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

Survey on
Auto-enrolment and NEST

Conducted by the Association of Consulting Actuaries
In July/August 2010

PUBLISHED 31 AUGUST 2010

2010 Auto-enrolment/NEST survey

Survey background

The survey was conducted by the Association of Consulting Actuaries (ACA) from mid-July for online completion by 6 August 2010 and was circulated to 1,000 of the UK's largest pension schemes drawn from *Pension Funds and their Advisers.* Responses were received from 210 private and public sector schemes (21% of those sampled) with scheme assets of £166bn (£161bn in defined benefit schemes and £5bn in defined contribution schemes) as well as responses from a number of unfunded schemes. A separate survey of pension trends in smaller firms, including questions on auto-enrolment and NEST, is currently underway, with a closing date towards the end of August.

Executive Summary

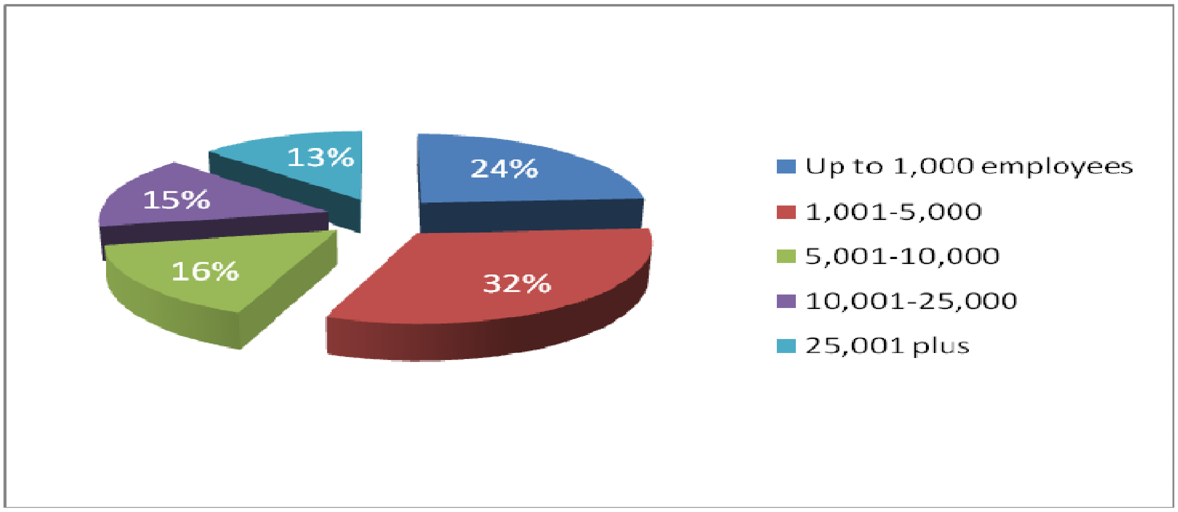
- **75% of employers support the principle of auto-enrolment.**
- **70% see the auto-enrolment regulatory regime as 'appearing complex'.**
- **Over 40% are 'likely' or 'highly likely' to consider levelling-down (reduction of existing scheme benefits) to help meet the cost of auto-enrolling additional employees.**
- **Support for NEST is mixed. Half of employers agree with it, while the remainder are split between those who would prefer existing commercial provision and those who disagree with the concept altogether.**
- **73% want minimum contributions to be a percentage of basic pay rather than of full earnings.**
- **Over 60% say that employers with fewer than five employees should be exempt.**
- **64% say that the requirement to re-enrol 'opters-out' every three years should be removed.**
- **75% say employees with less than three months' service should not be auto-enrolled.**
- **47% say auto-enrolment should be delayed until the Government passes legislation to allow greater freedom to offer more flexible pension designs than at present.**
- **41% say the introduction of auto-enrolment and NEST will 'significantly' add to their business costs.**
- **Overall, 52% say the auto-enrolment review should recommend a delay in its introduction.**

Organisations responding to the survey: by employee numbers

Organisations responding to the survey are largely drawn from the private and public sector schemes featured in *Pension Funds and their Advisers*. Of those responding, over a quarter of the organisations employ in excess of 10,000 employees and a further half employ over 1,000. The sample represents 21% of those contacted and approximately 3% of all UK organisations employing 250 or more employees.

The value of assets held by the schemes run by organisations reporting to the survey is £166bn, with £161bn held in defined benefit schemes and £5bn in defined contribution; assets representing approximately one-sixth of UK scheme assets. As well as private sector schemes, those responding included local government schemes and several public sector unfunded arrangements.

Figure 1: Organisations responding to the survey

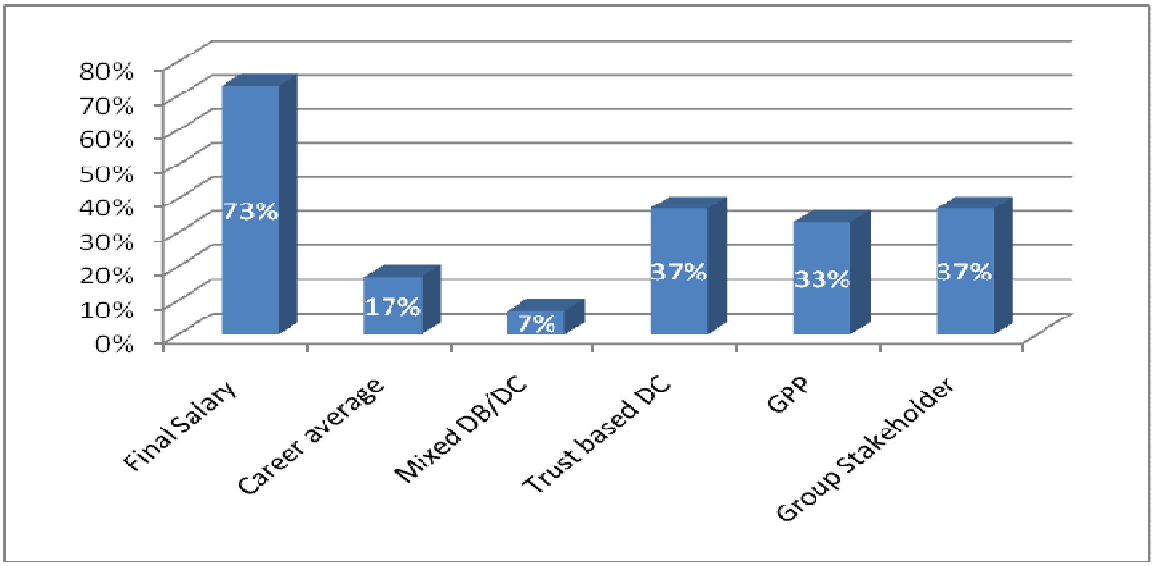


Types of schemes run by organisations responding to the survey

As this survey is of larger organisations, the predominant type of scheme being run by respondents is a final salary defined benefit arrangement. However, two-thirds of these schemes are closed to new entrants and 32% of schemes are also now closed to future accrual. When public sector schemes are taken out of the sample – all being still open – 71% of private sector schemes are closed to new entrants and 35% to future accrual. The majority of career average defined benefit and mixed DB/DC schemes also are reported to be closed to new entrants.

Reflecting the move away from trust based in favour of contract based defined contribution schemes, a fifth of trust-based schemes are reported as closed to new entrants, with the majority of these also closed to new contributions from existing employees.

