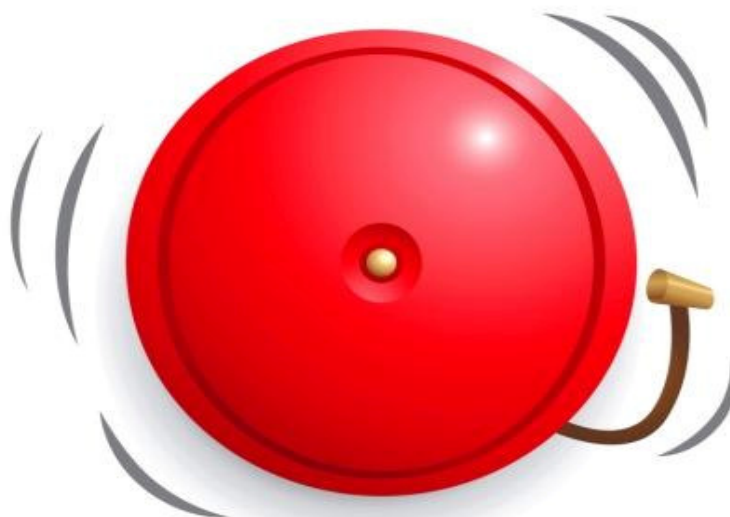


St Clement's House, 27-28 Clement's Lane, London EC4N 7AE  
Tel: +44(0)20 3207 9380 Fax: +44 (0)20 3207 9134 EMail: [acahelp@aca.org.uk](mailto:acahelp@aca.org.uk)  
Web: [www.aca.org.uk](http://www.aca.org.uk)



# Workplace pensions: the alarm bells are ringing

**Interim Report of the ACA's 2011 Pension trends survey**

**Conducted by the Association of Consulting Actuaries**

**PUBLISHED – 1 September 2011**

## Chairman's Introduction: ACA 2011 Pension trends survey



Late last year, when we published our biennial *2010 Smaller Firms Pensions Survey*, I commented that:

“whilst the country’s dire economic position does not presently allow, it seems clear to me that if we are to encourage a much wider proportion of our people to save adequately for their retirement, we will need to make greater room for savings from individuals’ disposable incomes. Employers too will need new rewards for boosting their pension contributions and greater freedom in pension design. Greater transparency and low-cost products will play a part in this, as will better consumer financial education and auto-enrolment – all of which is ‘work in progress’, with some areas more advanced than others, but more will be needed.”

Nearly a year on, the plan to ‘re-invigorate private pensions’, a Coalition Government commitment, remains unclear and undelivered. Yes, further sensible State pension reforms seem likely, but private pension reforms seem to have become overly focused on pension auto-enrolment rather than wider consideration about the efficacy of the arrangements into which employees will be joined.

The results of our latest *2011 Pension trends survey* are alarming in a number of ways. They point to a rising trend amongst 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 private sector employers as they begin to focus on the potential costs of pension reforms around the corner from 2012. This is understandable but, with 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. As things stand, there is a clear danger of more ‘levelling-down’ – a trend which our surveys have identified for some years now. With contribution rates into many 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 should be ringing in Whitehall and Westminster.

The results also suggest a sizeable majority of smaller firms, employing over half the UK private sector labour-force, have as yet failed to appreciate the impact of auto-enrolment on them and the decisions they must consider. Many are still unaware of the date when they must auto-enrol their employees into a scheme.

Yes, it is good news that auto-enrolment should widen pension coverage, particularly where no pensions are offered at present. Hopefully, the communications campaign associated with the reforms will mean employees’ general understanding about the need to save much more for a comfortable retirement will be a success, although I am not sure the Government has as yet really grasped the financial pressures falling on the target groups for auto-enrolment over the next few years. Nor, in my view, have they been sufficiently ‘in listening mode’ about ways in which they might encourage more employers to do better than simply the basic. The preparedness of employers to share risks, echoed by this survey, and the endorsement of this approach by the recent *Workplace Retirement Income Commission*, to open up new pension designs, need to be followed up with some urgency.

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

**Stuart M Southall**  
Chairman

1 September 2011

## 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. This initial survey report focuses on general pension trends, including contribution levels by private sector employers and members, and also 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. Worryingly, a third of larger employers say they are looking to decrease their spending on pensions.
- Over the last 3 years, 21% of employers' report that member opt-outs from workplace pension schemes have increased.
- 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. 28% of employers are still unaware of the date when they must auto-enrol their employees into a workplace pension.
- 73% of employers say they are likely to auto-enrol all employees into an existing pension scheme.
- 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.
- 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.
- 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%). 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.

## 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 (up from 18% two years ago).
- 5% of employers offer just a defined benefit scheme, with 54% offering only a defined contribution scheme and 41% running both defined contribution and defined benefit schemes.
- 22% of employers 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.
- 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.
- Employers say the principal reasons why employees do not join existing schemes are, in their view, 'cost' (92%), a 'preference to spend' (89%), a 'lack of interest' (74%) and 'disillusionment with pensions' (61%).
- 16% of the employers responding to the survey presently offer no pension arrangements at all. Their principal reasons for not providing a scheme are 'cost' (94%), 'economic conditions in their industry' (88%) and their view that employees have a 'preference for non pension benefits' (65%).
- 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 12½% of earnings. Average combined employer and employee contributions into defined benefit schemes remain at over double these levels at 27% of earnings.

## Auto-enrolment and NEST

- 72% of employers say they are aware of the date when they must auto-enrol 'eligible jobholders' into a qualifying scheme between 2012 and 2016.
- 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.
- 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. Of those that seem to have addressed them, 25% are likely to use NEST and 11% set up an employer's scheme.

## Other pension reforms

- 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.
- 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 being made 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%).
- 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 6.6 million (36%) are members of workplace pension schemes, as opposed to 84% (6.2 million) of those working in the public sector<sup>1</sup>.

