a fifth of organisations (21%) will consider auto-enrolling into a new employer’s scheme, suggesting either the closure of existing schemes, both defined benefit and defined contribution, or the possibility that present ‘non joiners’ will be enrolled into new schemes, possibly attracting lower employer contributions¹⁰. This approach is favoured by over a third of small employers with 49 or fewer employees.

A fifth of employers say they will consider restricting entry into their existing schemes, auto-enrolling the balance of employees into NEST. Such a two-tier approach to provision may seem to have negative HR implications and may prove difficult to deliver in practice, but the DWP’s 2009 research seems to suggest this is an approach being considered by a wide range of employers. These results suggest there is reasonable evidence that such a two-tier approach is being considered quite widely.

Only a small number of employers (7%) are proposing to use NEST as a foundation scheme, running a top-up scheme above this. And, encouragingly, only a few (5%), mostly smaller employers, are considering closing their current arrangements entirely, moving all employees into NEST.

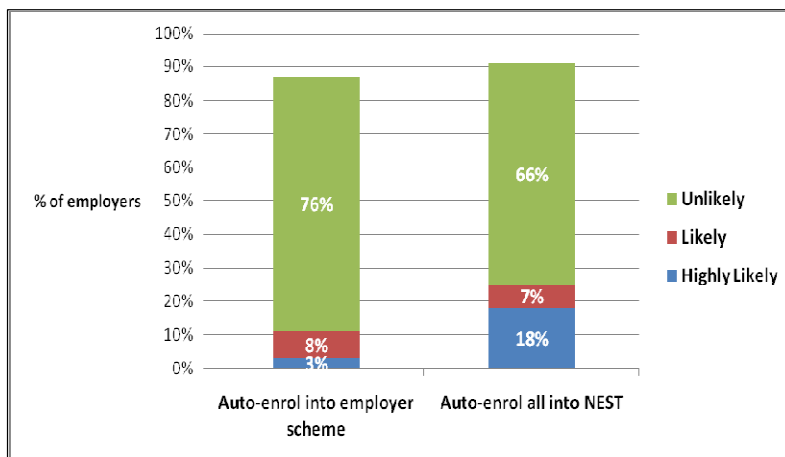
Figure 33: Employers with existing schemes: responses to auto-enrolment and NEST
(Data Source: ACA 2011 Statistical Supplement, Table 31)



¹⁰ This is supported by the findings in DWP Research Report *Employers’ attitudes and likely reactions to workplace pension reforms 2009*

Employers with no pension scheme at present: At least two-thirds of employers presently offering no pension scheme say they are unlikely to auto-enrol employees into either NEST or an employer's scheme. This suggests many smaller employers have as yet not understood the new legal requirements. It confirms the need for the reforms to be much better communicated to smaller employers over the period ahead so the obligations falling on them are better appreciated.

Figure 34: Employers with no existing pension scheme: response to auto-enrolment and NEST
(Data Source: ACA 2011 Statistical Supplement, Table 32)



Of those that seem to have addressed how the reforms will impact upon them, 25% are likely to use NEST as their qualifying scheme and 11% say they are likely to set up their own employer's scheme.

Since the survey was conducted, a number of other multi-employer schemes have been launched, which may have an impact on the use of NEST.

(Note: The balance of responses to the above were 'not sure')

Will employers review existing scheme benefits to mitigate the cost of higher scheme membership from auto-enrolment?