Figure 2: Schemes in survey: by type



Of these schemes:

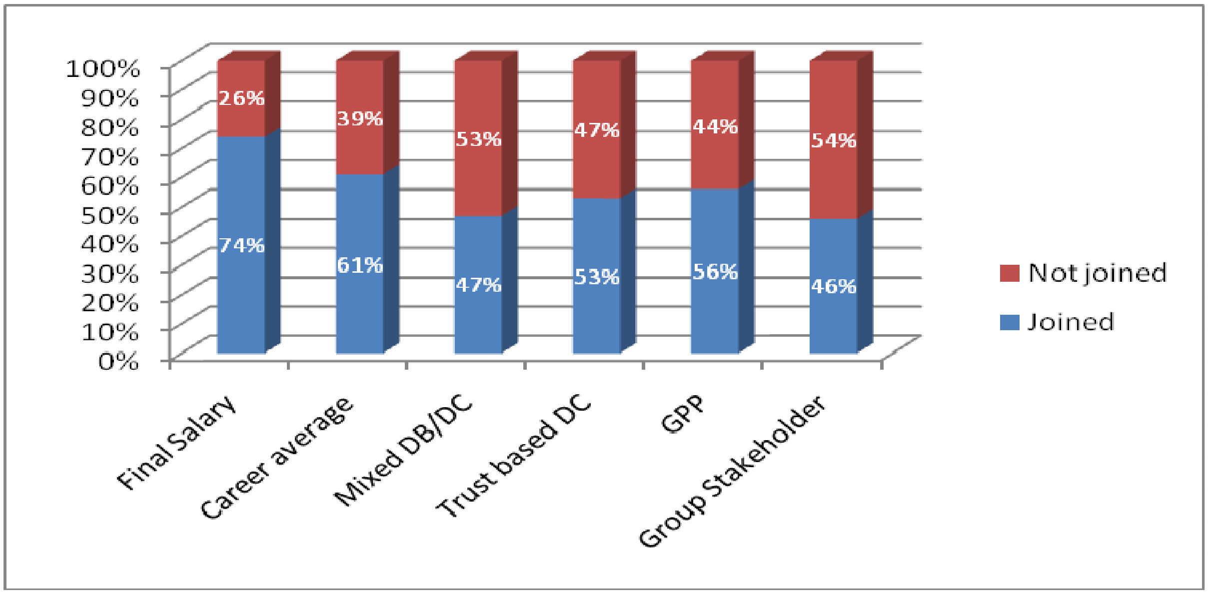
- 64% of final salary schemes are closed to new entrants, with 32% also now closed to future accrual
- 60% of career average schemes are closed to new entrants, with 13% also now closed to future accrual
- 71% of the mixed DB/DC are closed to new entrants, with 43% also now closed to future accrual/new contributions
- 22% of trust based DC schemes are closed to new entrants, with 16% also now closed to new contributions
- 33% offer GPP
- 37% offer Stakeholder

Average scheme membership by eligible employees

Of those eligible to join workplace pension schemes in these organisations, average participation rates vary between 46% in Stakeholder schemes through to 74% in final salary schemes. Of those organisations responding to the survey 34% already auto-enrol at least some employees into a scheme.

Across this sample, the participation rates in defined contribution schemes are generally markedly lower than in defined benefit arrangements with consistently well over 40% of employees either opting out of membership or failing to join schemes. There are clear implications in cost terms for organisations running these defined contribution arrangements, with relatively low participation rates, if they elect to auto-enrol employees into existing schemes.

Figure 3: Scheme membership

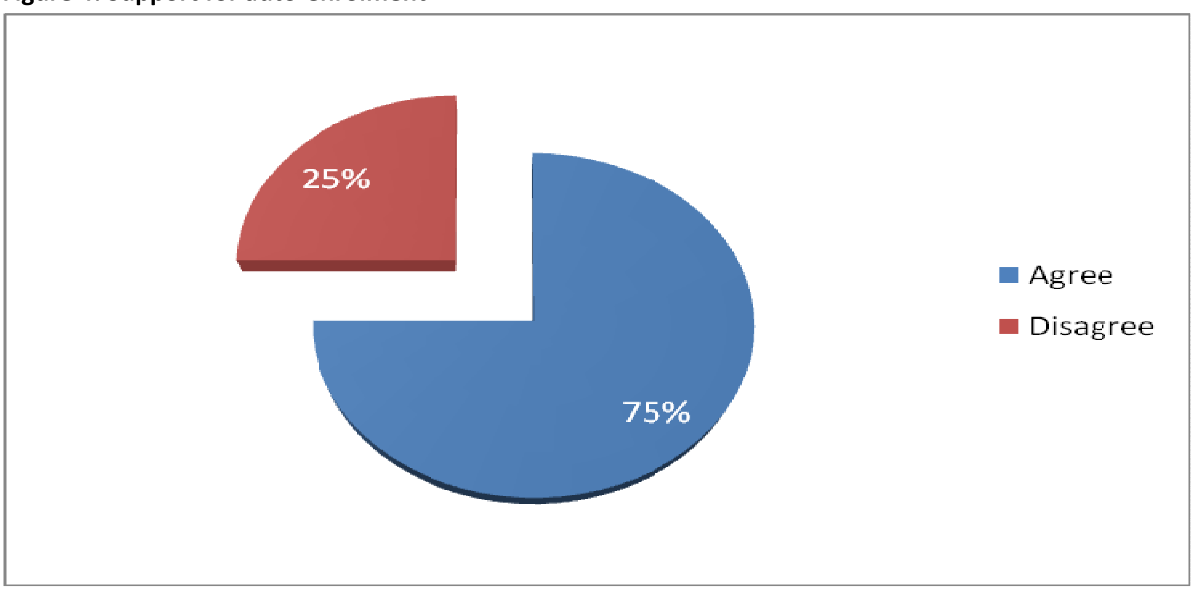


Key findings

Do you broadly agree with there being a new employer duty to auto-enrol most employees into a workplace pension scheme with certain minimum standards?

Three-quarters of organisations say they support the new employer duty to auto-enrol into a qualifying scheme.

Figure 4: Support for auto-enrolment

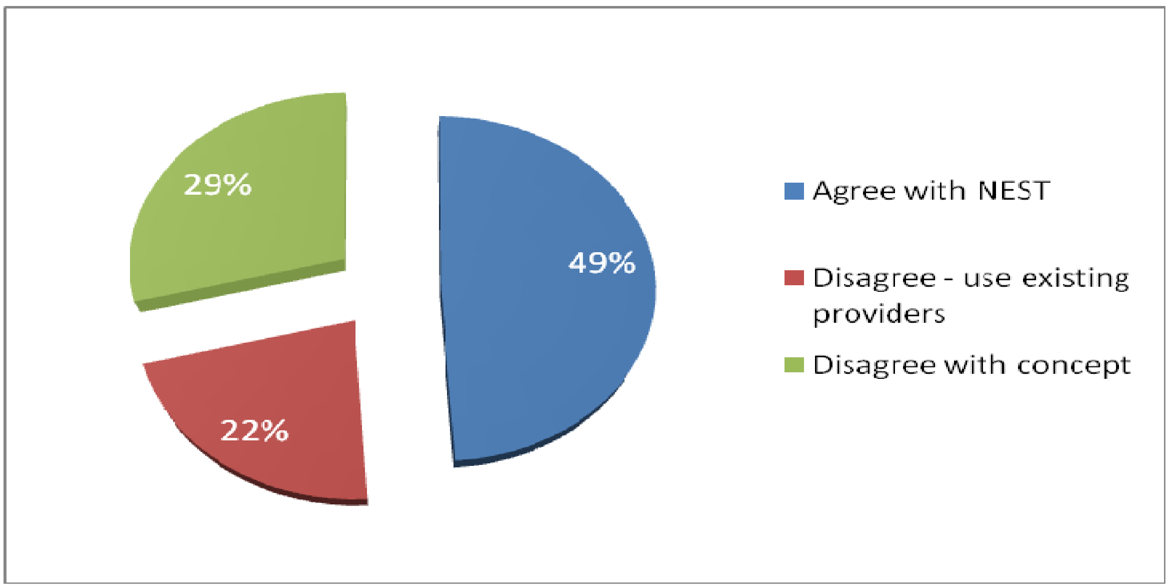


Do you broadly agree with there being a new national scheme (NEST) set up that employers must auto-enrol most employees into if they do not offer access to a workplace pension scheme of a minimum standard?

