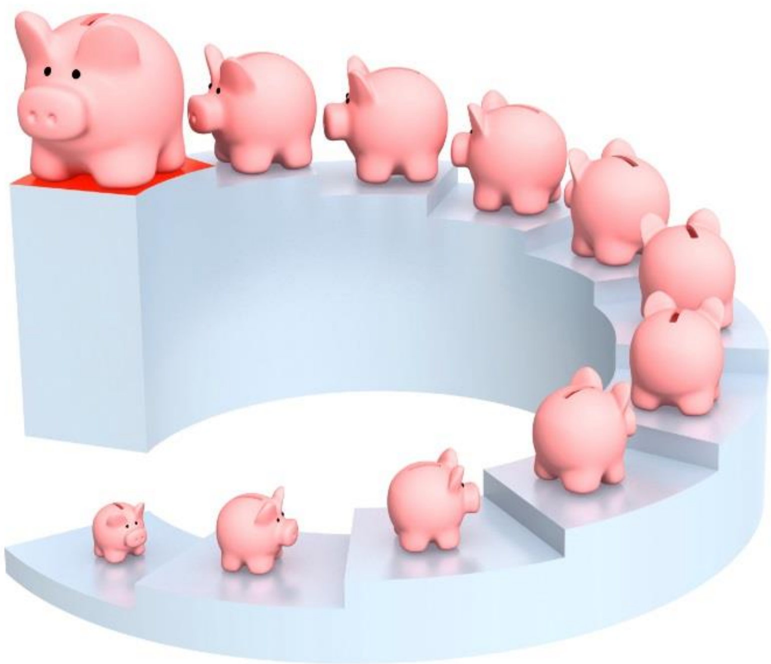
Regis House, 45 King William Street, London EC4R 9AN
Tel: +44 (0)20 3102 6761 EMail: acahelp@aca.org.uk Web: www.aca.org.uk



Time to get real

Survey underscores need for next-step reforms to increase minimum pension contributions

First Report of the ACA 2015 Pension trends survey

Survey conducted by the Association of Consulting Actuaries

PUBLISHED – 12 October 2015

Chairman's Introduction
First Report of ACA 2015 Pensions trends survey

Whilst the vast majority of smaller employers have still to auto-enrol their employees into pension schemes, it seems clear that the 'first step' of recruiting more employees to join schemes has been a considerable success to date.

Employee opt-out rates have been lower than many expected and as a result the number of UK employees in workplace pensions – so long in reverse – has increased to 63%, as against 42% in 2012. This survey report tracks how auto-enrolment has been acted upon by larger employers and assesses the challenges ahead for the 1.8 million smaller employers who, as yet, have to auto-enrol their employees into schemes.

In assessing the challenges ahead, we believe the Government now needs to have a 'next step' strategy ready to address the potential danger of rising opt-outs as employers – particularly small and micro-employers – and their employees react to the increase in minimum contributions in 2017 and 2018. For the majority of employers this is shortly after their staging date for auto-enrolment and lands in the middle of sizeable projected increases in the 'living wage'. Our survey also tests what support there is for a further increase in minimum pension contributions in a few years' time.

Whilst much of the recent debate about pensions has dwelt on legitimate desires to drive down charges and to free-up pension monies by way of the popular 'freedom and choice' reforms, our survey points to the greater need – part of what we see as the 'next step' strategy – that looks to a gradual, but essential increase in pension contributions. This is needed to ensure that many more retirees save sufficient amounts for both a comfortable retirement income and one where they have real choices to spend some of their accumulated savings as they approach or reach retirement. It is often forgotten that the present auto-enrolment reforms, aside from widening pension coverage, have the limited ambition of partially restoring the reduction in median private pension income expected by 2050, largely due to the 'loss' of defined benefit provision over the period. We must have a greater ambition to convince employers and employees alike to save more to improve retirement incomes, with the Government reviewing its spending plans, tax rates and incentives to help make this happen.

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

David Fairs
Chairman
Association of Consulting Actuaries

Contents

Report findings

The survey was conducted by the Association of Consulting Actuaries (ACA) in the summer of 2015 for online completion and was circulated to UK employers of all sizes, selected on a random basis. Responses were received from 477 employers sponsoring over 620 pension schemes. This first survey report examines general workplace pension trends focusing particularly on changes driven by auto-enrolment. Further reports on the survey will follow later in the year.

Key findings

- **For smaller employers, the forecast employee opt-out rate by smaller employers from workplace pensions is down on the figure reported two years ago, but the median band is in the range between 16% and 20% of eligible employees. This is much higher than large and mid-sized employers who have auto-enrolled their eligible employees, where median opt-out rates are reported in the 8-9% band.**
- **Over the years we have been monitoring trends there has been a gradual, if small, increase in median employer and employee contribution levels into defined contribution arrangements. It is clear from this year's research that this trend has reversed due to the present low minimum contribution rates required for auto-enrolment from employers and employees.**
- **Whilst the majority of survey respondents wanted both the minimum auto-enrolment employer and employee contributions to stay at the 2018 levels (respectively 3% and 4% of qualifying earnings), over four out of ten were prepared to see minimum contributions rise in 2020 to 4% from employers and 5% from employees, or higher.**
- **Whilst our 2013 survey found a higher level of interest in auto-escalation, this year's survey still found slightly over a quarter of employers prepared to support the idea whereby employees are encouraged to auto-escalate pension contributions at a future date when wages/salaries increase.**

Other findings

- **Half of the employers responding to the survey say they have or will be changing their pension arrangements as a consquence of auto-enrolment, with 30% of small and micro-employers[1] yet to make a decision.**
- **46% of employers responding to the survey have already reached their staging date for enrolling employees into a qualifying auto-enrolment scheme.**
- **Over a quarter of employers responding to the survey still sponsor a defined benefit scheme, but only 7% of these are open to new and existing employees, with the balance either closed to new members (56%) or entirely closed to future accrual (37%).**
- **Of those employers that have reached their staging date for auto-enrolling employees into a qualifying scheme, a fifth have enrolled all their employees into an existing or new employer's scheme. One third have enrolled all their employees into NEST or one of the other multi-employer schemes, whilst close to four out of ten have restricted entry into an existing scheme and have auto-enrolled previous non joiners and new entrants into NEST or a multi-employer alternative.**

---

[1] Throughout the report micro-employers are those with 1-4 employees, small employers are those with 5-49 employees, medium sized employers have 50-249 employees and those with 250+ are large employers.