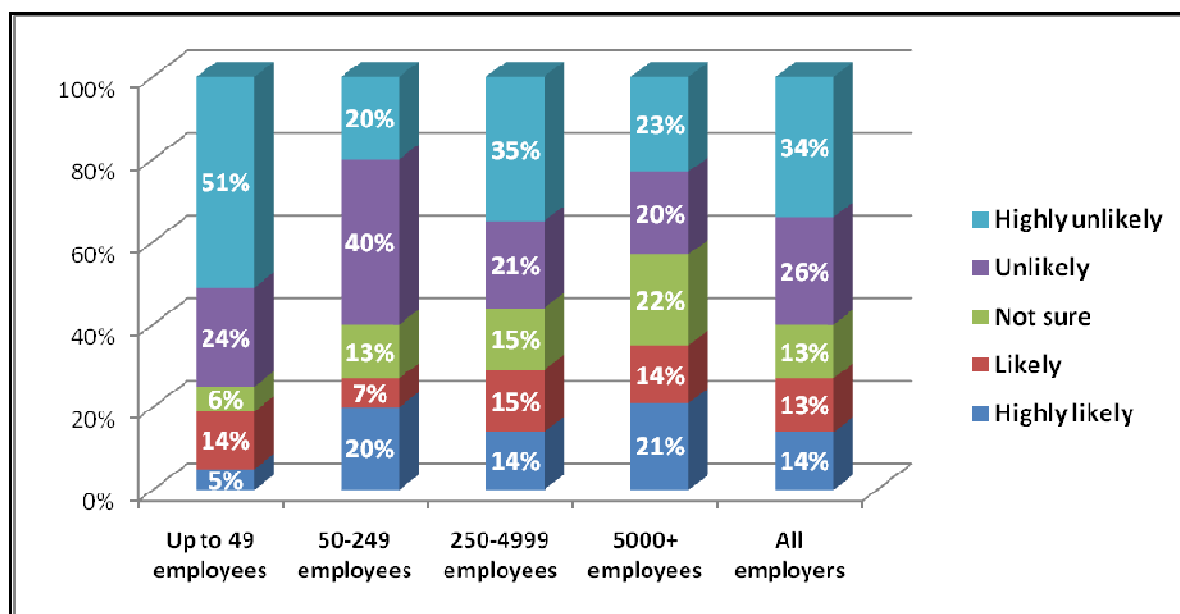
Overall, 27% of employers are likely to review existing scheme benefits/contributions to mitigate the cost of higher scheme membership as a result of auto-enrolment, with this rising to over a third amongst larger employers.

Given the numbers that have so far budgeted for the costs of auto-enrolment (26% - see *Figure 32, page 27*), this may be a figure that climbs as more organisations identify potential cost increases over the next few years. With current participation rates in schemes (see *Figure 9, page 12*), and the anticipated increases in membership expected from auto-enrolment suggested by this survey (particularly where current participation is low), there must be the ongoing likelihood when schemes are reviewed of some modest levelling-down of both contributions and benefits, where these are presently higher than the proposed minimum levels applying from 2017 (or later).

Other options may be lower pension contribution rates for current 'non joiners' and new employees and also adjustments to pay and employment levels or lower pay awards. Much is likely to hinge on the economic situation over the next few years and how this impacts on business performance and costs. As many of the Government's austerity measures have as yet to bite, there must be a considerable risk that hard pressed employers (and employees) might be forced to re-consider their approaches to pension spend

over the next few years – the threat of a further wave of levelling-down and higher employee opt-out rates than recorded in this survey may then emerge.

Figure 35: Auto-enrolment: will employers mitigate the cost of higher scheme membership
(Data Source: ACA 2011 Statistical Supplement, Table 33)



Given the challenging economic climate, do employers think auto-enrolment should be delayed?

It might be expected that the difficult economic climate, and the likelihood that this may remain challenging over the entire period of the implementation of auto-enrolment, would mean that employers might welcome a delay in auto-enrolment phasing and staging. **Indeed, whilst close to half (47%) of the smallest employers are of this opinion (and it was this lobby that eventually prevailed with the November announcement of a delay in staging for smaller employers), overall two-thirds of employers (68%) are opposed to any further delay in implementing auto-enrolment.**