Broadly, half of organisations responding to the survey are supportive of NEST (the National Employment Savings Trust) as a fall back arrangement for employers who fail to offer their own workplace pension scheme with certain minimum standards into which employees are auto-enrolled.

Of those that are opposed to NEST, the majority (29%) disagree with the concept – in the main these are those who also oppose the auto-enrolment approach. A further 22% oppose NEST on the basis that they feel existing commercial providers should be able to meet the market's needs, presumably on the grounds that this would avoid the need to establish a new centrally organised administration at a time when the Government's financial resources are already over-stretched. The difficulty with this view is that commercial providers have shown little enthusiasm for such an approach and this would probably only be viable in cost and organisational terms if the number of enterprises subject to compulsory auto-enrolment was radically reduced (presently, well over 1 million enterprises employ one or more employees) or if the requirement to auto-enrol was relaxed so organisations have a much longer period to comply, perhaps making this voluntary at the micro-employer level (5 or fewer employees).

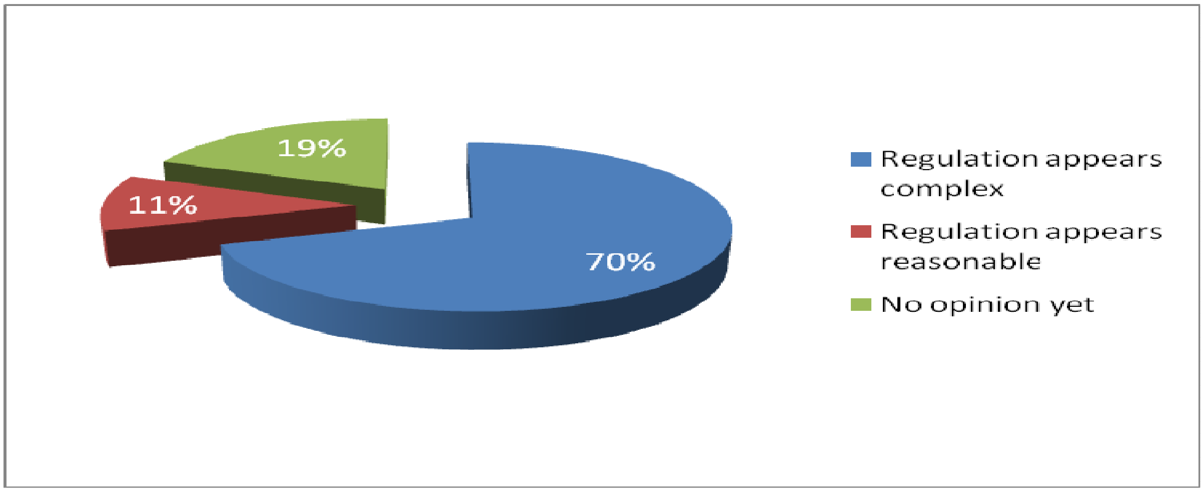
Figure 5: Attitudes towards NEST



What is your general impression of the regulatory regime for auto-enrolment?

Seven out of ten organisations have the general impression that the regulatory regime for auto-enrolment is complex, with only one in ten seeing the regulation as being 'reasonable'. This suggests a priority for the auto-enrolment review is a serious reappraisal and simplification of the regulations presently in place. This approach fits well with the new Government's overall approach to regulation. The ACA amongst others has suggested a number of simplification proposals to the reviewers.

Figure 6: Attitudes to regulation



Under current policy, depending on the number of employees in your organisation, you will be required to auto-enrol all 'eligible jobholders' into a 'qualifying workplace pension scheme' (QWPS) - a company scheme or NEST - between 2012 and 2016. Are you aware of the date when your organisation must auto-enrol 'eligible jobholders' into a qualifying scheme?

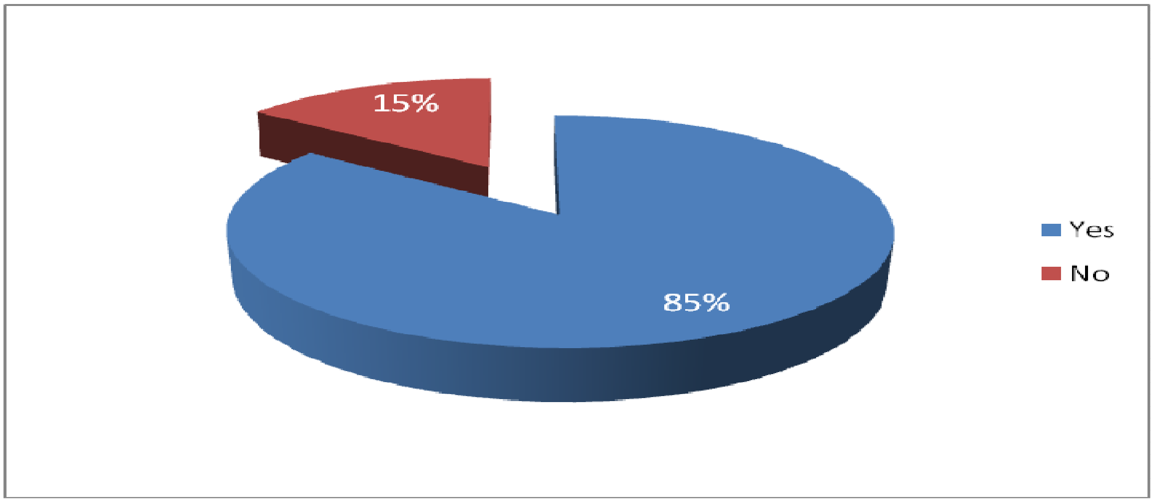
Encouragingly, 85% of organisations say they are aware of the date between October 2012 and September 2016 when they must auto-enrol eligible jobholders into either an existing or new organisation scheme or NEST.

In October 2012, the largest employers begin auto-enrolment. In fact, the vast majority of organisations responding to this survey will have to auto-enrol during the first year by October 2013 (by which time all employers with over 800 employees will have to comply). Those organisations offering auto-enrolment into an open defined benefit or hybrid scheme will however not have to auto-enrol until October 2016.

If there is no change to the process as a result of the current review, the challenging period for those running and monitoring auto-enrolment will be in the period from April 2014. Over a 4-month period, some 27,000 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 18 months, some 1.2 million enterprises with fewer than 50 employees will be required to introduce auto-enrolment! These are challenging numbers and given the inevitable restrictions on spending to implement this policy at a time when the economic position remains very uncertain, serious questions need to be asked by the reviewers and Government as to whether the timetable is at all realistic.