With mounting evidence that the percentage of employees in the private sector with access to workplace pensions has been falling in recent years, 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 (around 30,000), 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 staging timetable from 2014 onwards. Aside from their awareness of when they must auto-enrol, 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                                         |

**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)

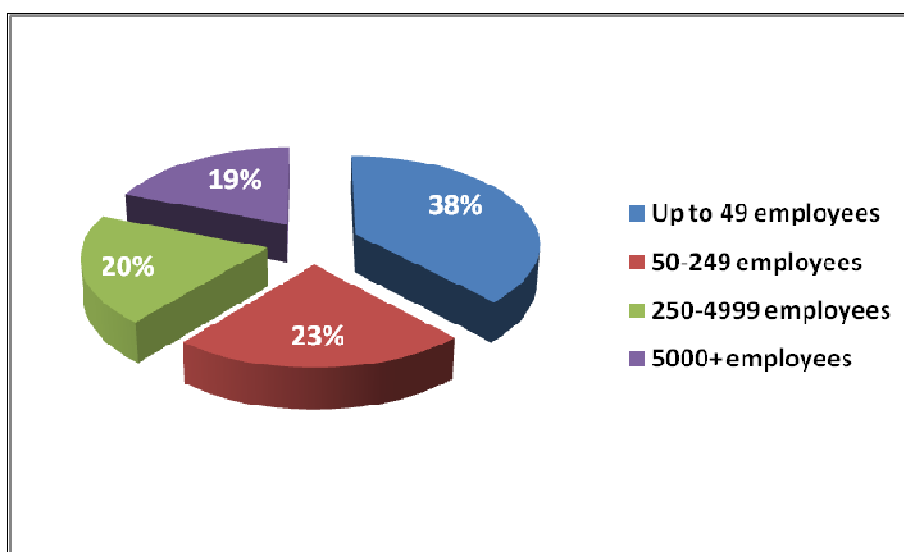
<sup>1</sup> Hansard, Pension Minister, Steve Webb MP responding to written question from Karen Lumley MP, 11 August 2011.

## Employers responding to the survey

Of the 468 employers 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 employees<sup>2</sup>.

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 pensions<sup>3</sup>.

Figure 2: Breakdown of employers responding to the survey



<sup>2</sup> Source: ONS Inter-Departmental Business Register 2010

<sup>3</sup> Source: DWP Research Report No.683, *Employers' attitudes and likely reactions to workplace pension reforms 2009*

## 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 by existing employees.

Figure 3: Schemes run by employers responding to the survey

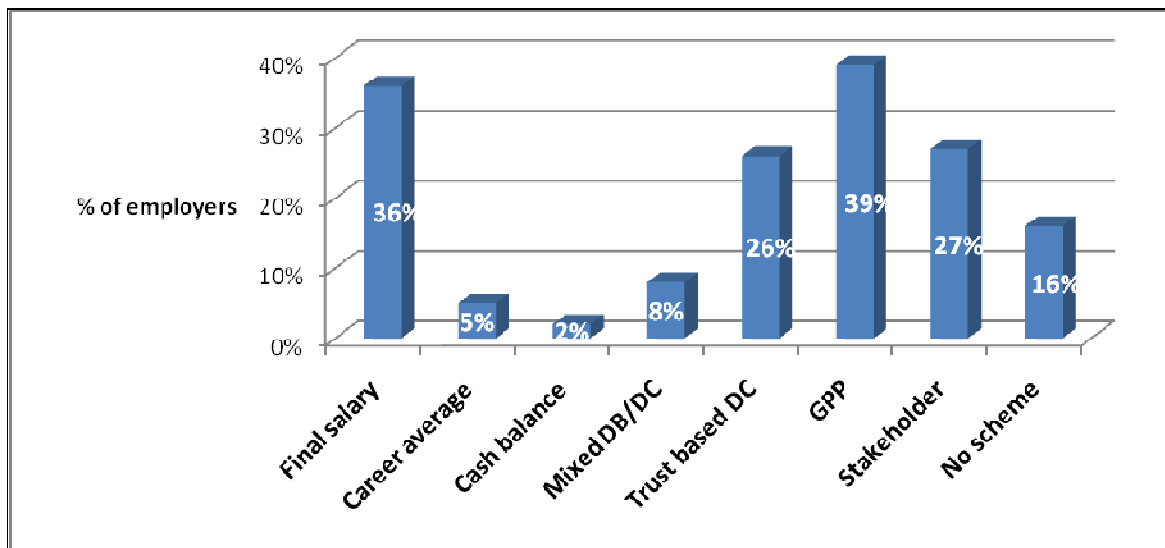
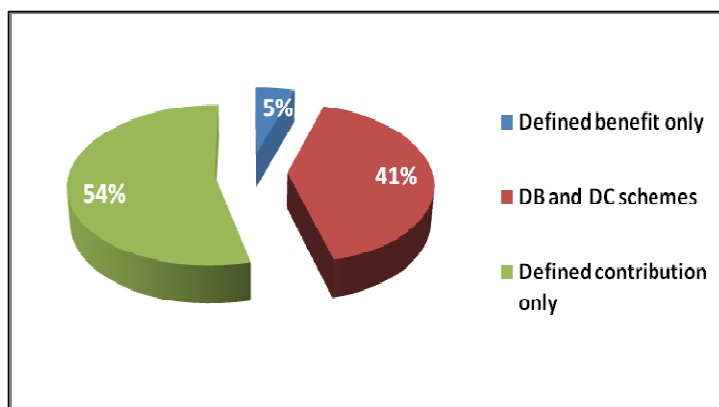


Figure 4: Schemes designs run by employers: by regulatory type

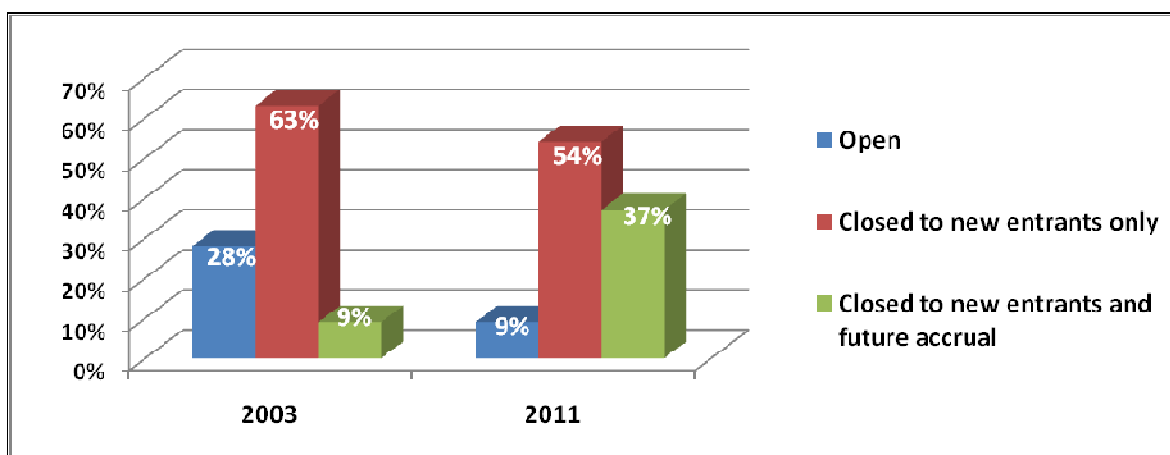


Of those employers running schemes, over a half provide just a defined contribution scheme and 5% offer a defined benefit scheme alone.