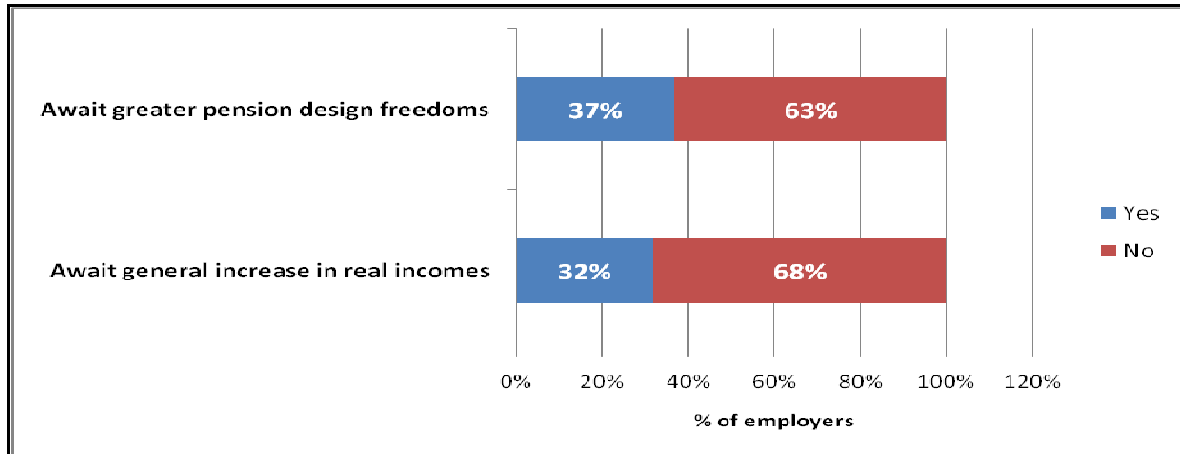
Do employers think auto-enrolment should be delayed as a requirement until the Government passes legislation to allow employers greater freedom to offer more flexible pension designs than at present?

Currently, many would argue that there are too many complexities in UK pension legislation, so employers find it difficult to identify pension designs that are cost effective and flexible. In particular, the defined benefit regime has become overly prescriptive as successive governments have attempted to engineer risk to members out of the design. As a result, the number of open schemes has reduced rapidly in recent years, ironically leaving more and more employees exposed to 100% of investment, inflation and longevity risks as they have been moved across into defined contribution arrangements.

If there were to be greater freedom and flexibility in design, it is doubtful that the appetite for DB 'lite' or other risk sharing approaches would transform general pension provision in the near-term, although for

some larger employers it might offer some new options that are not presently available. **This may explain why close to two-thirds of employers (63%) oppose auto-enrolment now being delayed to await greater pension design freedoms being introduced.** There is an acceptance that legislation to free-up designs is very unlikely ahead of the 2012 reforms, but – set against this – there are encouraging signs that the Government has not entirely given up on the Coalition manifesto commitment to ‘re-invigorate occupational pensions’, with the Pensions Minister announcing that he is looking again at risk-sharing options and publishing a paper in the New Year on re-invigoration.

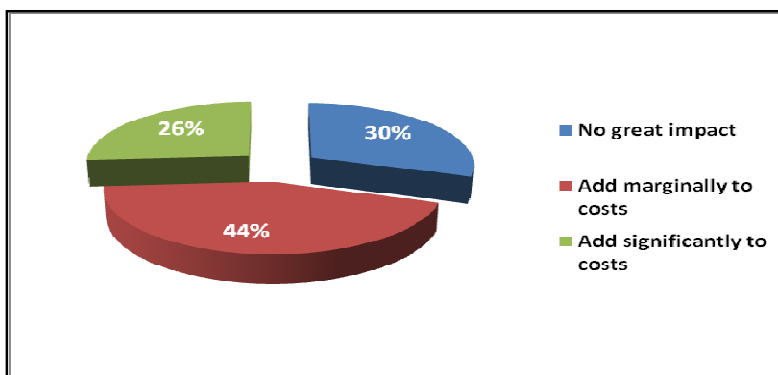
Figure 36: Should auto-enrolment await a general increase in real incomes or Government legislation to allow greater freedom of pension design?
(Data Source: ACA 2011 Statistical Supplement, Table 34)



Overall, how do employers think the introduction of auto-enrolment and NEST will affect their business and workplace pension provision?

26% of employers expect that auto-enrolment will add significantly to their costs, with a further 44% expecting the impact to be marginal. Aside from the administrative costs involved in ensuring observance of auto-enrolment rules, those employers facing significant increases in costs will be those with no present scheme or low existing levels of scheme participation, or where estimates of employee opt-outs ultimately fall short of expectations.

Figure 37: Overall, how will auto-enrolment impact on your organisation?
(Data Source: ACA 2011 Statistical Supplement, Table 35)



A quarter of employers (26%) think the implementation of auto-enrolment will directly lead on to a review of existing pension arrangements and 13% think this will lead onto a general levelling-down in benefits for those in existing schemes.

