Aon Defined Contribution Scheme Survey 2017

Navigating the future

Plotting the course for contributions

Empower Results®

Plotting the course for contributions

Companies need to ensure that they meet the mandated increasing auto-enrolment contributions in 2018 and 2019. More widely, employers need to consider the future workforce planning implications of inadequate DC contributions.

It is up to employers to get their plans on track. But many are held back by not having a clear idea of what they will do.

Key discoveries

Many trustees and scheme managers need guidance – from our survey over half do not know how much their members are likely to receive when they retire.

41% of schemes need to alter course and increase contributions before April 2019.

The average default company contribution rate has fallen to 6%, but this varies significantly across different sectors.

Of those who knew, 2 in 3 respondents expect their lifetime members to get a replacement ratio of less than 40% of salary.

Unexpected findings

1 in 4 schemes offer a maximum company contribution level in excess of 13% pensionable salary.

Many respondents are worried their members will opt out when auto-enrolment increases.

Only 10% of respondents whose schemes need higher minimum contribution levels intend to let employees opt back down to a lower rate.

Obstacles

'**Integrating auto-enrolment** staged increases into existing contribution structures'

'**Keeping members in the scheme** when the phased contributions increase in April'

'**Funds too low** to consider retirement due to low contributions'

Moving forward

Make sure your scheme is auto-enrolment ready and communicate any changes.

Know your outcomes.

Consider contribution design including **auto-escalation.**

Plotting the course for contributions

The level of contributions made on behalf of members into DC schemes will have a significant impact on outcomes at retirement. A course should be plotted so that when your members need to increase their contributions, there should be no surprises.

The Government's auto-enrolment initiative is a requirement on employers to enrol workers who meet certain criteria into a pension scheme with a minimum level of contributions. This minimum level for a DC arrangement is set to be 8% of 'qualifying earnings', including at least a 3% contribution from the employer, and this is phased in over a number of years:

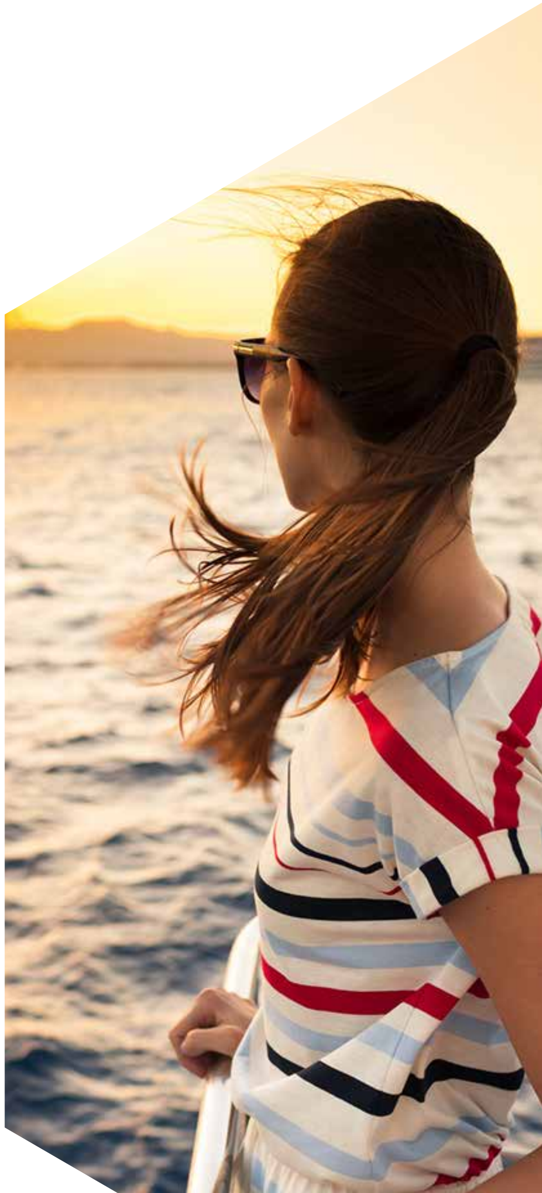
Date	Total minimum level of qualifying earnings
Until April 2018	2% (of which at least 1% is from the employer)
From April 2018	5% (of which at least 2% is from the employer)
From April 2019	8% (of which at least 3% is from the employer)

The Government's intention was to encourage more people to save towards their pension; in December 2016 almost 7 million people were enrolled into a pension scheme by nearly 300,000 employers.