Elsewhere in the survey, respondents are supportive of changes in policy that would remove micro-employers from the requirement to auto-enrol and, certainly, the ACA recommendation to the reviewers is that it may be wise to delay any extension of auto-enrolment to this group until there is a clearer picture of how successfully it has been implemented across larger organisations.

Figure 7: Awareness of auto-enrolment date for organisation

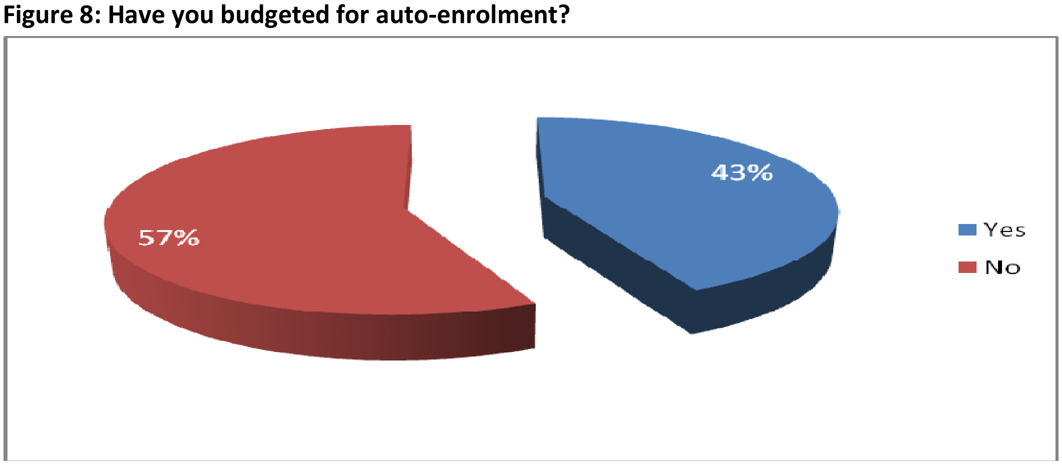


Have you budgeted for the likely increase in costs that could arise from higher scheme membership as a result of auto-enrolment?

A minority of respondents (43%) of these larger organisations have at present budgeted for the likely increase in costs arising from auto-enrolment. Given the generally low level of scheme participation in open defined contribution pension arrangements reported (see *Figure 3*), this is perhaps surprising and somewhat worrying, albeit two years remain before the first compulsory requirement to introduce auto-enrolment in October 2012, when the largest employers must act. It may mean many more employers over the next year or so will become aware of the potential costs involved and take mitigating actions, leading on to an increase in scheme reviews and the potential for more levelling-down.

Of those organisations that have budgeted for extra costs, the average opt-out rate assumed is 15%. For many open defined contribution schemes, this suggests auto-enrolment might lead to an extra 35-45% of employees in membership of schemes – potentially increasing employer pension contribution costs by similar (and often higher) percentage amounts.

Figure 8: Have you budgeted for auto-enrolment?

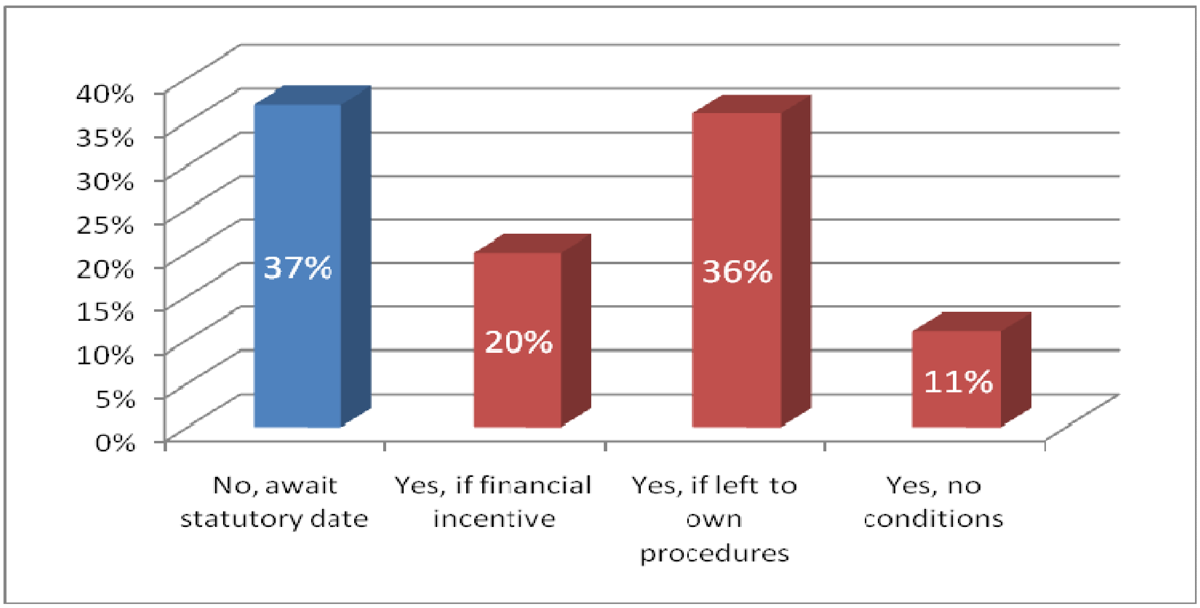


If the Government 'encourages' you to voluntarily auto-enrol all your 'eligible jobholders' into your organisation's existing scheme ahead of your required date, would you agree?

There seems a strong likelihood the Government may encourage organisations to adopt auto-enrolment ahead of the statutory timetable already announced. The results of this survey suggest that such an approach may not result in any great success without some incentives being offered. A blend of financial incentives – which may be unlikely in present circumstances – and, more importantly, leaving employers free to sort out such arrangements domestically, with no central regulation (effectively abandoning centralised auto-enrolment regulations) would persuade broadly a half of these larger organisations to consider earlier auto-enrolment. However, over a third say they will await the statutory date to act.

Clearly, the early extension of auto-enrolment would be helpful in advancing the current policy objective, but the survey results suggest the price of achieving this may require the abandonment of the centralised regulation in current legislation. This would represent a major policy change, albeit one that might be more in tune with the regulatory approach of the new Government.