Set against this, a fifth of employers expect levelling up for many, which is perhaps a surprisingly low figure as expectations seem to be that many more employees will be covered by pensions than hitherto, although this survey has also found many employers forecasting quite high member opt-out rates from pensions post-2012.

Other pension reform issues

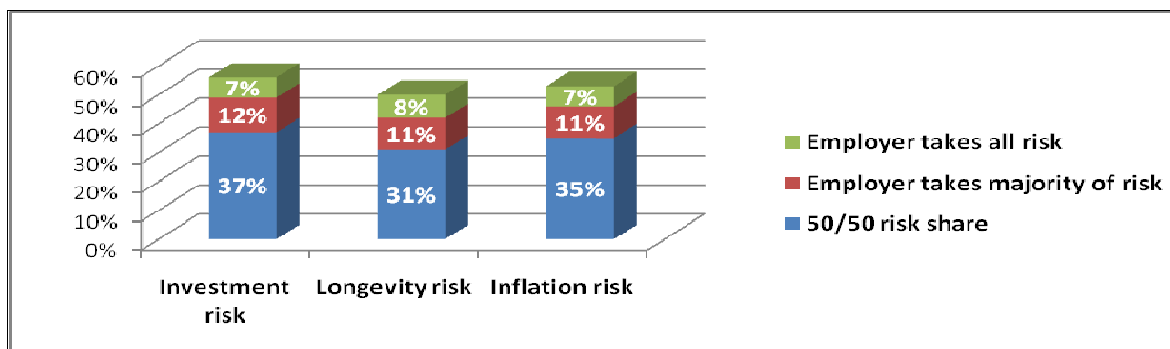
Appetite for risk sharing

The recent report of the *Workplace Retirement Income Commission*, chaired by Lord McFall, noted ‘we do see a strong case for exploring how the risk-sharing principle could be developed both to help individuals mitigate their risks and to improve the overall efficiency of the pension system...The Government should take forward a programme of work to understand, and address, the barriers and disincentives to risk-sharing approaches that remain’¹¹.

The potential for risk sharing is one that continues to resonate with employers. **In all three areas of investment, longevity and inflation risk, at least half of the employers responding to the survey say that employers should share or take on a majority of these risks.** Whilst mid-sized employers (50-4,999 employees) were broadly of the view that individuals should take on the majority of these risks, employers with fewer or more employees take an opposing position. Quite why may be for very different reasons. Perhaps it is explained by a more paternalist approach at the smaller end, and greater employer resources to cope with risks (but not 100% of the risks) at the other.

Figure 38: In designing pension arrangements, broadly what percentage of risk should employers be prepared to take on?

(Data Source: ACA 2011 Statistical Supplement, Table 36)



As we noted earlier, there are encouraging signs that the Government has not entirely given up on a commitment to ‘re-invigorate occupational pensions’, with the Pensions Minister announcing that he is looking again at risk-sharing options and publishing a paper in the New Year on re-invigoration.

¹¹ *Workplace Retirement Income Commission* final report, published August 2011, page 70

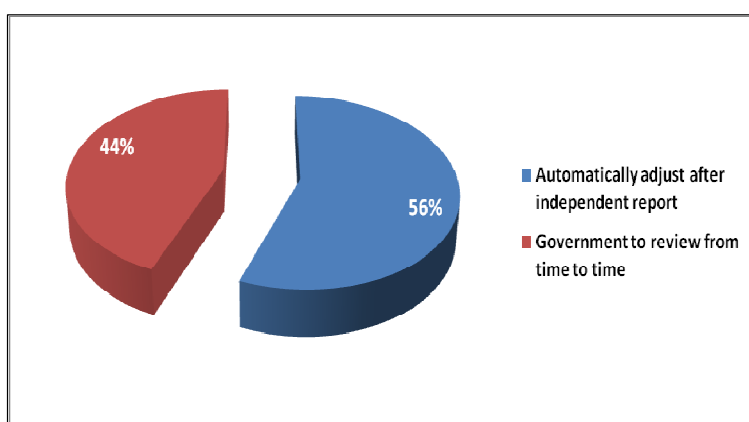
Changes in Pension Ages

The Government has already moved forward the date when the State Pension Age (SPA) will change to age 66. This will happen over a transitional period between 2018 and 2020, some six years sooner than was set in earlier legislation. That earlier 2007 legislation looked to move SPA up to age 67 by 2036 and to age 68 by 2046, but it is generally understood that if the cost of State pensions is not to increase markedly over the period, based on current increases in life-spans, SPA will have to move up to these higher ages on a much quicker path. More recently, the Government announced the move to age 67 would be advanced by some 8 years, to between 2026 and 2028. Also, the Government has consulted on the ways future changes to SPA might be enacted and our questionnaire put to employers what their preference would be.