Other findings (continued)…

- **Of those smaller employers who have not as yet reached their staging date, a third have not made a decision on what they will do. Of those that have, close to a quarter will enrol all employers into NEST or another multi-employer scheme, with three out of ten enrolling previous non joiners and new entrants into NEST or another multi-employer arrangement. Just one in ten will enrol all employees into an existing scheme.**
- **Employers who have already auto-enrolled eligible employees say assessment of the options available, the processes in preparing for change, systems, regulatory complexity and communications – in that order – have been the biggest problem areas with auto-enrolment.**

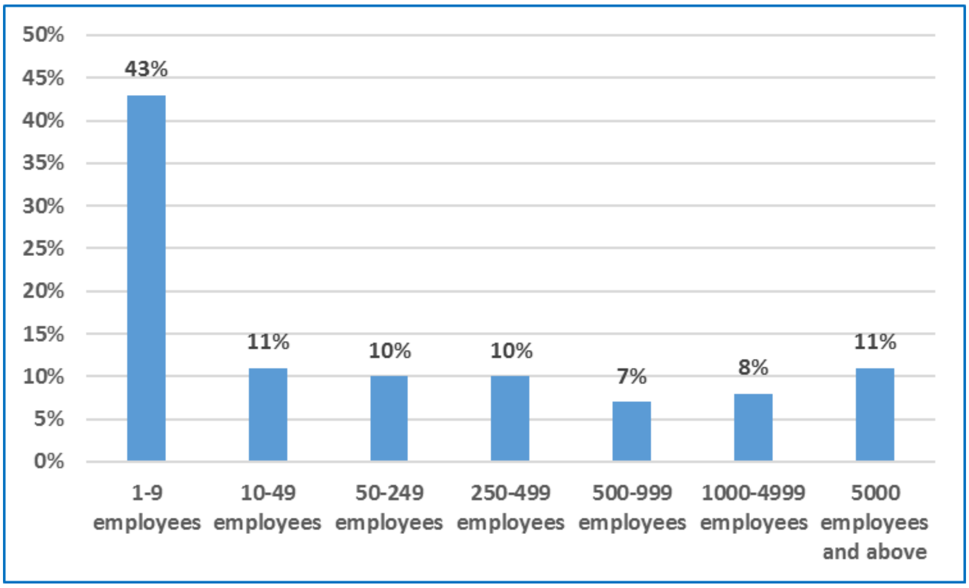
Section 1 – Survey respondents and workplace pension provision

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

Two-thirds of the responses this year came from smaller firms employing fewer than 250 employees, with a tenth replying from organisations with 5,000 employees or more (see *Figure 1*). The sample does not represent a 'mirror image' of UK employers broken down by size. If it did, over 95% of the sample (rather than 55%) would be drawn from firms with fewer than 50 employees[2], but it provides a good indication of trends across all types of enterprises with a higher proportion of smaller employers responding than in previous biennial surveys dating back to 1997.

With 29% of respondents indicating they do not run a pension scheme, the sample also over-represents the proportion of firms presently offering pension arrangements. At present, some 30% of the UK's employers provide workplace pension schemes with around a further 7% making contributions into employees' personal pensions[3]. However, this is a picture that will change markedly over the next three years as the Government's pension auto-enrolment policy[4] impacts on over 1.8 million small and micro-employers.

Figure 1: Organisations responding to the survey



(Source: ACA 2015 Pension trends survey, First Report, Table 1, page 19)

Of the employers responding to the survey as at 31 July 2015 **46% had already reached their staging date for enrolling employees into a qualifying auto-enrolment scheme, with the balance set to reach their staging date within a matter of months or not scheduled to stage until well into 2017/18** (see *Table 2,* page 19)**.**

---

[2] **Source:** BIS Business Population Estimates 2014

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

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

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

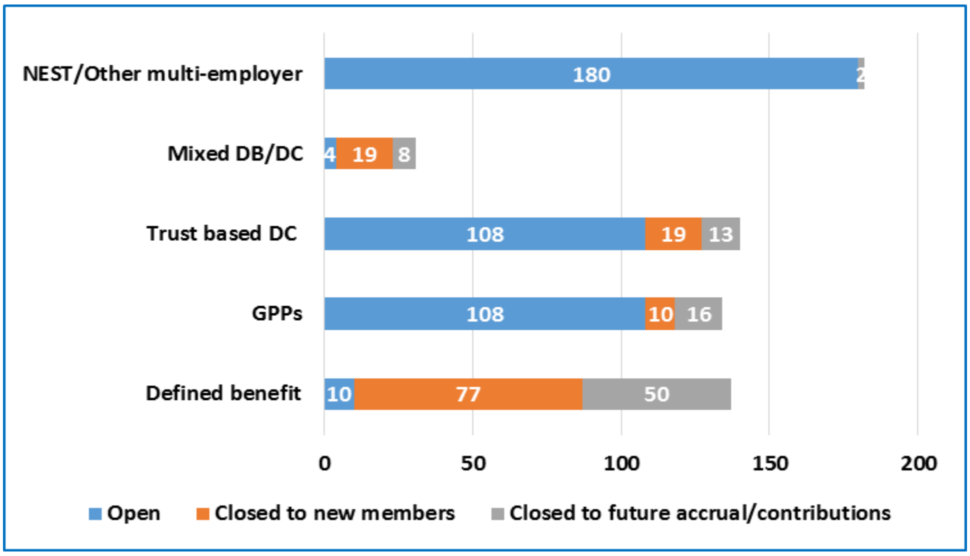
It is clear that very many of those employers who have passed their staging date for auto-enrolling employees into a qualifying scheme have turned to NEST or another of the multi-employer scheme providers to establish their first pension arrangement or to enrol previous non joiners of established schemes and new entrants (see *Figure 2* and *Table 3*, page 19). It also seems likely that a number of employers have taken the opportunity to close established trust-based and GPPs in favour of (probably) lower-cost multi-employer schemes. The survey found **around a fifth of trust-based DC schemes and GPPs were now reported closed** to either new entrants and/or further contributions. However, this year the survey did not test the extent of levelling-down of pension provision for existing employees.