Figure 9: Responses to early 'voluntary' auto-enrolment



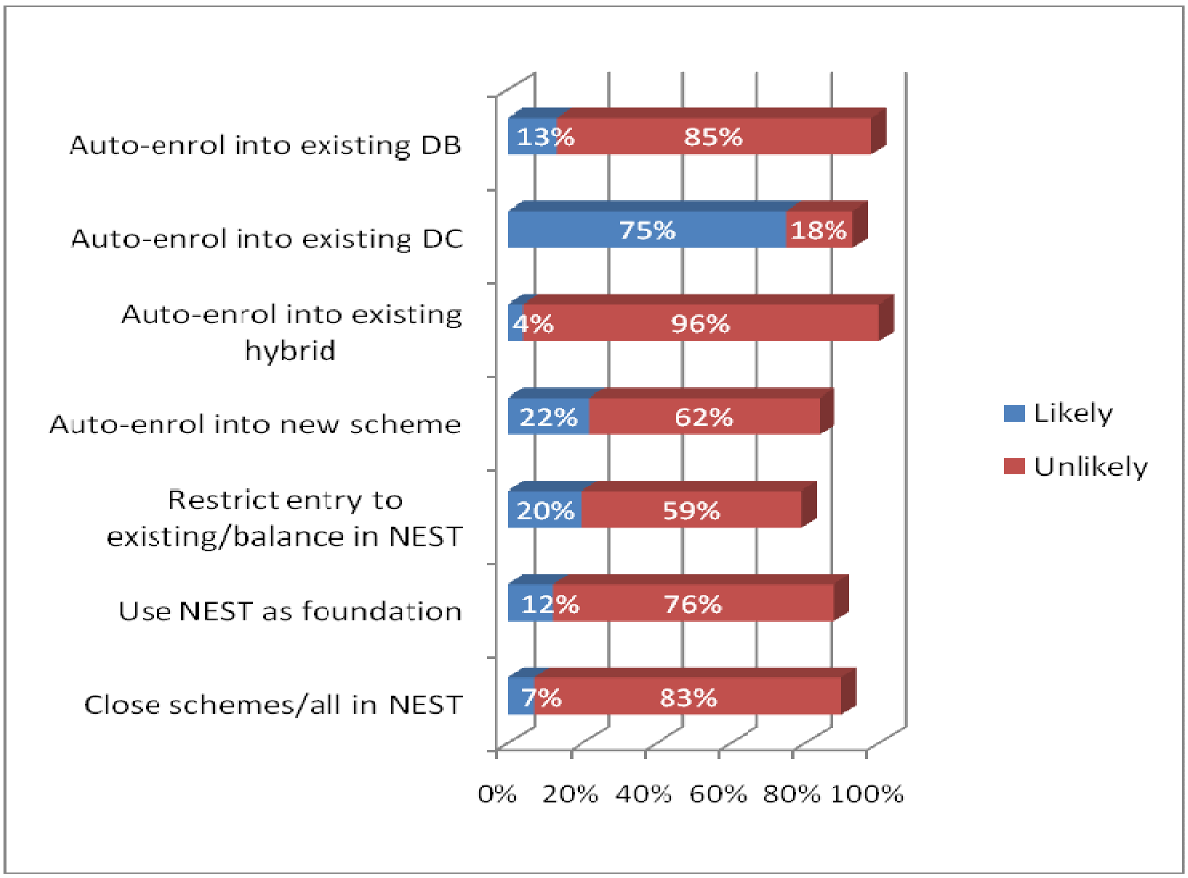
Note: 'Yes, if left to own procedures' is a précis of the option given, which was 'arrangements to be left to individual organisations to sort out domestically with such arrangements continuing thereafter (i.e. no central regulation plus self-certification)'. More than one answer is possible.

What in your view will be the most likely response of your organisation to auto-enrolment and NEST?

The survey found that organisations running defined contribution schemes are the most likely to simply extend membership to all via auto-enrolment. However, employees in organisations which presently still run open hybrid or defined benefit schemes are highly unlikely to find that they are given the opportunity to be auto-enrolled into these schemes (save in the public sector arena, where changes driven by the results of the current Public Service Pension Commission under Lord Hutton may alter expectations).

The results also suggest that around a fifth of organisations will consider auto-enrolling into a new domestic scheme, suggesting the further closure of more existing schemes, both defined benefit and defined contribution. A further fifth say they will restrict entry into their existing schemes, auto-enrolling the balance of employees into NEST. A tenth may use NEST as a foundation scheme, running a top-up scheme above this, with only a small minority of these larger organisations expecting to abandon all existing provision in favour of simply using NEST.

Figure 11: Organisation responses to auto-enrolment and NEST

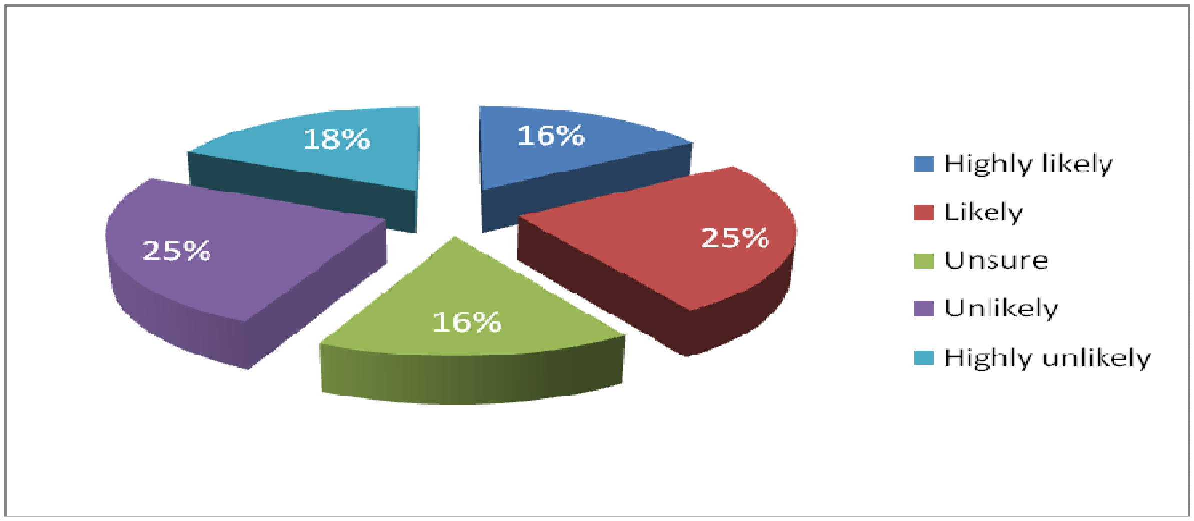


Note: Where totals are below 100%, the balance of respondents said ‘not sure’.

Will you review existing scheme(s) benefits to mitigate the cost of higher scheme membership from auto-enrolment?

Over four out of ten organisations (41%) are likely to review existing scheme benefits to mitigate the cost of higher scheme membership from auto-enrolment. Given the numbers that have so far budgeted for the costs of auto-enrolment (43% - see *Figure 8*), this may be a number that climbs as more organisations identify potential cost increases over the next year or so. Given current participation rates in schemes (see *Figure 3*), and the anticipated increases in membership expected from auto-enrolment suggested by this survey (increases in membership of 35-45% of employees), there must be the serious expectation of a general levelling-down of scheme benefits, particularly given the economic backcloth.

Figure 12: Auto-enrolment: will your organisation mitigate the cost of higher scheme membership?