56% of employers say they support the proposal that further increases in State Pension Age should be linked automatically to average increases in life-spans as recommended by an independent body. However, the majority of larger employers say they would prefer that any recommendations should be subject to a final decision being made by Government.

Figure 39: How should future changes in the State Pension Age be decided?

(Data Source: ACA 2011 Statistical Supplement, Table 37)



As it is widely accepted that employees probably need around ten years to plan for changes in retirement age, and presently with longevity generally improving by well over one year in every ten, it will be a challenge for those in government to keep pace with these advances by using ad hoc legislation as opposed to the greater certainty provided by an automatic process incorporating due

notice. Allowing governments to postpone or delay changes, which may prove attractive to politicians given the election timetable and growing 'grey' vote, would be to continue along much the same lines as in the past, with the danger that changes would run well behind advances in longevity, to the serious financial cost of later generations of taxpayers.

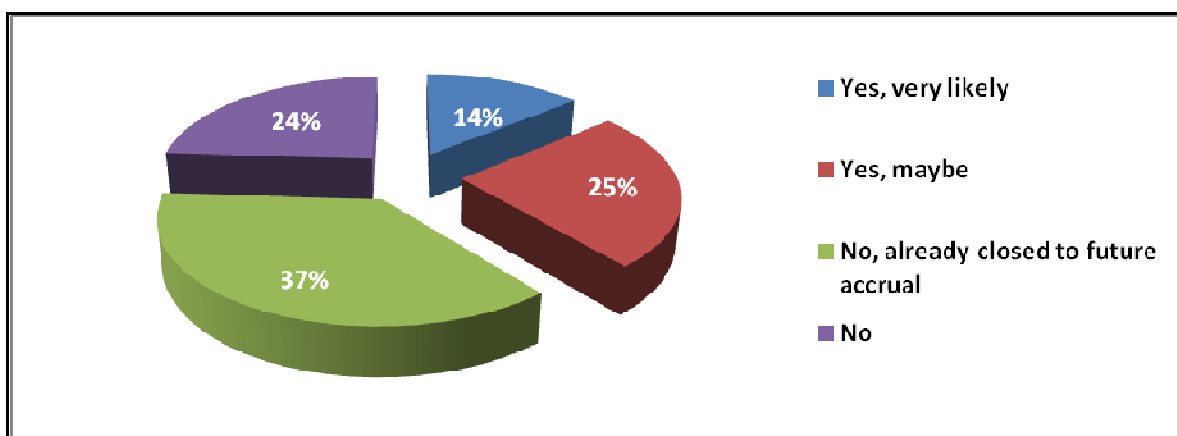
In many respects, the challenges in changing defined benefit scheme pension ages are greater as legislation presently requires that accrued pensions cannot be changed, even if advances in longevity mean that the retirement benefits generally will be enjoyed for many more years than was expected when the scheme was designed (and upon which the 'balance of costs' to the employer were based). If employers could move scheme pension ages in a more timely way than at present, this would be helpful both in terms of helping to cap the increase in defined benefit scheme costs as longevity improves, but also might convince more employers as a result to keep schemes open.

Mirroring the idea of a more automatic process in changing the State Pension Age, 64% of employers say they would like to see a statutory override introduced that would enable them to adjust their scheme pension age automatically as life-spans extend. The ability to move automatically in line with changes in State Pension Age is the most popular linkage (39%)¹².