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

Of the employers that have not reached their staging date for auto-enrolment (54% of the sample), coincidentally 54% of these (29% of all employers responding) operate no pension arrangements at all as at 31 July 2015 (see *Table 2,* page 19).

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

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



(Source: ACA 2015 Pension trends survey, First Report, Table 3, page 19)

Section 2: The changing pensions scene

Presently, the auto-enrolment policy in terms of employers that have staged is still at an early stage of implementation. Auto-enrolment of eligible jobholders[5] into schemes has been required of around 58,000 employers as at the end of August 2015, with 5.4 million workers auto-enrolled since October 2012[6]. Because those who have auto-enrolled to date are the UK's larger firms, the number of active members of schemes has increased to around 63%[7] of all employees compared to 42% in 2012.

Over the next three years it would seem around a further 1.8 million employers will be required to auto-enrol eligible jobholders. This is a huge increase in employers subject to auto-enrolment duties compared with those to date, with the number of employers being required to auto-enrol increasing to between 100,000 and 350,000 per quarter (as compared to less than 20,000 in the present quarter, which itself is by far the highest to date). We have questioned in previous survey reports and in our evidence to the auto-enrolment review in 2010 whether it would not be wise to have a pause in staging ahead of micro employers[8] being subject to auto-enrolment duties whilst providers, advisers and the Pensions Regulator take a breather. What occurs over the next few months – given the sizeable increase in quarterly staging of employers henceforth – may clarify whether this is essential or advisable. After all, The Pensions Regulator has only recently announced[9] that there will be ½ million more small and micro employers with auto-enrolment duties than was previously estimated. Whilst this increase in employers has been explained away as due to new businesses established since 2012, this is difficult to reconcile against ONS data published to date[10] and would seem in part to reflect a re-analysis of data from businesses hitherto categorised as having 'no employees'. The outcome of this huge increase in employers apparently needing to comply with auto-enrolment has meant big jumps in the number of employers who are subject to staging – an extra 120,000 in the summer quarter of 2017 alone.

Our survey found that the scale of change in workplace pension arrangements as a result of auto-enrolment has been and will continue to be significant. **Half of the employers said they had or would be changing their pension arrangements as a consquence of auto-enrolment, with still a substantial number of small and micro-employers (30%) yet to make a decision** (see *Figure 3* and *Table 4*, page 20).

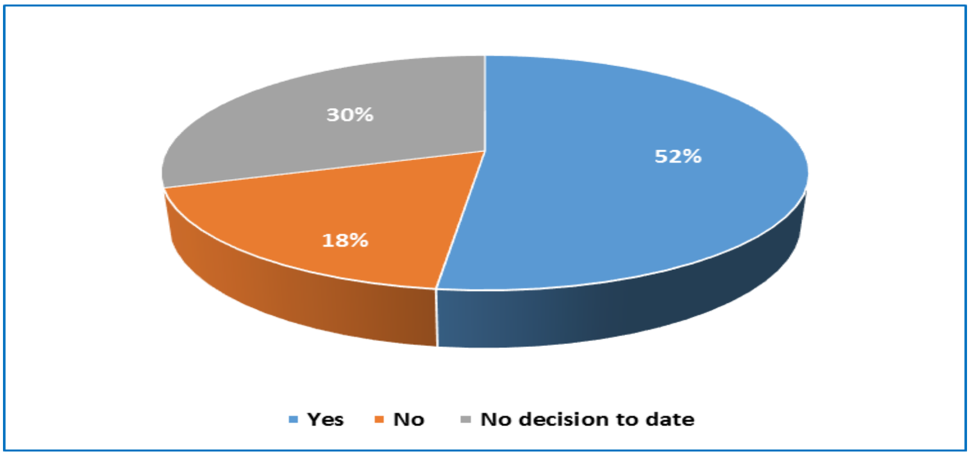
It is concerning how many small employers have yet to make a decision on their pension choices. Inevitably, this will mean a torrent of employers will be approaching NEST and other multi-employer scheme providers from now onwards, with this peaking from late 2016 through to 2018. NEST has acknowledged that there is a risk of failing to keep pace with demand[11] and this is all the more likely as other providers without a statutory requirement

---

[5] Eligible jobholders are those aged 22 or over and below State Pension Age with earnings above £10,000 per annum.
[6] *Automatic Enrolment Declaration of compliance report*, July 2012 – end August 2015, published by The Pensions Regulator in September 2015.
[7] *Official Statistic on workplace pension participation and saving trends of eligible employees: 2004-2014,* published by DWP, July 2015, page 6.
[8] Micro-employers employ 1-4 people and make up two-thirds of those employers left to stage.
[9] The Pensions Regulator, press notice, 23 July 2015.
[10] *Business Population estimates for the UK and Regions 2014,* 26 November 2014, published by Department of Business Innovation & Skills and the ONS.
[11] *NEST Annual Report & Accounts*, page 33.

to make available a scheme step back on grounds of both cost and their ability to service as demand peaks.