Jargon busting

Qualifying earnings

The band of earnings used to calculate the minimum contributions under auto-enrolment. For the 2017/18 tax year qualifying earnings are those between £5,876 and £45,000.
If pensionable pay is not based on qualifying earnings then there are alternative requirements to be met under auto-enrolment.



Current contribution levels

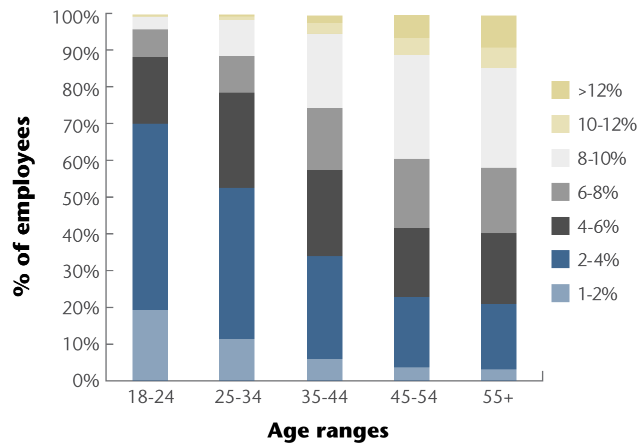
Looking at contribution levels, our respondents' average default contribution rate is 9% of salary (3% employee and 6% employer). This is lower than the average default found in our previous scheme survey and it is significantly lower than the average rates of around 12.5% in total that members reported in our 2016 DC Member Survey. While this is not moving in the right direction, our findings are not entirely surprising as employers reaching their staging date with no pension scheme often enrol employees by default on the minimum level of contributions required.

While the default contribution levels have decreased over the last two years, the majority of respondents' schemes offer members the option to increase their contribution levels. A quarter of schemes offer a maximum company contribution level in excess of 13% of salary and a maximum employee contribution in excess of 8% of salary.

According to our 2016 DC Member Survey, a typical 25 year old man needs to save 18% of salary to maintain his standard of living in retirement, if he is starting with no retirement savings but expects to get a full State Pension in addition and wants to retire at State Pension Age. Although we recognise that the other financial pressures on people vary over their lives, and the chart on the right from our report 'Wellbeing: Examining the correlation between employee health and financial wellbeing' shows how member contributions typically vary with age.

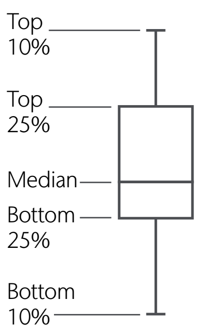
While members may choose to increase their contributions, those running schemes may wish to consider the number of members who elect to do this and whether more can be done to encourage this. Examples include improved education and communication or auto-escalation of contributions.

Proportion of members' salaries paid into pension scheme.



Based on our report, 'Wellbeing: Examining the correlation between employee health and financial wellbeing'

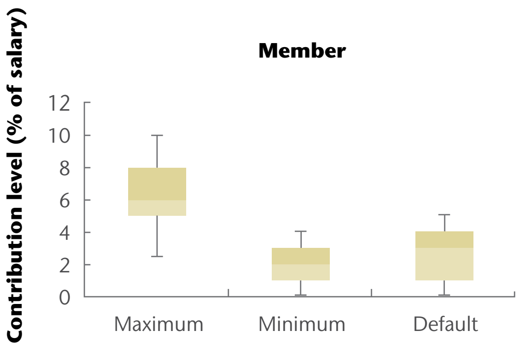
Reading the Box Plot charts

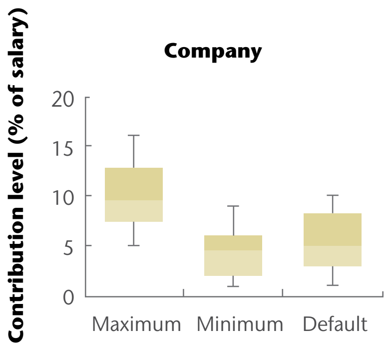


The centre line in each box represents the median average result, while the edges of the 'box' represent the first and third quartiles (ie, the 25% to 75% mark).

The end of the whiskers represent the bottom and top deciles, so any results outside of these lines are either in the bottom 10% or top 10% of scores.

Minimum, default and maximum level of contributions





Auto-escalation of contributions

Where a member's contribution rate is automatically increased for certain triggers such as length of service, a promotion or a salary increase.

Responding to auto-enrolment requirements

Nearly half of our respondents have default contribution levels below the minimum default contribution level under auto-enrolment from April 2019. Action will need to be taken in advance of the increase dates.