**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



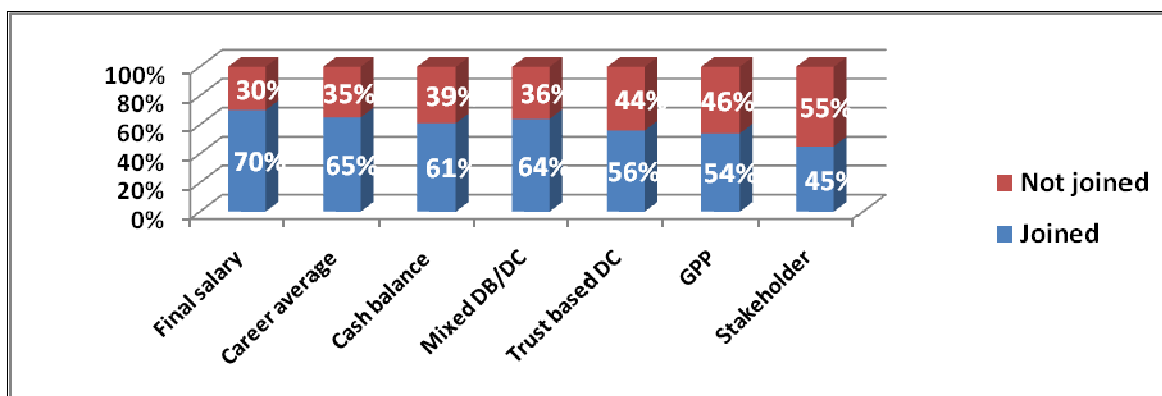
Reflecting a move away from trust based in favour of contract based defined contribution schemes, the survey found 31% of trust based schemes are closed to new entrants, with just under a third of these also closed to new contributions from existing employees. The majority of firms reporting such a closure now offer either contract-based GPPs or Stakeholder schemes.

### Average scheme membership by eligible employees

Of those eligible to join workplace pension schemes, average participation rates vary between 45% in Stakeholder schemes through to 70% in final salary arrangements. 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 employees.

With generally over 35% of employees not participating in membership of 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. 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 6: Scheme participation by eligible employees



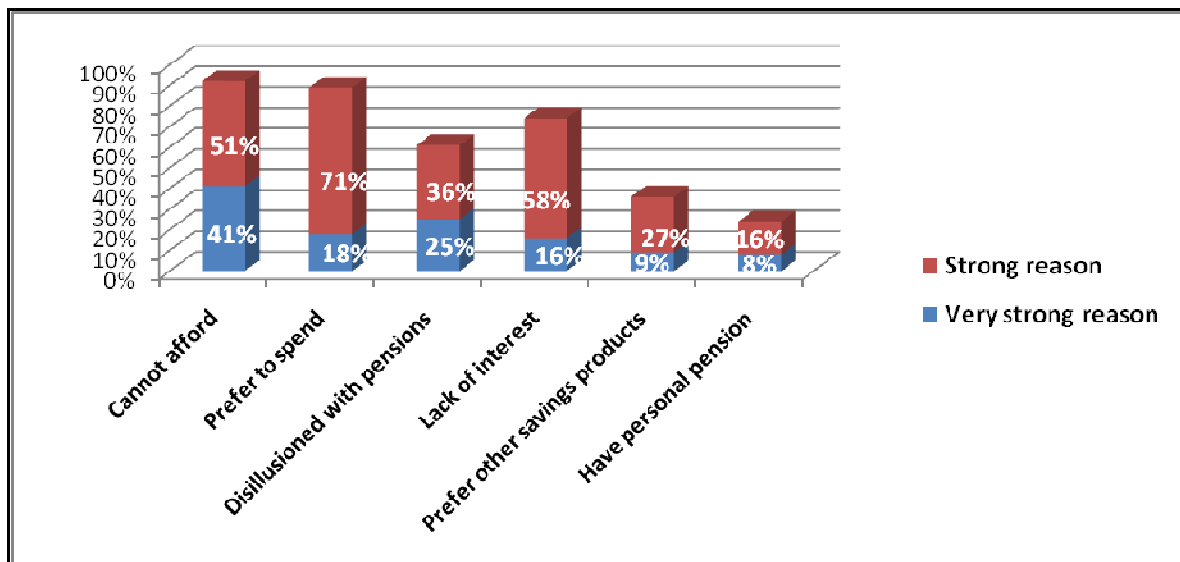
## Why are so many employees not in workplace pension schemes?

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, 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 years.**

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, 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. This is a situation which may have some way to run.

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.

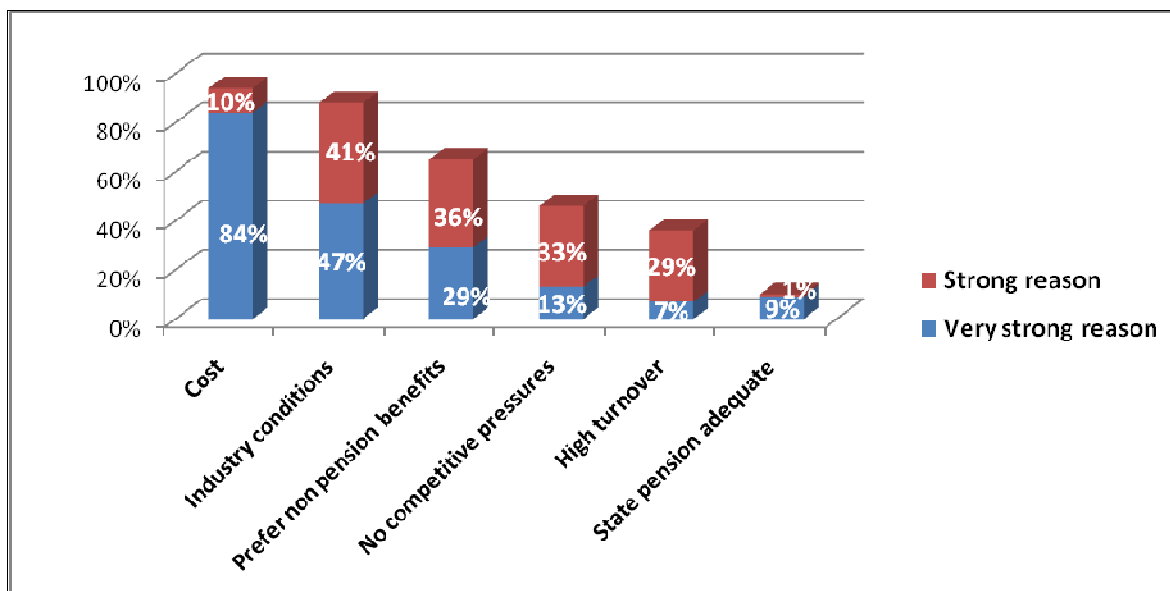
Figure 7: Why do employers think employees do not join your pension scheme?