Defined benefit contracting-out and indexation

It seems likely the Government is minded, finances permitting, to consolidate the State Second Pension into a new single tier and higher Basic State Pension with, as a result, defined benefit contracting-out being abolished. Whilst consultations are continuing on how this might be achieved without undermining ongoing provision, **14% of employers running a defined benefit scheme said the abolition of contracting-out would bring forward a decision to close their scheme to future accrual, with a further 25% saying 'it might'.**

Figure 40: If the Coalition Government decides to implement a new single tier and higher Basic State Pension, it seems likely defined benefit contracting-out will be abolished. If this happens, will it bring forward a decision to close defined benefit schemes to future accrual?
(Data Source: ACA 2011 Statistical Supplement, Table 39)



Since the Government's announcement that it intended to change the indexation of benefits in public service schemes to the 'more appropriate' CPI as opposed to RPI, private sector employers have in many cases sought to follow suit. As our survey has found, quite a number have succeeded, but it has become clear many others are not free to do so because of their existing scheme rules. **Just over a half of employers said that sponsors should have a statutory over-ride to change scheme indexation rules to overcome problems with current scheme rules¹³.**

With a view to practice applying prior to legislative intervention in the 1990s and that reflecting current practice in countries like The Netherlands, **58% also said sponsors should also have discretion to hold back indexation of benefits where a defined benefit scheme is in deficit.**

¹² Data Source: ACA 2011 Statistical Supplement, Table 38

¹³ Data Source: ACA 2011 Statistical Supplement, Table 40

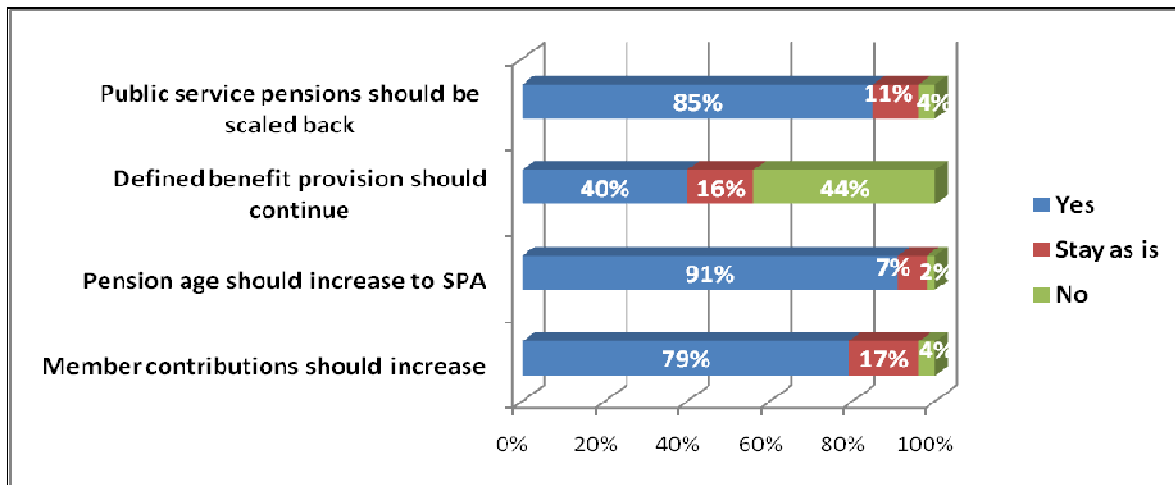
Changes in public service pensions

In the light of the review of public service pensions by Lord Hutton and his broad recommendations for change, the Government presently is wrestling with public sector unions, endeavouring to make progress in reducing the longer-term costs of public service pensions. Our questionnaire examined what degree of support there is across the private sector for the broad range of changes proposed by Lord Hutton and taken up by Government in its negotiating position this year.

With the very different pension position applying across most of the private sector, the views of private sector employers are supportive of the reforms. **Upwards of eight out of ten employers support the recommendations made by Lord Hutton that public service pensions should be scaled back (85%), that member contributions should increase (79%) and that the pension age in such schemes should increase to the State Pension Age (91%).**

However, over half (56%) support the continuation of defined benefit provision for public service employees but, of these, only 16% support the continuation of existing benefit levels. This would appear to endorse a move to lower-cost defined benefit provision, such as career average, cash balance and mixed defined benefit/contribution arrangements.