Of the respondents who were not meeting the auto-enrolment minimum, 9% were intending to retain the previous lower level, allowing employees to opt down from the auto-enrolment minimum, and 50% were intending to remove the lower level altogether. Worryingly, 29% were still undecided. The preparation required ahead of the increase date depends on the action taken, with potentially long lead time for changes to scheme design, or where employee consultations are potentially needed. We suggest that a discussion regarding the most appropriate option is started as soon as possible.

Many respondents were also worried their members would opt out when the minimum level of contributions under auto-enrolment increases. To those with similar concerns we suggest that there is a simultaneous communication strategy to educate members about how the contribution level impacts retirement income, enabling them to make decisions appropriate for them.

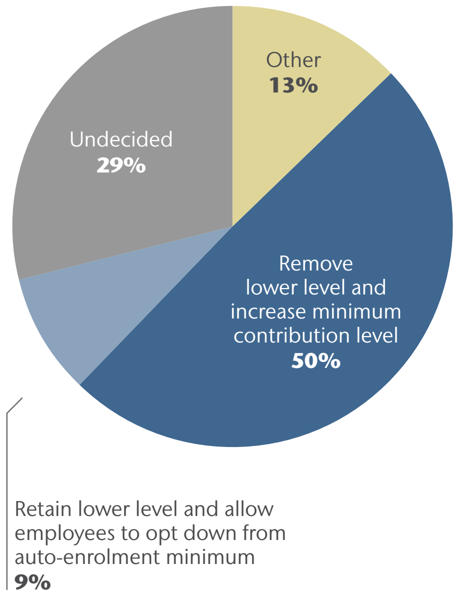
Challenges highlighted by respondents

'Maintaining employee contributions into the scheme following increases to contributions'

'Educating on the impact of increasing contributions'

'Ensuring members appreciate the value of employer contributions'

Actions planned to meet auto-enrolment increases where needed



Our consultants can help you by:

- Analysing your scheme design and the options available to meet the auto-enrolment minimum
- Drafting employee communications
- Helping manage a review of your auto-enrolment processes

Translating contributions into outcomes

Part of plotting the course for contributions includes translating this into member outcomes at retirement. One way to do this is by looking at the replacement ratio.

Replacement ratio

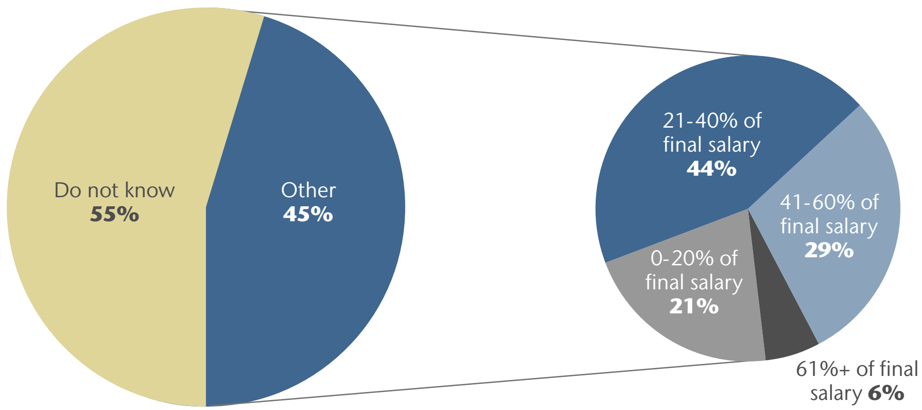
This is the ratio of retirement income to pre-retirement earnings.

We asked people what the expected replacement ratio of retirement income to pre-retirement earnings (excluding State Pension) would be for a lifetime member of their scheme. The majority (55%) did not know what the ratio would be. If those managing the scheme do not know the answer then it is unlikely that their members will.

Of the respondents that did know what replacement ratio a typical member could expect, two-thirds expect this to be less than 40% of salary at retirement.

While better member outcomes are not only about replacement ratios, they are a useful yardstick.

Expected replacement ratio of retirement income



Aon's DC Analytics can help you to determine the expected replacement ratio for all members of your scheme, showing who is on track for a reasonable retirement income and who is not. This can be used as a basis for discussion on whether the current contribution levels are appropriate for the scheme, and where your focus should be to improve outcomes.

To discuss the findings of this report further, or to understand more about how Aon's complete range of DC services can support you in delivering your scheme's goals, contact us:

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