## 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 buoyed 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 8: Why employers do not offer a pension scheme



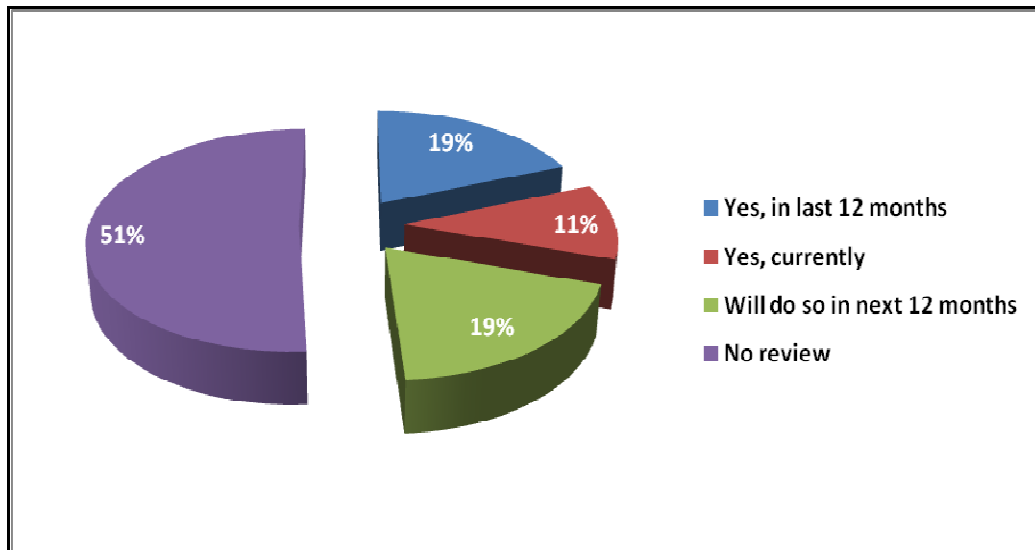
## Scheme reviews

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, or the approach of auto-enrolment, or because of financial reasons in a generally difficult economic climate.

This higher 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.

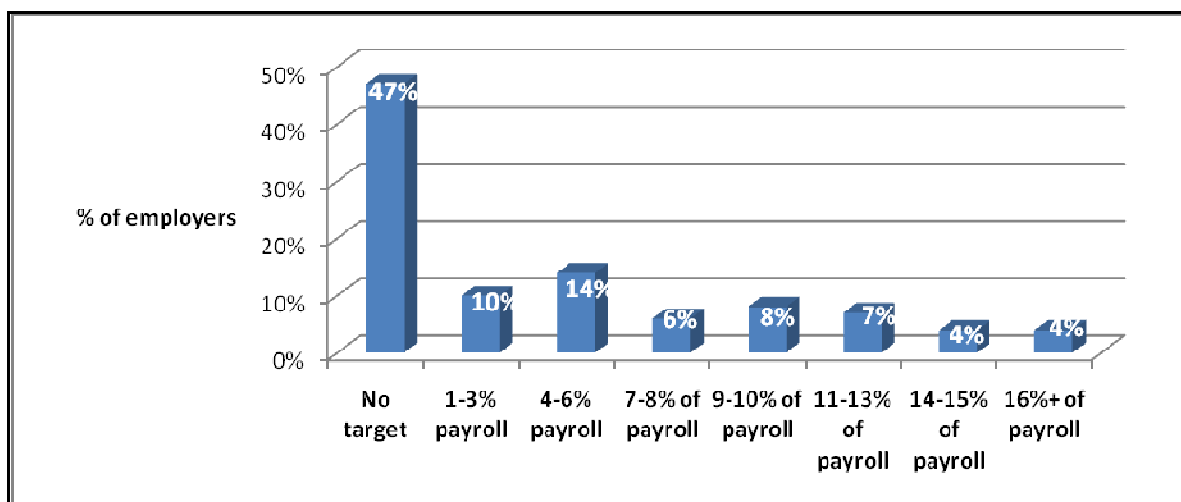
Figure 9: Reviews of current workplace pension arrangements



### Targets for pension costs

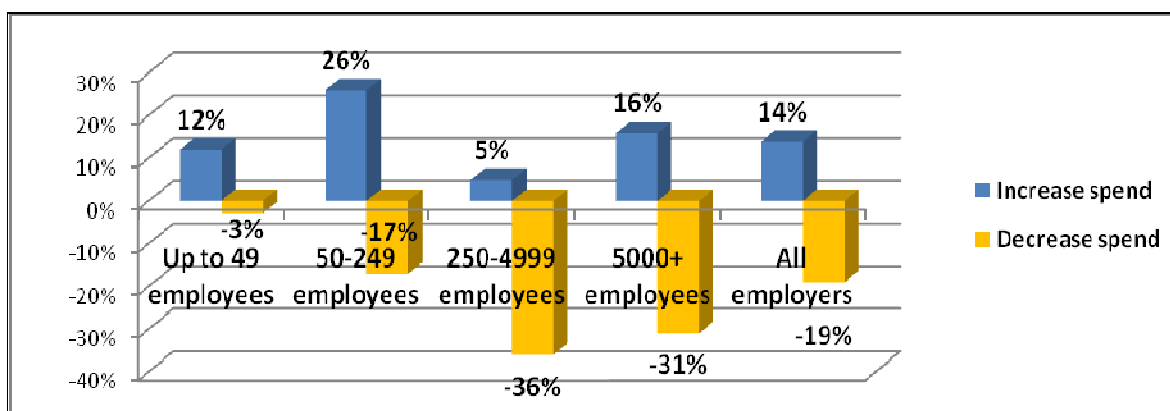
Whilst close to half of the employers responding to the survey do not have a target for their total pension costs, it is encouraging that over 4 in 10 are targeting employer pension costs of 4% of payroll or more (i.e. broadly in excess of the minimum employer contribution levels that will come into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

Figure 10: Do employers have a target as to what their business will spend on pensions as a percentage of payroll?



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

**Figure 11: Overall, is your business trying to increase or decrease its spend on pensions?**



## Pension contributions and levelling-down

Employer contributions into defined contribution schemes across these employers 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 (and NEST) move 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 firms<sup>4</sup>, 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.** As we noted earlier (*see page 11*), the high level of scheme reviews in larger organisations may already reflect an acceleration in levelling-down decisions.