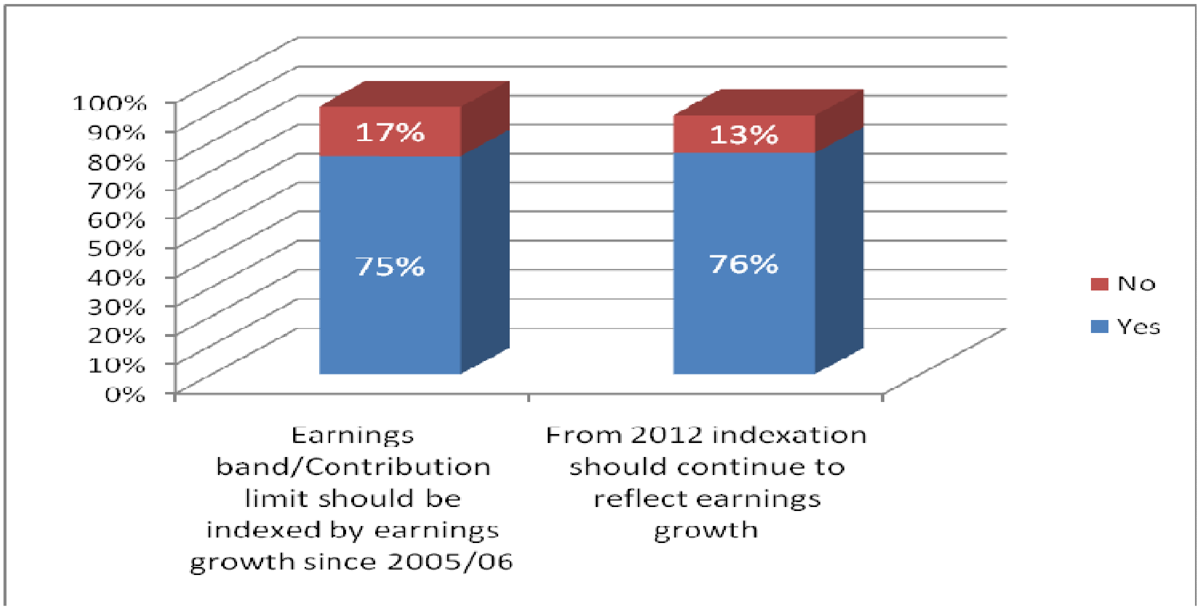
By 2012 the earnings band of qualifying earnings and maximum contribution into NEST are due to be updated in line with earnings growth since 2005/2006, so minimum contributions could be on earnings between broadly £6,000pa and £40,000pa, with the NEST contribution limit set at around £4,000pa. How should the earnings band and NEST annual contribution limits be adjusted?

The long evolution of the auto-enrolment/NEST project means that the earnings band of qualifying earnings (set in 2006/7 at £5,034 to £33,540) and the maximum annual contribution into NEST (set in 2005 at £3,600pa) are likely to be very much higher when updated in line with average earnings growth to 2012. To date (2009), the increase in earnings over the period exceeds 9%.

There might be an argument that the adjusted levels should not reflect increases in average earnings over the period – perhaps at a lower level reflecting lower earnings growth at lower income levels over the period or to better focus on lower, as opposed to middle and higher, income groups. For instance, according to ONS 2009 ASHE survey, only 25% of employees earned more than £31,750pa, so extending the top level of the band in line with earnings growth since 2006/07 means the top level of band earnings could well be above the earnings level of over eight out of ten employees.

However, three-quarters of respondents say they favour indexation of the earnings band and contribution limit from their original figure in line with earnings growth therefrom and into the future.

Figure 13: Indexation of band earnings and NEST annual contribution limit

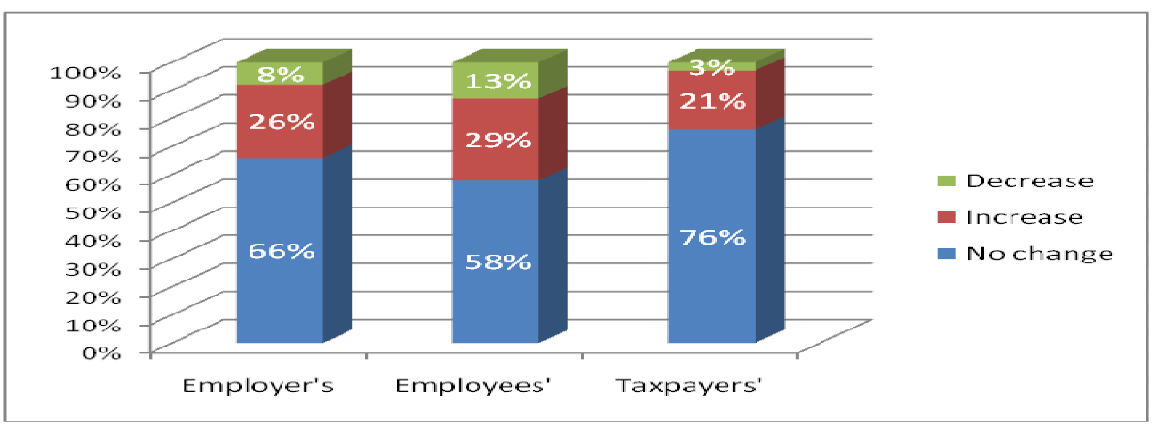


Note: Balance of respondents said 'other'.

Should the review of auto-enrolment consider any change to the presently planned minimum contribution of 8% of band earnings (4% from employee, 3% from employer, 1% tax relief), which will apply in full from October 2017?

A clear majority of respondents favour 'no change' in the planned minimum contribution of 8% of band earnings (4% employee, 3% employer and 1% tax relief), which will apply in full from October 2017 (phased, lower contributions apply between October 2012 and September 2017). Between a fifth and just over quarter of organisations favour an increase in the contribution rates, particularly the employee rate, with only a minority calling for reductions in the rates.

Figure 14: Should minimum contribution rates be changed?

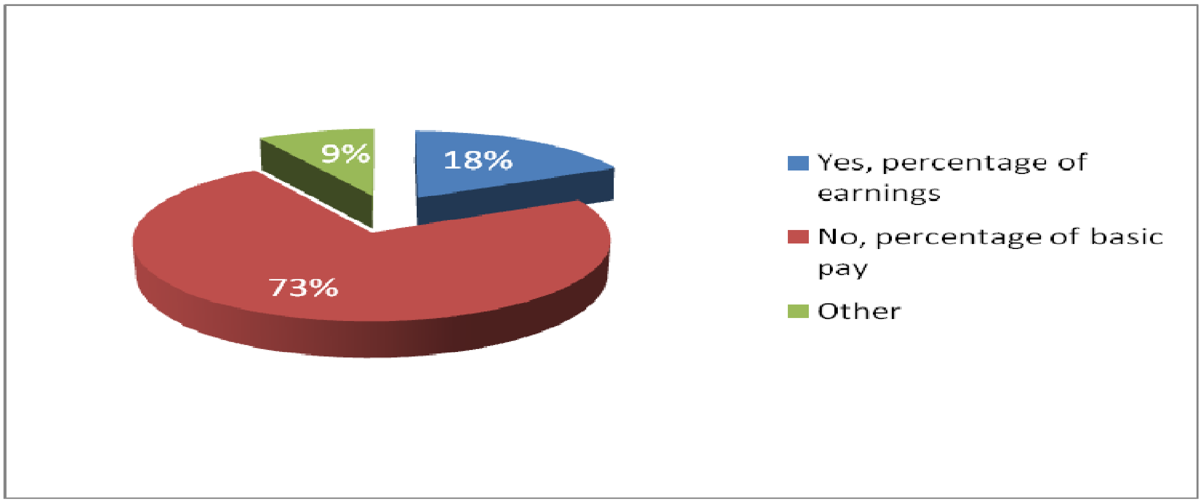


Under current rules, minimum pension contributions are to be based on a percentage of earnings (including salary, wages, overtime, bonuses and commission) rather than a percentage of basic pay. Do you agree with this?

There has been much debate during the genesis of the auto-enrolment/NEST about how best and most simply to determine minimum contribution rates. As matters stand, contribution rates are to be based on a percentage of earnings (including salary, wages, overtime, bonuses and commissions) rather than a simple percentage of basic pay.

Our survey found fewer than one in five support the earnings basis, with 73% calling for contributions to be based on basic pay. The ACA has made a number of recommendations to the reviewers as to how this could be achieved.

Figure 15: Contributions: link to earnings or basic pay?



Do you think auto-enrolment should be delayed or removed in respect of certain requirements?

The survey investigated a number of current requirements in respect of auto-enrolment and whether any should be delayed or removed.