Figure 3: Has or will your business change its workplace pension arrangements as a result of the requirement to auto-enrol all eligible jobholders into an auto-enrolment scheme from your staging date?



(Source: ACA 2015 Pension trends survey, First Report, Table 4, page 20)

The survey found a very broad spread of responses in terms of the pension arrangements that are being made available to eligible jobholders on auto-enrolment.

Of those employers that have reached their staging date for auto-enrolment, a fifth have enrolled all their employees into an existing or new employer's scheme.

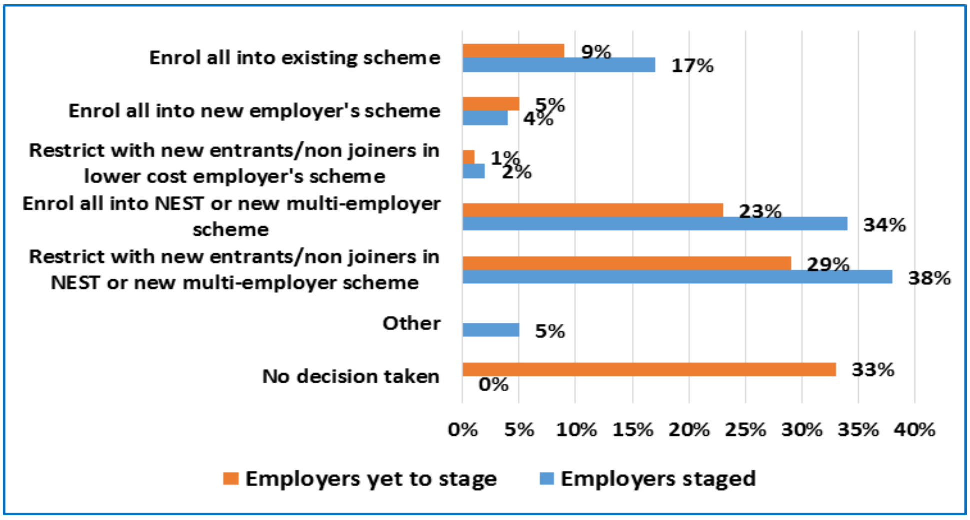
One third have enrolled all their employees into NEST or one of the other multi-employer schemes, whilst close to four out of ten have restricted entry into an existing scheme and have auto-enrolled previous non joiners and new entrants into NEST or a multi-employer alternative.

Of those smaller employers who have not as yet reached their staging date, a third have not made a decision on what they will do. Of those that have, close to a quarter will enrol all employees into NEST or another multi-employer scheme, with three out of ten enrolling previous non joiners and new entrants into NEST or another multi-employer arrangement. Just one in ten will enrol all employees into an existing scheme (see *Figure 4* over page and *Table 5*, page 20).

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

As we have noted in our reports on pensions since 2012, there are arduous times ahead particularly for The Pensions Regulator over the next two to three years as it attempts to enforce auto-enrolment compliance on micro-employers, bearing in mind the huge ebb and flow in entities, many of which will have no or very few employees from time to time.

Figure 4: As a result of auto-enrolment what has been/will be your most likely change to your workplace pension arrangements?



(Source: ACA 2015 Pension trends survey, First Report, Table 5, page 20)

Problems experienced in preparing for auto-enrolment

Our survey found that amongst large and mid-sized employers who have already auto-enrolled eligible employees, assessment of the options available, the processes in preparing for change, systems, regulatory complexity and communications – in that order – have been the biggest problem areas (see *Figure 5*).

Figure 5: Biggest problems experienced by employers in preparing for auto-enrolment

Employers: passed staging date for auto-enrolment		Employers: not yet reached staging date
Assessment of options available	1	Assessment of options available
Processes preparing for change	2	Regulatory complexity
Systems	3	Communications
Regulatory complexity	4	No preparations to date
Communications	5	Processes preparing for change
Uncertainty of financial cost	6	Uncertainty of financial cost
	7	Systems

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

These findings chime with those reported in the DWP evaluation paper[12] which reported that the main challenges faced by larger employers have been the 'complexities of assessing and categorising workers, adapting payroll systems and communicating the changes to workers'. Larger employers have also said that legal fees and developing payroll systems have been the most costly items in their preparations with costs coming in at 'six or seven[13] figures'.

---

[12] *Automatic Enrolment evaluation report 2013*, published by the DWP in November 2013, Research Report No.854, page 3.
[13] Ibid, page 86.

The survey found smaller employers, many of which have not begun preparations for auto-enrolment, see the assessment of the options available and regulatory complexity as their biggest problems. Whilst differences in this 'batting order' may reflect the fact that awareness of auto-enrolment duties remains much lower, particularly at the micro-employer level, the administrative challenges facing small employers – most with no specialised in-house HR or pensions resource – are likely to be very different to the experiences of the early staging, larger employers. It is encouraging that a range of advisers are launching services to assist smaller employers through the maze of auto-enrolment rules, but it remains to be seen whether these services will encompass the sheer number of micro-employers, many of which will not be looking to incur significant costs in complying with auto-enrolment.

Budgeting for auto-enrolment and employee opt-out rates

Amongst those that have not reached their staging date for auto-enrolment we found only just over a third of small and micro-employers are budgeting for the likely increase in costs arising from auto-enrolment (see *Table 6*, page 20).

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

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

Those employers that have budgeted for auto-enrolment generally appear to have been conservative in their budgeting, apparently taking account of the increase in costs once phasing has been completed in 2018 and additional payroll/administration costs.