<sup>4</sup> 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](http://www.aca.org.uk) – publications)

**Figure 12: Average contributions into defined contribution workplace pensions (as a percentage of earnings): broken down by employer sizes**

| 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

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 13, page 15). 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 survey<sup>5</sup> 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.

<sup>5</sup> ACA Final Report, *Survey of smaller firms' pensions*, published 4 January 2011 (see: [www.aca.org.uk](http://www.aca.org.uk) – publications)

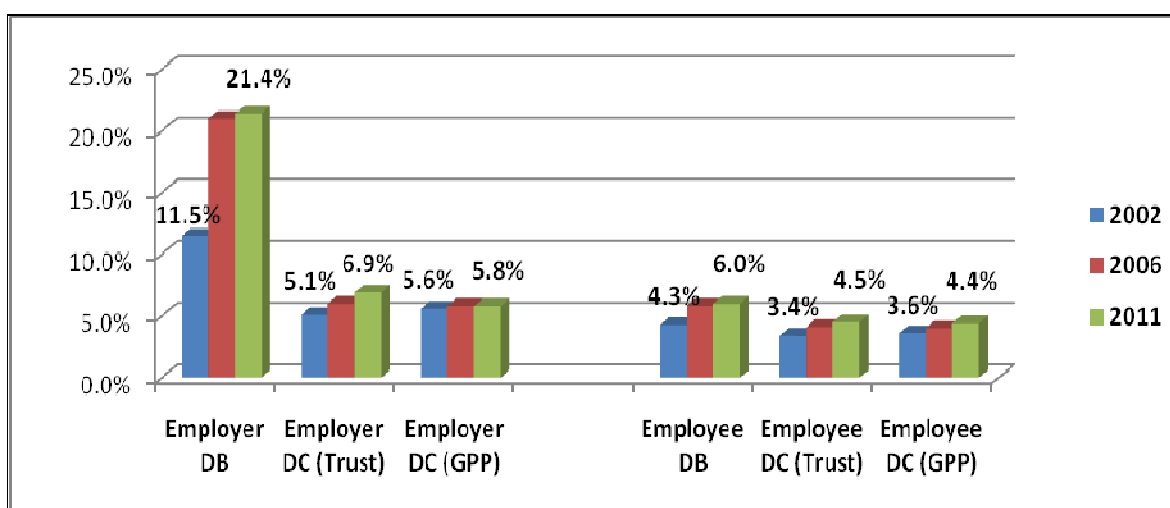
This process aside, over the last 5 years, only 11% of employers report any, and mostly modest, increases in their contribution levels (and 8% any increase in the minimum employee contributions) into their defined contribution schemes/plans.

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 paper<sup>6</sup> 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.

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, persuading the wider public, 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 13: Comparison of average employer and employee pension contributions (as a percentage of earnings) 2002 – 2011**



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

## Pension reform issues

### Auto-enrolment and NEST

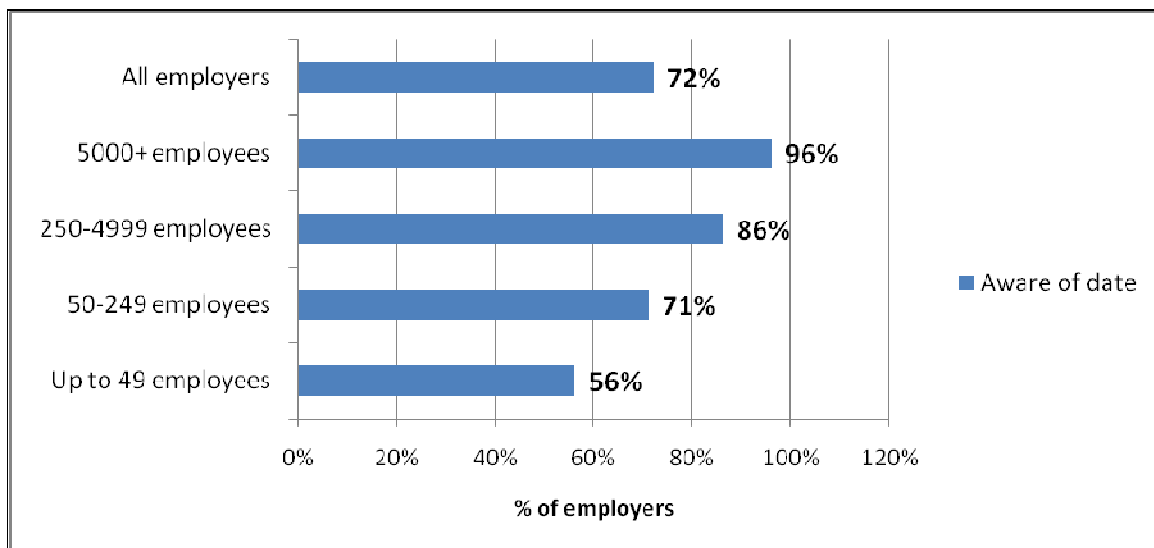
In 2010, we conducted two major surveys of both large and smaller firms on their views about the progress of auto-enrolment and NEST. This year's survey has looked again at a few of the key issues to assess whether attitudes and actions are changing as the staged auto-enrolment dates approach.

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

**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 new employer's scheme or NEST.** Even amongst smaller employers between 56-71% say they know the date when the measure applies to them (54% a year ago). Amongst larger employers, awareness is moving towards and beyond nine out of ten employers.

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 will be in the period from March 2014. Over a 4-month period, some 27,500 enterprises with between 50 and 249 employees will be expected to begin auto-enrolment (unless they already do so). And then, the even bigger task, in the next two years, some 1.1 million enterprises with fewer than 50 employees will be required to introduce auto-enrolment.**