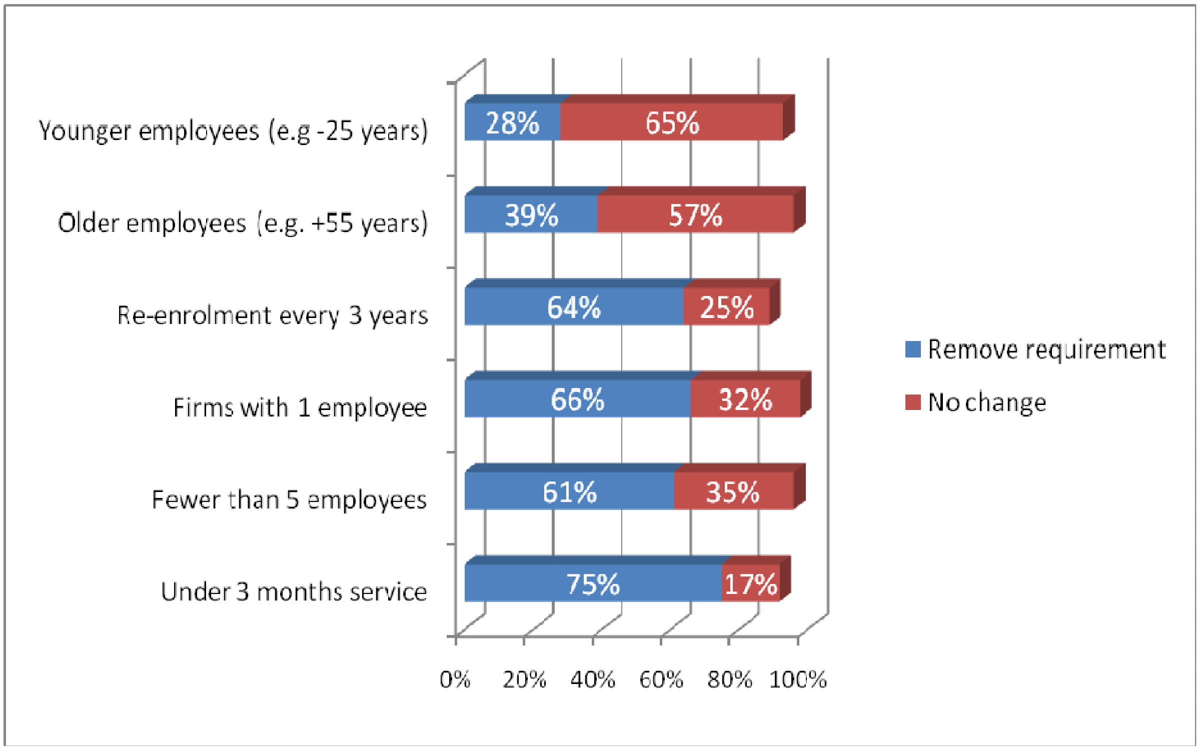
In fact, respondents said none of the requirements listed should be delayed, but there were clear majorities as follows:

- 75% say those with under three months' service should not be auto-enrolled
- 66% say firms with 1 employee and 61% say firms with fewer than 5 employees should be removed from the auto-enrolment requirements
- 64% say the requirement to auto-enrol every three years should be removed

However, a majority did not support auto-enrolment being removed for older employees joining a scheme/NEST (say those aged 55 or over), where some argue there is a danger of a mis-sale as the amounts that might be saved until retirement may only produce sufficient income to disentitle retirees from State benefits.

Similarly, a majority oppose an extension to the requirement for younger employees (between age 22 and, say, age 25) to be excluded on the basis they may move employments more rapidly and have other spending priorities in their early 20s.

Figure 16: Should auto-enrolment be removed as a requirement for:



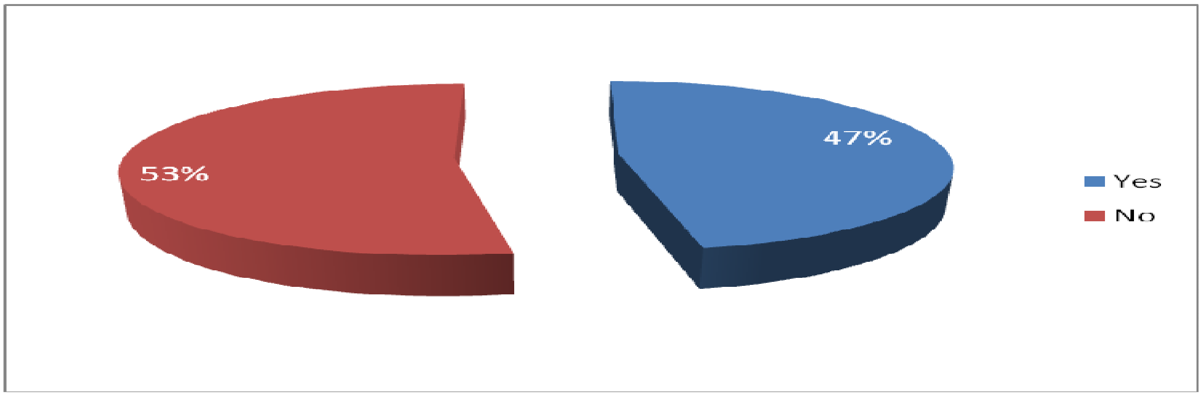
Note: where totals fall short of 100%, the balance of respondents said 'delay'.

Do you 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?

Close to a half of respondents say the auto-enrolment project should be delayed until the Government passes legislation to re-invigorate pensions by allowing employers greater freedom to offer more flexible pension designs than at present. Currently, many would argue that there are too many complexities in UK legislation so employers find it difficult to design pension arrangements that are cost-effective and flexible enough. In particular, the defined benefit regime is too prescriptive and, as a result, the number of open schemes falling under the regime has reduced rapidly in recent years, save in the public sector, where funding (at present), covenant and regulatory requirements are less onerous. It is noteworthy that trust-based defined contribution schemes are also in decline due to more onerous regulatory requirements than apply to contract-based schemes.

If the existing pension regimes are not eased ahead of the introduction of auto-enrolment, then it is extremely likely that the process of employers levelling-down existing provision (with no new options available), evident from the results of this survey, will accelerate.

Figure 17: Auto-enrolment to await Government legislation to allow greater freedom of pension design



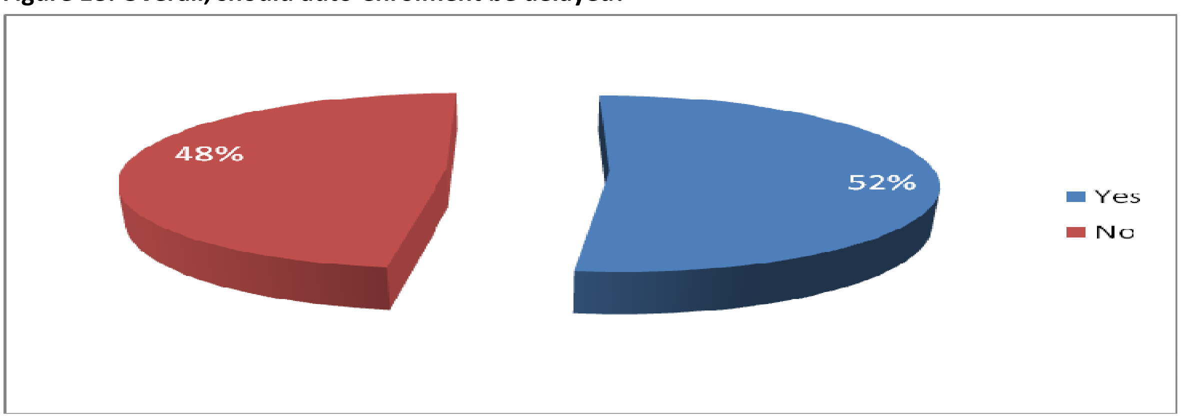
Overall, do you think the Government's review of auto-enrolment should recommend delay in its introduction?