Across those organisations that have budgeted for extra costs, the estimated member opt-out rate by smaller employers from workplace pensions is down on the figure reported two years ago, but still falls in the range between 16% and 20% of eligible employees. Indeed, close to half of the small employers who have not staged expect opt-outs to exceed 26%. **This is much higher than large and mid-sized employers who have auto-enrolled, where median opt-out rates are reported in the 8-9% band** (see *Figures 6* and *7* and *Table 7*, page 20).

There has been a general welcome for the 'low' employee opt-out rates reported elsewhere to date, with a figure of 9% amongst larger employers[14] (increasing to around 12% - 14% when 2014 'stagers' are included[15]). In some quarters there was clearly an expectation of much higher opt-out rates, although it is not quite clear why this should be the case. Our

[14] *Automatic Enrolment evaluation report 2014*, published by the DWP in November 2014, Research Report No.887, page 63.

[15] *Automatic enrolment: Commentary and analysis – March 2014-March 2015,* published by The Pensions Regulator, July 2015, page 3.

2011 ACA Pension trends survey[16], conducted ahead of auto-enrolment starting found, on average, that larger employers were budgeting for an opt-out rate of 12%. It was mid-sized, small and micro-employers who pushed the average opt-out rate up to around 25%.

Whilst it is to be hoped that opt-out rates do keep to the low levels reported to date so that pension provision is extended to some nine million[17] employees, there has to be some expectation that rates may be higher amongst employers with much more limited resources to communicate the project effectively. Another factor that may in a sense disguise the number of employees who are not auto-enrolled is the high number of employees who do not meet the eligibility criteria. Amongst larger employers this already totals over 5.2 million employees[18] and it may be the sizeable increase in part-time and self-employed working[19] will mean the number of those ineligible for auto-enrolment climbs higher than originally expected. And, in sheer mathematical terms, each employee opting out in a small firm can equate to a high percentage (one employee opting out at a four person micro-employer equates to a 25% opt out).

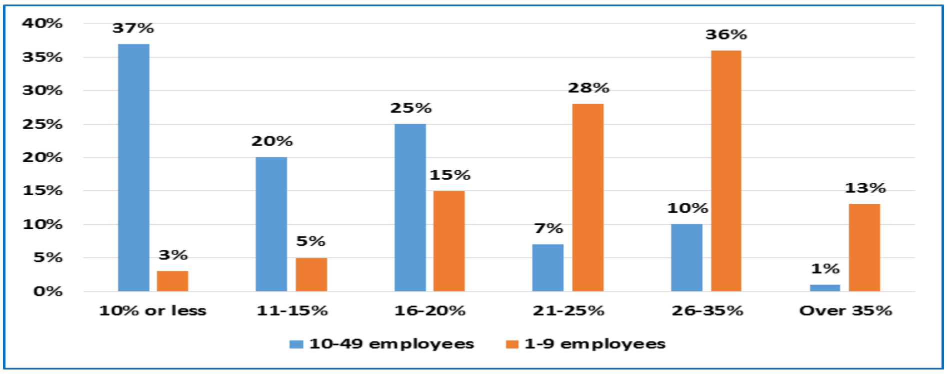
Our survey tested whether opt out rates had increased significantly post-staging. Only 7% of employers reported any change in the opt-out 'band', with four out of ten reporting an increase in enrolment rates since staging and six out of ten a small decline.

Figure 6: Median employee opt-out rates reported by employers that have already auto-enrolled and the rates forecast by employers yet to reach their staging date

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

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

Figure 7: Range of employee opt-out rates forecast by employers yet to reach auto-enrolment staging date



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

---

[16] *2011 ACA Pension trends survey*, published 3 January 2012, page 27 at www.aca.org.uk (Research and Surveys page).
[17] DWP forecast, updated 21 September 2015.
[18] *Automatic Enrolment Declaration of compliance report*, July 2012 – end August 2015, published by The Pensions Regulator in September 2015.
[19] ONS January-March 2015 figures report 4.5 million self-employed workers, up 39% on 2000 figures. Of these around 17% are saving for retirement (*Hansard, 21 September 2015,* PQ answer by DWP Minister, Justin Tomlinson MP).

Section 3: Contribution rates now and into the future

Median employer contributions into GPPs and defined contribution pension schemes across our sample are respectively in the 4% and 5% band of earnings (see *Figure 8* and *Table 8*, page 21)**.**

Median employee contributions into GPPs and defined contribution schemes are respectively 3% and 4% of earnings.

Contributions into NEST and other multi-employer arrangements are reported at a much lower level, with many employers and employees contributing at the minimum initial auto-enrolment level, which is below 1% of total earnings[20].

Combined employer and employee contributions into defined benefit arrangements at between 16-20% of earnings are running at four to five times those going into defined contribution. Higher defined benefit contributions reflect the cost of delivering salary related pensions in the years ahead as longevity extends and in a low interest rate environment.

Figure 8: Median contribution rates into pension arrangements provided by responding employers (figures in brackets are 2013 mean figures from ACA 2013 Pension trends survey report)

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

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

Auto-enrolment stalls and reverses DC contributions

Over the last decade there has been a gradual, if small, increase in median employer and employee contribution levels into defined contribution arrangements. However, it is clear from this year's research that this trend has reversed due to the much lower minimum contributions paid by both employers and employees for many on auto-enrolment. This is highlighted by comparing this year's findings with those reported in the *ACA 2013 Pension trends survey*[21] (see *Figure 8*, above).

We must expect over the next two to three years until phasing is completed in late 2018 that average and median contributions into all types of defined contribution schemes (including

---

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

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

multi-employer schemes) will decline or remain very low as many more employees are auto-enrolled into pension schemes for the first time[22]. However, set against this, many more employees are now saving something into pensions, which they were not prior to 2012.