Figure 14: Awareness of auto-enrolment date by size of employer



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

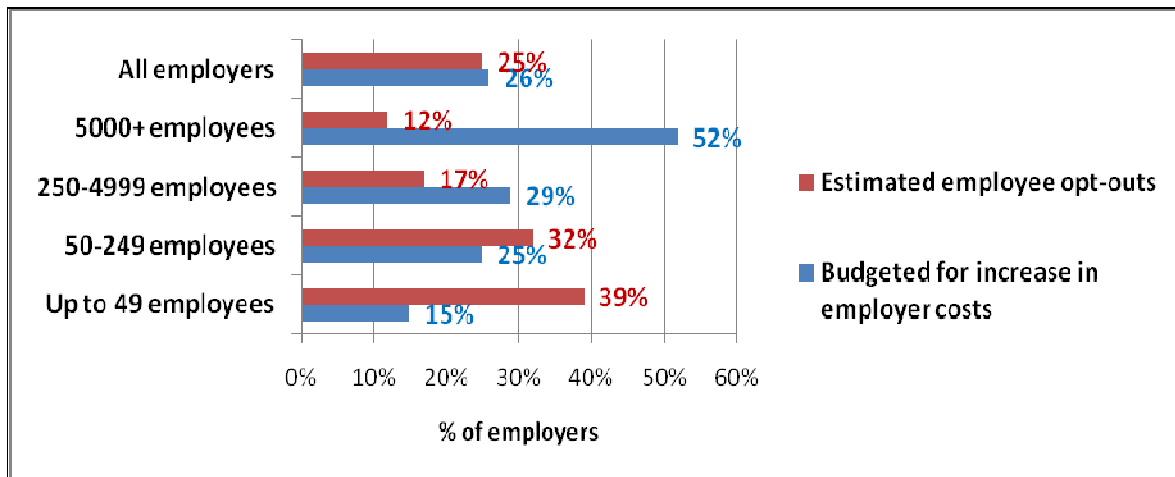
This year's survey found just over a quarter of employers (26%) are budgeting for the likely increase in costs arising from auto-enrolment, slightly more than our surveys found in 2010. However, amongst larger employers due to auto-enrol in 2012/2013, over half (52%) say they have now budgeted for the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

However, 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, albeit it is three to four years before the first compulsory requirement to auto-enrol applies to many smaller firms. **It may mean many more employers over the next three years or so will wake up to the potential costs involved and 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 as 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, potentially will be greatest.

Figure 15: Have employers budgeted for auto-enrolment (including estimated opt-out rates)?



## What will employers response be to auto-enrolment and NEST?

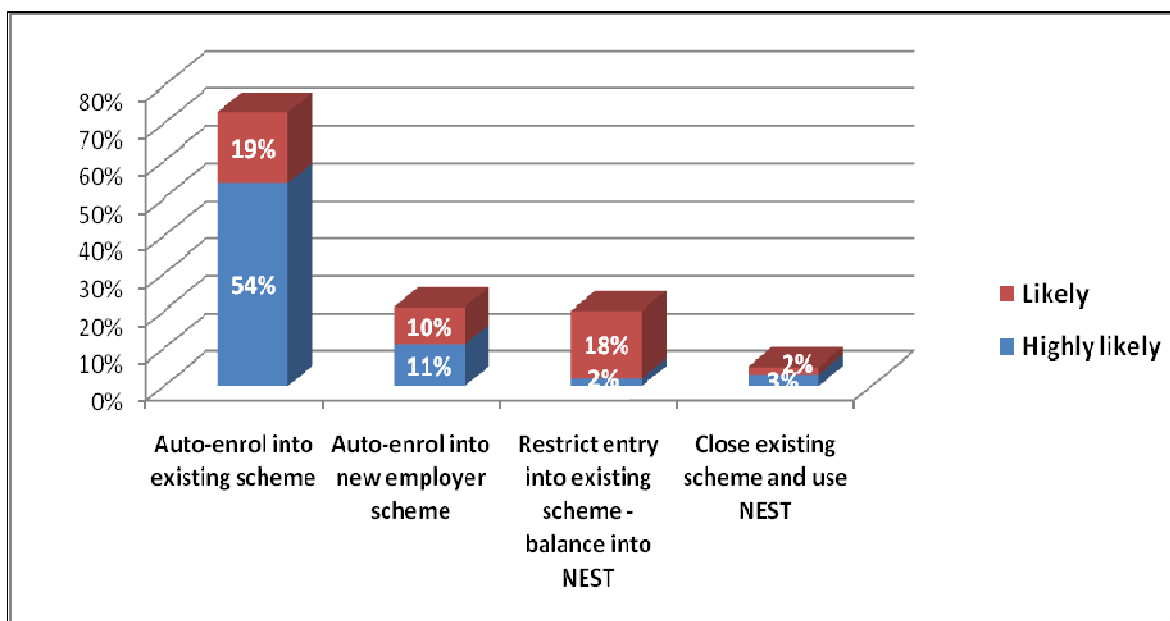
**Employers with schemes at present:** Encouragingly, the survey found that well over half of employers (73%) are likely to auto-enrol present ‘non joiners’ into their existing pension scheme(s) – in the main into GPPs, Stakeholder and trust based DC schemes. There may be some levelling-down in contributions to mitigate costs (see *Figure 22, page 20*), 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 contributions<sup>7</sup>. 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 20: Employers with existing schemes: responses to auto-enrolment and NEST**

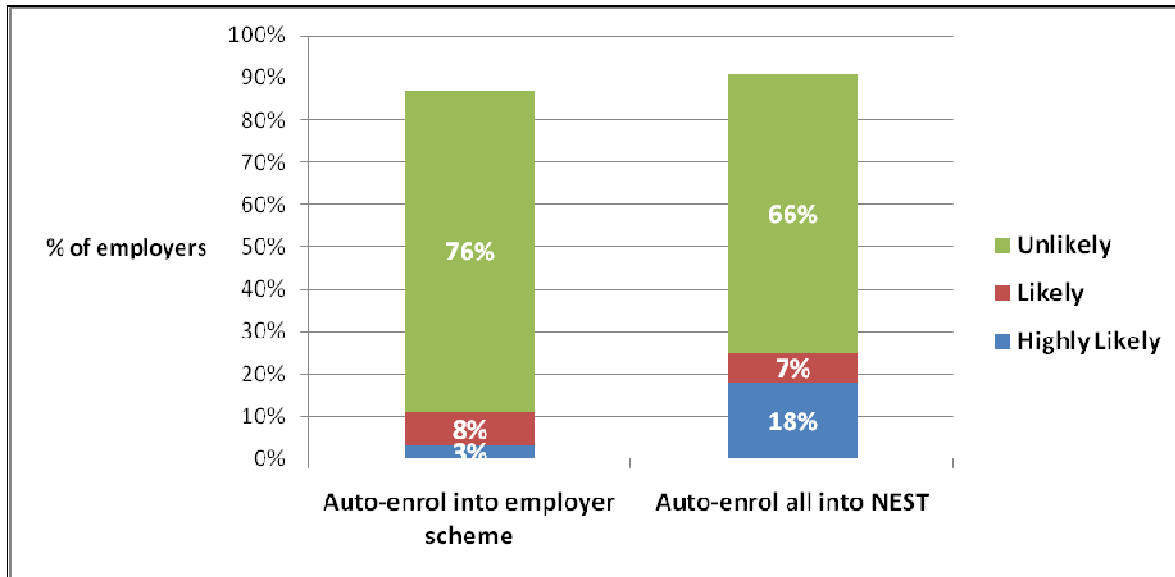


<sup>7</sup> This is supported by the findings in DWP Research Report *Employers’ attitudes and likely reactions to workplace pension reforms 2009*

**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.

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.