Figure 41: How should public sector pensions change?
(Data Source: ACA 2011 Statistical Supplement, Table 41)



Summary of new employer duties under Auto-enrolment and NEST

The *Pensions Commission Reports* in 2005 and 2006 pointed to significant under-saving for retirement, notably amongst low-to-moderate earners, with millions heavily reliant on inadequate State pensions. The then Government responded by flagging its intention to restore the indexation of State Pension to earnings growth alongside a number of other improvements (but with the State Pension Age gradually increasing in stages to 68). Additionally, to boost pension coverage and to take in up to 10 million new pension savers, the Government accepted the need for both a low-cost national scheme (now called NEST) for employees not offered access to an employer's scheme meeting certain minimum requirements and auto-enrolment into either NEST or an employer's scheme. Following an independent review over the summer of 2010 the coalition government has made a few changes in the policy detail but has endorsed the launch of auto-enrolment and NEST from 2012, albeit with some recent announcements delaying the introduction of auto-enrolment for smaller employers.

The key features of the policy, as revised by the coalition government, are:

- a new employer duty is due to come into force from October 2012. From then, **auto-enrolment of all 'eligible jobholders'** (those aged 22 and below State Pension Age) **with earnings above £8,105pa #** (aligning the threshold with the personal allowance for income tax from April 2012) into a **'qualifying workplace pension scheme' (QWPS) will begin as a statutory requirement** for the largest employers. Minimum contributions will however be calculated on earnings above £5,564pa # up to £39,853pa #.
- Medium sized and small employers will be required to auto-enrol their 'eligible jobholders' into a qualifying scheme on a staged basis geared to PAYE references, such that all employers, including single employee firms, will be integrated, based on current announcements, by 2017 (but now likely to be later for some small employers).
- 'Jobholders' aged over 16 and under 22 or over State Pension Age up to age 75 will be able to ask to be auto-enrolled into a qualifying scheme if they exceed the updated earnings level of £5,564pa # (and the employer must comply and pay the employer's contribution). If they have no qualifying annual earnings above £5,564pa #, they can enrol, but no employer contribution is required. If they have earnings between £5,564pa # and £8,105pa # they can ask to be enrolled and their employer will have to make a minimum contribution.
- All jobholders will have the right to 'opt-out' (but eligible jobholders must be auto-enrolled first) and all eligible jobholders will be re-enrolled every three years during a six month window, with a view to increasing scheme coverage over time.
- Although these dates may now be varied, currently in the staging period up to 30 September 2016 the total minimum pension contributions will be 2% of employee earnings, with a minimum of 1% from the employer. From October 2016 this will rise to 5% of employee earnings, with a minimum of 2% from the employer. From October 2017 contributions will be 8% of employee earnings, with a minimum of 3% coming from the employer plus 4% from the employee and 1% by way of tax relief. For small employers, this date may be extended (announcement pending). Regulations have set out an alternative approach to provide employers with a simpler way to comply with the earnings requirements.
- Defined benefit and hybrid schemes will be exempt from staging – the duty to auto-enrol will instead be delayed until October 2016.
- Employers will be able to auto-enrol eligible jobholders into a firm's own existing (or new) qualifying scheme, when this is certified as such by the Pensions Regulator, or otherwise must enrol them in the new National Employment Savings Trust (NEST). An employer's own scheme will only be certified as a qualifying scheme if it reaches requirements that are at least equal to or better than NEST. There will be an optional waiting period of up to 3 months before a worker needs to be auto-enrolled, although workers may opt in during the waiting period.
- NEST has been developed as a trust-based, defined contribution, portable, low-cost scheme (0.3% annual management charge plus 1.8% charge on each contribution until NEST set up costs are met), designed for the needs of low-to-moderate earners. Its investment approach will reflect the needs of these groups.
- NEST will only accept transfers in and out of the scheme in very limited circumstances, but this may be reviewed.

All 2012/13 figures are subject to a current consultation exercise (closing 25 January 2012)

© Association of Consulting Actuaries, 2012. All rights reserved. References to the research statistics herein must be attributed to the Association. Otherwise, no part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the permission of the Association of Consulting Actuaries.

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.

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

St Clement's House, 27-28 Clement's Lane, London EC4N 7AE

Tel: +44(0)20 3207 9380 Fax: +44 (0)20 3207 9134 Email: acahelp@aca.org.uk

Web: www.aca.org.uk

January 2012