A DWP paper on the progress of auto-enrolment has reported 'in order to manage contribution costs, the majority of larger employers (have) set their contributions at the minimum level required'[23]. It would appear from the survey results, confirmed by later DWP[24] and ONS reports, that as more mid-sized and smaller employers have met their staging dates, they too have auto-enrolled at very modest contribution levels, which are below the median contribution rates our survey found from the minority of employers who already provide schemes ahead of auto-enrolment[25].

Speaking in the House of Lords during the Lords' Second Reading debate on the then *2013 Pensions Bill*, Lord Hutton of Furness, the former Secretary of State for Work & Pensions, noted 'the time is probably not far off when we will have to have a very honest debate in the country about whether 8% or 9% of earnings into a defined contribution pension will be sufficient to guarantee people a decent and adequate pension in retirement. I, for one, do not believe it is...that debate cannot be postponed for very much longer'[26].

However, it has to be expected that modest progress in increasing contribution levels amongst hundreds of thousands of firms who presently offer no workplace scheme is unlikely ahead of 2018. There are existing ways that more employers could build on initiatives like the NAPF Pension Quality Mark[27] by fostering a trend towards higher member pension contributions or by adopting auto-escalation (see page 14) as a feature of their approach to pensions.

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

Our survey tested whether there was any appetite from employers to support increases in the minimum level of auto-enrolment contributions from, say, 2020. By then, unless there are any late changes, employers will be contributing 3% on qualifying earnings and employees 4% (with tax relief adding a further 1%). The Government has said that it will

---

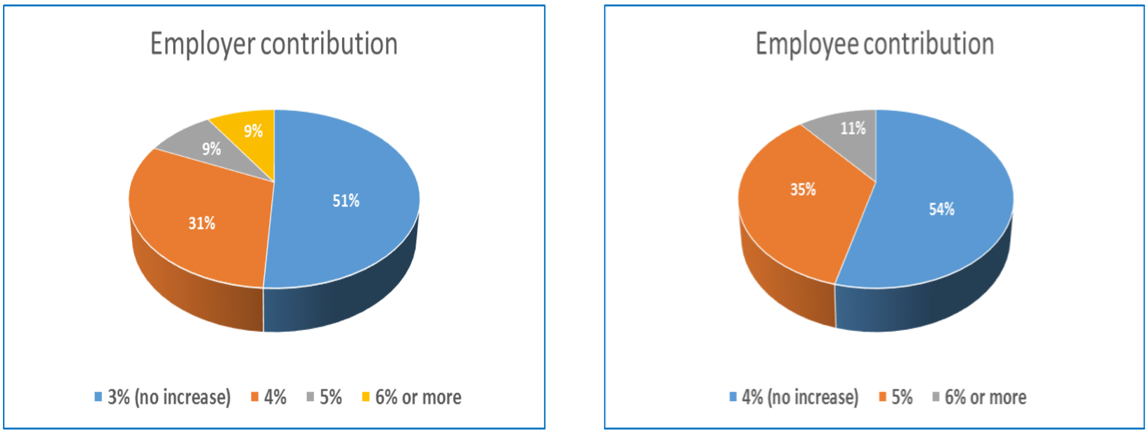
[22] At present a minimum of 2% of qualifying earnings (split evenly between the employer and employee) is required on earnings between £5,824 and £42,385 (2015/16 levels) for eligible employees aged at least 22 and under SPA, who earn at least £10,000 per annum. From October 2017 employers will be required to contribute a minimum of 2% on qualifying earnings as part of a total minimum contribution of 5%. The minimum employer contribution will rise to 3% in October 2018 supplemented by the jobholder's own 4% contribution and 1% in tax relief.
[23] *Automatic Enrolment evaluation report 2013*, published by the DWP in November 2013, Research Report No.854, page 28.
[24] 'In the private sector, there has been a marked decline in the amount saved per eligible saver in 2014. This is likely to be a result of the increased number of savers in the private sector, many of whom will be making contributions at the minimum level'. Extract from *Official Statistic on workplace pension participation and savings trends of eligible employees: 2004-2014*, published by DWP in July 2015, page 20.
[25] See also *Official Statistic on workplace pension participation and savings trends of eligible employees: 2004-2014*, published by DWP in July 2015, which found median occupational defined contributions by employers have reduced from 8% in 2012 to 3% in 2014 and by employees from 4% to 1%.
[26] *Lords' Hansard*, 3 December 2013, Column 154.
[27] Schemes can be awarded the Pension Quality Mark (PQM) where total pension contributions equal at least 10% of employees' pensionable salary (with a minimum of 6% from the employer) or PQM PLUS where total contributions equal at least 15%, with minimum employer contributions of 10%.

review how auto-enrolment has worked in 2017, and – given that it is generally recognised that for many the 8% minimum contribution on qualifying earnings is not adequate to fund a comfortable retirement when combined with the State pension – it seems likely there will be some consideration given to raising minimum contributions, possibly in phases, in the years ahead and/or broadening the band of qualifying earnings.

Whilst the majority of survey respondents wanted both the minimum employer and employee contributions to stay at the 2018 levels, namely respectively 3% and 4% of qualifying earnings, over four out of ten were prepared to see minimum contributions rise to 4% from employers and 5% from employees, or higher from 2020 (see *Figure 9* and *Table* 9, page 21)**.** Given that many of the employers responding to the survey are presently contributing less than 3% towards many of their employees' pensions, this preparedness to raise the minimum employer contribution is encouraging for future pension provision (it is less surprising that employers are content to see employee contributions increase as well).