**Figure 21: Employers with no existing pension scheme: responses to auto-enrolment and NEST**



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

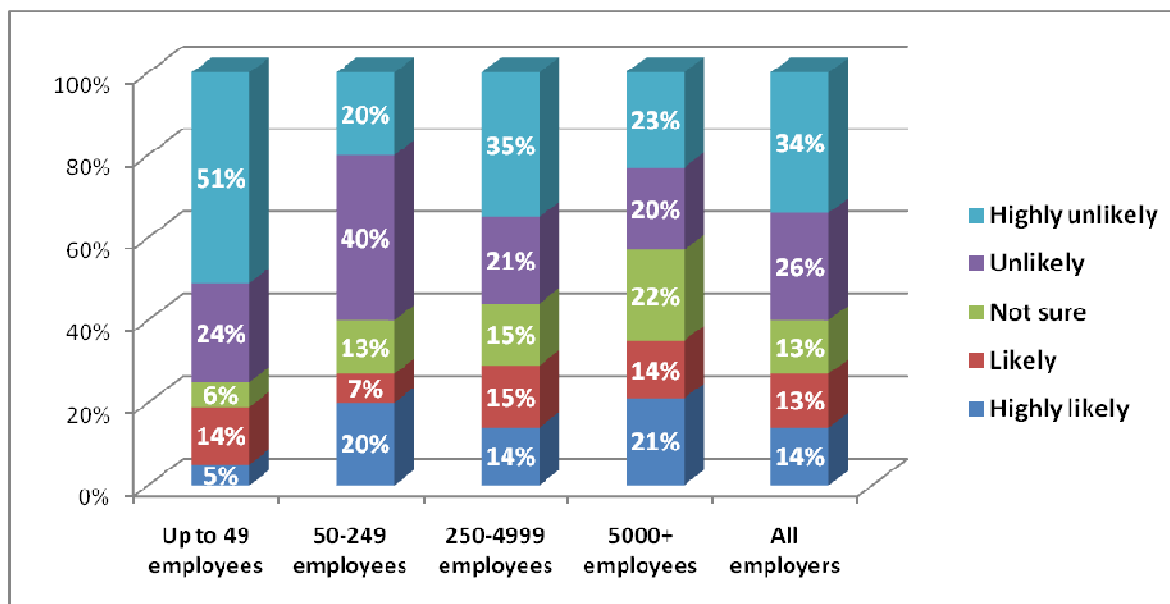
### Will employers review existing scheme benefits to mitigate the cost of higher scheme membership from auto-enrolment?

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 15, page 17*), 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 6, page 9*), 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.

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 most 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 22: Auto-enrolment: will employers mitigate the cost of higher scheme membership**



### 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, overall two-thirds of employers (68%) are opposed to any further delay in implementing auto-enrolment.**

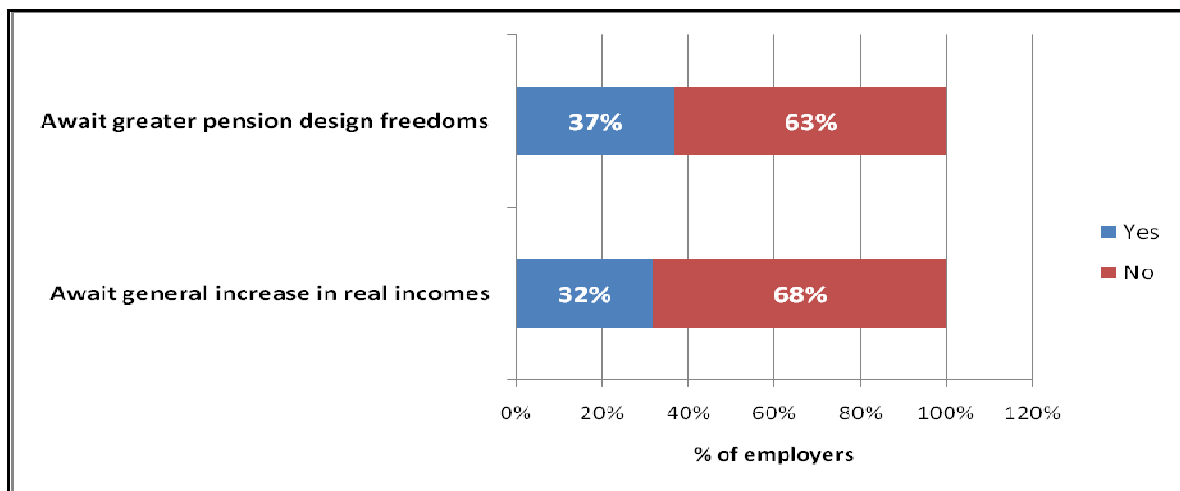
### Do employers think auto-enrolment should be delayed as a requirement until the Government passes legislation to allow employers greater freedom to offer more flexible pension designs than at present?

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.** It would appear that there is an acceptance that legislation to free-up designs is not now likely ahead of the 2012 reforms.

**Figure 23: Should auto-enrolment await a general increase in real incomes or Government legislation to allow greater freedom of pension design?**



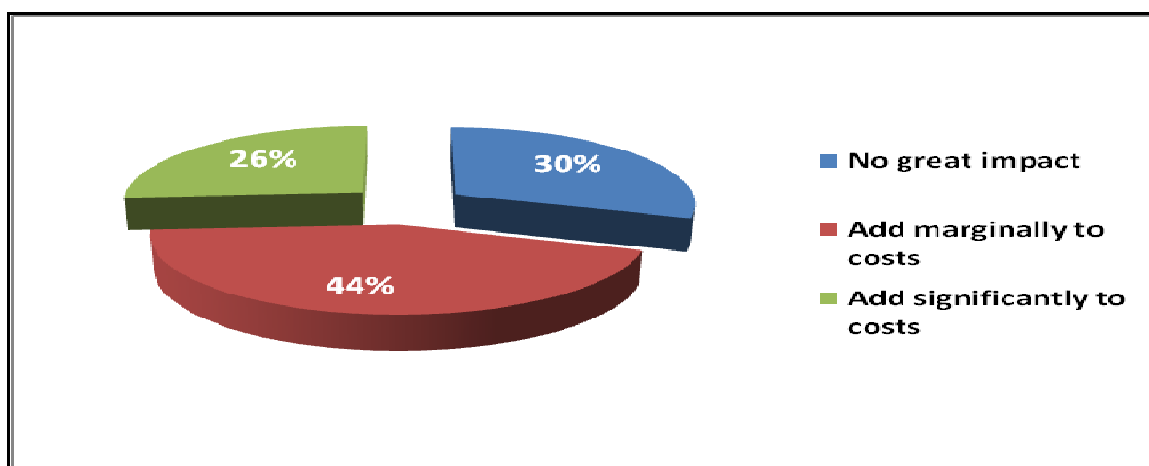
**Overall, how do employers think the introduction of auto-enrolment and NEST will affect their business and workplace pension provision?**

**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.

**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,** albeit this survey has also found many employers forecasting quite high member opt-out rates from pensions post-2012.