Respondents are almost equally divided on whether the current review of auto-enrolment should delay its introduction. The process to date could hardly be described as rapid – from the Pensions Commission's reports, which first recommended auto-enrolment through to full implementation will have taken over a decade. Those opposing delay might argue that there will never be an ideal time to launch auto-enrolment, that the phasing in of contributions should ease the pain for both employers and employees and the importance of encouraging wider private savings simply cannot be delayed any longer.

Set against this, those favouring delay may base this on the failure to date of Government to ease the legislation covering existing scheme designs and the concerns of levelling-down (see *Figure 17*). Some little time may be needed to bolster existing 'quality' provision and to allow employers to consider new design options. They may also feel the immediate period ahead of economic uncertainty is a bad time to place further costs on employees and business. As a result, auto-enrolment may get off to a bad start with high levels of opt-outs with many employees hard pressed financially and, rightly, concentrating on debt repayment.

For businesses, those most affected, and who may seek delay, will be those offering no pension scheme or those with low participation rates at present; particularly if trading conditions and profitability in particular sectors remains poor.

Figure 18: Overall, should auto-enrolment be delayed?

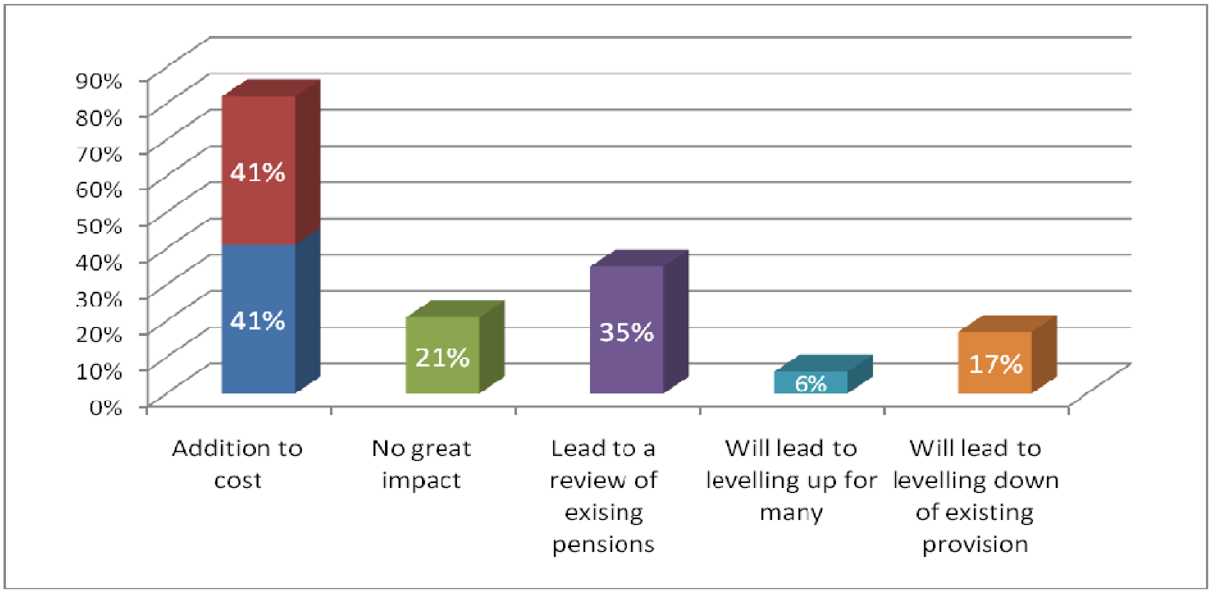


Overall, how do you think the introduction of auto-enrolment and NEST will affect your organisation and workplace pension provision?

Overall, respondents see the impact of auto-enrolment and NEST on organisations and workplace pensions as being sufficiently important to merit considerable attention, particularly for those organisations that have not as yet paid any great attention to the decisions and requirements involved. Over a third of the respondents expect a review of existing pensions to be a result, with 17% expecting levelling-down as a consequence. Far fewer expect levelling up for many, which is perhaps surprising as expectations across this group of larger employers seem to be that many more will be covered by pensions than previously.

The most serious concern must be that 41% expect a ‘significant’ addition to organisation costs and 41% a ‘marginal’ one. Aside from the administrative costs involved in ensuring observance of the auto-enrolment regime as presently conceived, those larger organisations covered by this survey facing significant increases in costs will be those with low existing levels of scheme participation, or where it is resolved to retain and extend a generous level of pension benefits.

Figure 19: Overall, how will auto-enrolment impact on your organisation?



Note: ‘Addition to cost’ - 41% say ‘marginal’ additional cost and 41% say ‘significant’ increase in cost. More than one answer possible.

Other survey findings

- 71% support the increase in State Pension Age to age 66 to sooner than 2026.
- If the SPA was moved to age 66 in 2016, respondents then favour age 67 being implemented between 2020 and 2026 and age 68 between 2026 and 2036.
- 47% say there should be a statutory override enabling occupational schemes to automatically adjust scheme pension age in line with State Pension Age changes. 29% say changes should apply automatically for future pensions only, whilst 17% say for future and accrued pensions, if possible. 22% oppose a statutory override.
- 66% say they support a statutory override to enable schemes to index in line with CPI if they so wish.
- 41% say the default retirement age should be increased gradually, with 15% saying it should rise gradually and then be abolished. 28% say they support its abolition, with 11% saying there should be special exemptions for smaller employers.
- 99% say the removal of the default retirement age will not lead to employers offering better pension schemes as a means to encourage employees to retire.

For a copy of the Association's response to the review of auto-enrolment visit:
www.aca.org.uk (publications page – 13 August 2010)

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 between 2024 and 2046). 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. The new Coalition Government has established a review of auto-enrolment, with the reviewers asked to report back to the Pensions Minister by 30 September 2010.**

As things stand:

• 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 qualifying annual earnings between £5,034pa and £33,540pa, **into a 'qualifying workplace pension scheme' (QWPS) will begin as a statutory requirement** for the largest employers. These earnings figures will be up-dated for 2012, bringing the possible earnings band closer to between £6,000pa and £40,000pa.

• Medium sized and small employers will be required to auto-enrol their 'eligible jobholders' into a QWPS on a staged basis geared to PAYE references, such that all employers, including single employee firms, will be integrated by September 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 QWPS if they fall within the updated earnings band above (and the employer must comply and pay the employer's contribution). If they have no qualifying annual earnings, they can enrol, but no employer contribution is required.

• 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 on a set date every 3 years, with a view to increasing scheme coverage over time.

• During the staging period up to 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). Earnings include salary, wages, overtime, bonuses and commission, as well as statutory sick and maternity pay.

• 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) QWPS, when this is certified as such by the Pensions Regulator, or otherwise must enrol them in the new National Employment Savings Trust (NEST), previously known as the 'personal accounts' scheme. A firm'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.

• NEST has been developed as a trust-based, defined contribution, portable, low-cost scheme (0.3% annual management charge plus 2% 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.

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

31 August 2010