Of course, the unknown in all of this is the degree to which opt-outs may rise as minimum employee contributions climb in late 2017 and 2018 and how this might then colour any further increases in minimum levels. As we have noted in the introduction to this survey report and elsewhere, the possible reaction to increases in minimum contributions needs to be examined by Government well ahead of their impact with contingencies planned in terms of tax relief and other incentives to address any significant increase in employee opt-outs.

Figure 9: Close to half of employers are prepared to support increase in 2020 minimum auto-enrolment contribution rates made by employers and employees



(Source: ACA 2015 Pension trends survey, First Report, Table 9, page 21)

One in four support auto-escalation of employee contributions

One possible way of building up employee contributions into pensions is via 'auto-escalation'. Auto-escalation encourages people to commit to increasing their pension contributions at a future date, often in line with wage increases. The idea is one that the DWP has said is worthy of further examination[28] as, much like auto-enrolment, it plays on inertia. Once signed up, an individual no longer has to take active decisions to increase their contributions – that happens automatically. By synchronising the point of increase in contributions with an increase in wages, individuals not only defer to a later date the loss of immediate income that an increase in contributions represents, but also know that when it comes, it will be tempered by their overall income increase.

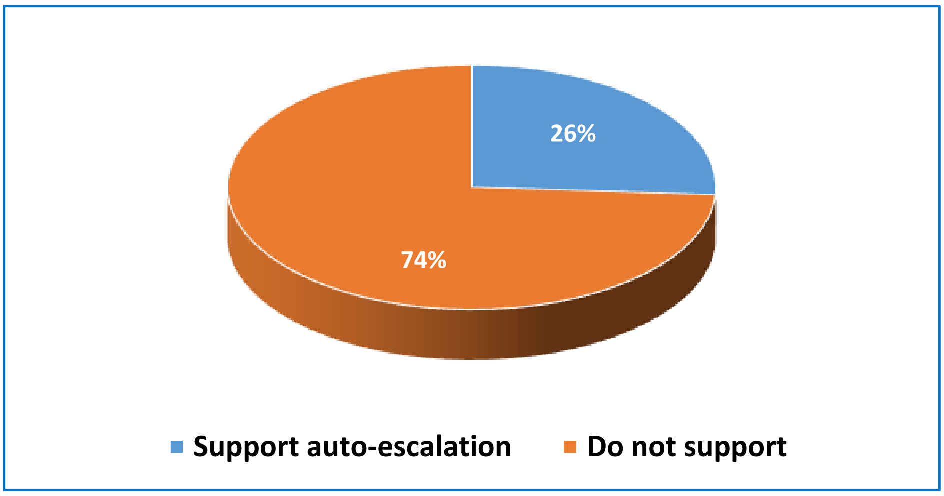
[28] DWP paper, *Reinvigorating workplace pensions,* November 2012, Cmnd 8476, pages 19-20.

Whilst the concept has been taken up by many large companies using defined contribution in the USA, the idea has not taken off in the UK. A clear economic pre-condition is, however, that earnings are generally increasing year by year. It may be that the UK economy is entering a phase where year on year wage increases will begin to re-emerge enabling auto-escalation to take hold, and in this event it is likely that larger employers will be the first to consider such an approach in the UK.

Our 2013 survey found a higher level of interest in auto-escalation, however this year's survey still found slightly over a quarter of employers prepared to support the idea whereby employees are encouraged to auto-escalate their pension contributions at a future date as wages and salaries increase (see *Figure 10* and *Table 10,* page 21). This still must be seen as encouraging, but it seems likely that for the initiative to take-off there may be a need for the Government to incentivise employers to offer such an option.

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

Figure 10: Employers prepared to support idea of 'auto-escalation' whereby members are encouraged to increase pension contributions at a future date, often in line with wage increases



(Source: ACA 2015 Pension trends survey, First Report, Table 10, page 21)

Section 4: Shaping the 'Next Step' strategy

Growing workplace pension contributions

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

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

We believe that the oft-quoted 'success' of auto-enrolment has yet to be proven with so many new pension savers as identified by this and other report making minimal pension savings, especially as 'affordability' has been reported as the principal reason why individuals to date have opted-out[29]. What occurs in 2017 and 2018 when minimum contributions rise quite steeply will determine the true scale of the policy's success in extending pension coverage.

However, even if the high rates of participation are maintained, the eventual 2018 minimum 8% contribution, when phasing is completed, is unlikely to generate for very many the retirement income that will lead onto a comfortable retirement. Assuming 40 years of contributions at 8%, with 3% real return on investment, a person on average earnings is likely to fall markedly short of the Pension Commission's targeted replacement income[30] of two-thirds of pre-retirement income. Indeed, a contribution rate of between 14-16% would probably be needed to reach this benchmark. Variable earnings over a lifetime and shorter periods of savings make the argument for higher than 8% contributions all the more powerful, especially given the forward pressures in funding State pensions due to a rapidly ageing society.

A PPI study[31] has broadly confirmed these findings. Whilst a low-earner contributing 8% would have a 63% probability of achieving the Pension Commission's target replacement income (including the single tier State pension) on retirement, an average earner has a 49% probability and a high earner a 40% probability. However, these probabilities decline sharply with career breaks or if pension saving starts at a later age.