Figure 24: Overall, how will auto-enrolment impact on your organisation?



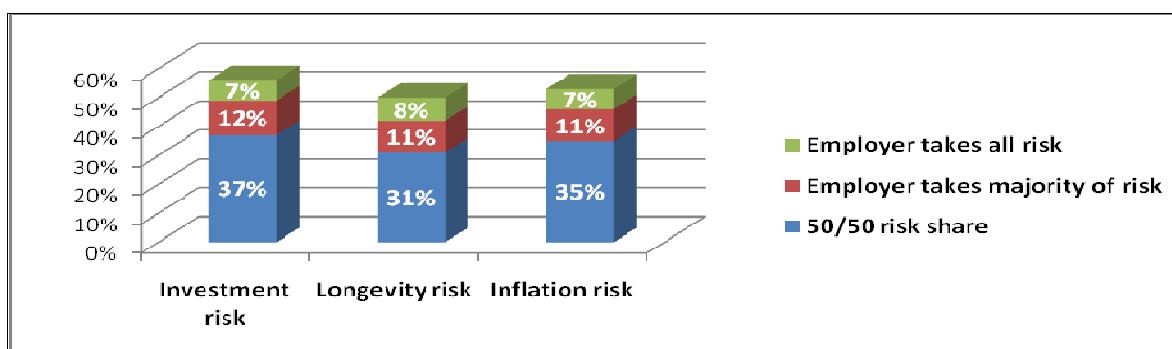
## Other pension reform issues

### 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'<sup>8</sup>.

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



<sup>8</sup> *Workplace Retirement Income Commission* final report, published August 2011, page 70

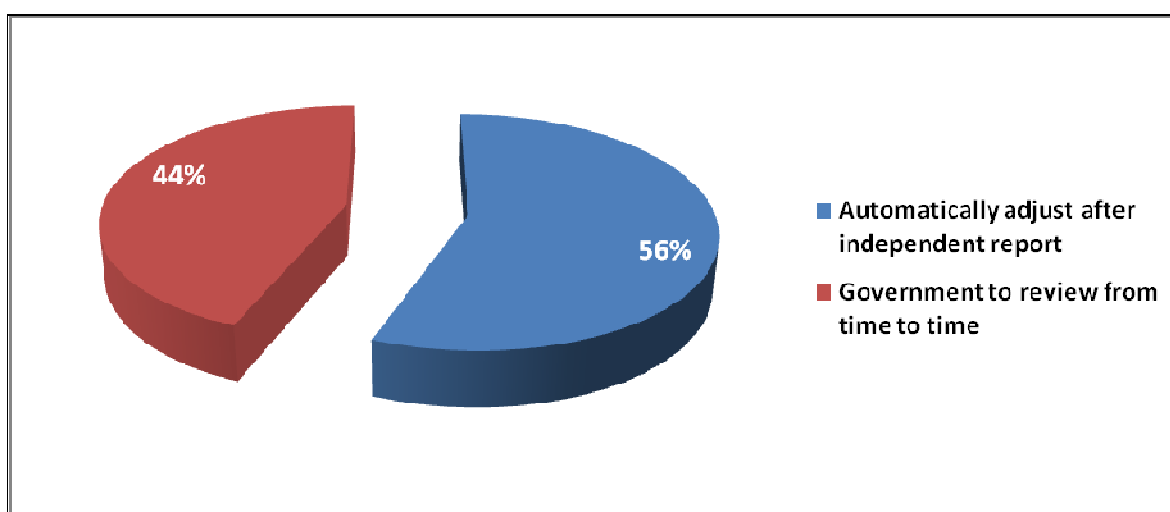
## Future changes in State Pension Age

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. 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.**

As it is widely accepted that employees probably need at least 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 financial cost of later generations of taxpayers.

Figure 26: How should future changes in the State Pension Age be decided?



## Changes in Scheme Pension Ages

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%).**

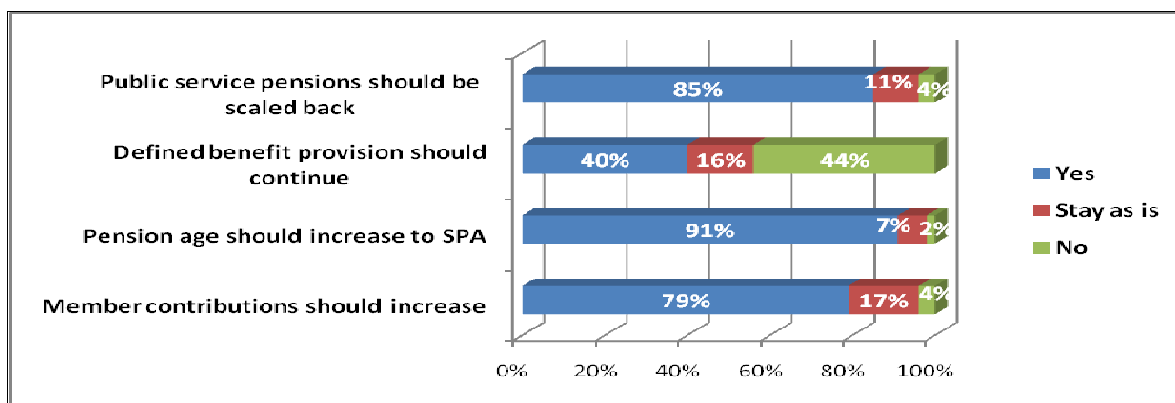
### Changes in Public sector pensions

In the light of the review of public sector 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 27: How should public sector pensions change?**



## 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.

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 £7,475pa** (aligning the threshold with the personal allowance for income tax from April 2011) 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 £5,035pa up to £33,540pa. All these figures are likely to be up-dated for 2012.
- 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 by late 2016.
- '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 £5,035pa (and the employer must comply and pay the employer's contribution). If they have no qualifying annual earnings above £5,035pa, they can enrol, but no employer contribution is required. If they have earnings between £5,035pa and £7,475pa 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.
- During 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. Recent draft regulations have set out an alternative 'Certification' 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.

© Association of Consulting Actuaries, 2011. 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](mailto:acahelp@aca.org.uk)**

**Web: [www.aca.org.uk](http://www.aca.org.uk)**

September 2011