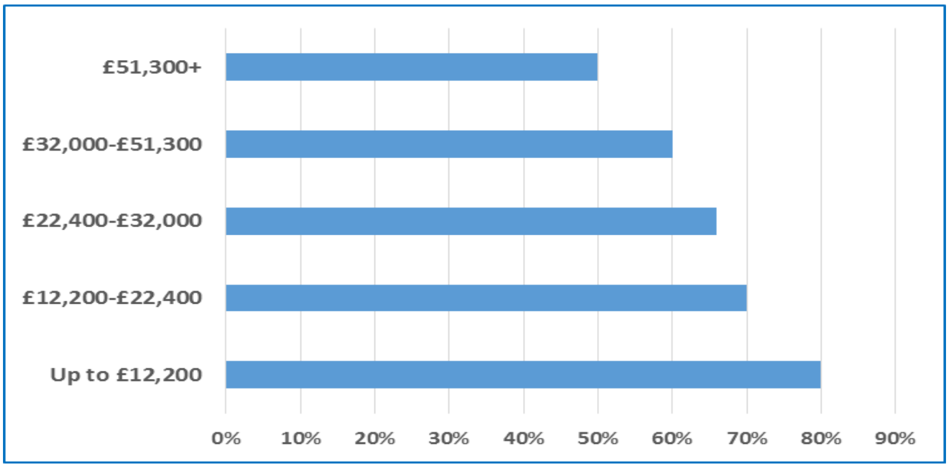
---

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

[30] *Figure 11*, page 17.

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

Figure 11: Pension Commission: target replacement ratios by income



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

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

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

Minimum pension contributions: the future

- **Serve notice that in 2018 the Government will reduce the lower band on earnings eligible for auto-enrolment and lower the auto-enrolment earnings threshold to extend provision to more women and low earners.**
- **Serve notice that the Government will increase the minimum auto-enrolment contributions by 1% every two years after 2020 until they have reached a combined contribution of 16%. The Government's contributions will take account of the outcome of the current tax relief consultation.**
- **Serve notice that the Government will assist employers and employees over the period of these increases in pension contributions by way of planned reductions in NI and further increases in tax free allowances and the Employment Allowance.**
- **Serve notice that these increases in contributions and tax adjustments may be implemented subject to the performance of the economy, particularly in terms of earnings growth and growth in earnings net of tax.**

Other 'next step' policy recommendations

Establish a standing Independent Retirement Income Commission charged with promoting the active extension and betterment of private retirement income provision and making recommendations on the future of State and public sector retirement provision.

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

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

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

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

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

Provide greater incentives for lifetime savings by allowing early access after 10 years of pension savings to a proportion of their fund currently available only from age 55 to help fund house deposits and/or to meet life's crises. This to be implemented at such time that the *Pension Wise* service can be extended to provide guidance on such withdrawals.

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

Statistical Appendix: ACA 2015 Pension trends survey results

The survey was conducted by the Association of Consulting Actuaries (ACA) in the summer of 2015 for online completion and was circulated to UK employers of all sizes, selected on a random basis. Responses were received from 477 employers with over 620 pension schemes. This survey report focuses on general workplace pension trends, including changes driven by auto-enrolment and the Government's ongoing pension reforms.

Employers responding to the survey and the changing pension scene

Table 1

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

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

Table 2

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

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

Table 3

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

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

Table 4

Has or will your business change its workplace pension arrangements as a result of the requirement to auto-enrol all eligible jobholders into an auto-enrolment scheme from your staging date?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	38%	60%	70%	61%	58%	60%	65%	**52%**
No	11%	11%	11%	32%	39%	31%	24%	**18%**
No decision yet	51%	29%	19%	7%	3%	9%	11%	**30%**

Table 5

As a result of auto-enrolment what has been/will be your most likely change to your workplace pension arrangements?

	Staged	Not staged
Enrol all eligible jobholders into an existing scheme	17%	9%
Enrol all eligible jobholders into a new employer's scheme	4%	5%
Enrol all eligible jobholders into NEST or new multi-employer scheme	34%	23%
Restrict entry of pre-existing non joiners and new entrants to new employer scheme	2%	1%
Restrict entry of pre-existing non joiners and new entrants to NEST/multi-employer scheme	38%	29%
Other	5%	-
No decision taken	-	33%

Table 6

Are small and micro-employers that have not reached their staging date for auto-enrolment budgeting for the likely increase in costs arising from auto-enrolment?

	1-9 employees	10-49 employees	Total
Yes	23%	90%	36%
No	77%	10%	64%
Expected increase in payroll costs (median)	← 3 – 5% →		

Table 7

Median employee opt-out rates on auto-enrolment at employers who have staged and forecast rates by employers yet to stage

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +
Staged (Actual)		10 - 15%	10 - 15%	8 - 9%	8 - 9%	8 - 9%	8 - 9%
		← 8 – 9% →					
Yet to stage (Forecast)	21 - 25%	11 - 15%					
	← 16 - 20% →						

Table 8

Median contribution rates into pension arrangements provided by responding employers (by types of scheme). Figures in brackets are 2013 mean figures from the *ACA 2013 Pension trends survey* report)

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

Table 9

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

Employer contribution	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
No increase (3%)	57%	43%	54%	41%	48%	45%	49%	**51%**
4%	30%	40%	34%	44%	19%	21%	26%	**31%**
5%	8%	11%	6%	6%	14%	17%	11%	**9%**
6% or more	5%	6%	6%	9%	19%	17%	14%	**9%**

Employee contribution	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
No increase (4%)	62%	51%	44%	65%	53%	61%	40%	**54%**
5%	29%	43%	47%	26%	35%	29%	46%	**35%**
6% or more	9%	6%	9%	9%	12%	10%	14%	**11%**

Table 10

Do you support the idea of 'automatic escalation schemes' whereby members are encouraged to increase their pension contributions at a future date, often in line with wage/salary increases?

	1-9 employees	10-49 employees	50-249 employees	250-499 employees	500-999 employees	1000-4999 employees	5000 employees +	Total
Yes	25%	24%	25%	19%	29%	30%	38%	**26%**
No	75%	76%	75%	81%	71%	70%	62%	**74%**

The Association of Consulting Actuaries (ACA) is the representative body for UK consulting actuaries and is the largest national grouping if consulting actuaries in the world and is a full member of the International Actuarial Association (IAA).
Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code.

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

October 2015