

A positive outlook on auto-enrolment contributions phasing





Summary

UK businesses are focusing on securing the organisation's future by strengthening their competitive position, increasing revenue and profit growth. Success however depends on a productive and motivated workforce which can be achieved by safeguarding their wellbeing.

So can organisations also help shape the futures of their employees? The past five years have proved that they can.

Auto-enrolment has been a success so far and employers have been behind this achievement, helping over eight and a half million people take the first step towards building a better future in retirement.

Why High 5?

They say good things come in threes. In the case of auto-enrolment, it's more about fives.

It's been five years since auto-enrolment was introduced, and 5% will be the new minimum contribution from April 2018. And one more five, a high five for the successes of the scheme's first phase.

Great achievements so far:



Around 8,707,000¹ employees have joined a workplace pension - which means that over 88%² of UK employees are in a scheme. And that's with an opt-out rate of about 10% - much lower than the original estimate.



£87.1bn³ was saved by eligible members in 2016, a £3.8bn increase compared to 2015.



Since 2012, more than 807,810⁴ employers have completed their declaration of compliance.

If all that doesn't deserve a high five, what does?

Building on this success

The hardest part of any journey is taking the first step; the same applies for auto-enrolment.

Through collective responsibility and by working together, this first step was overcome with success. The journey continues and contributions phasing is a part of this, this second stage is focusing on engagement and helping people to save more.

Standard Life will continue to help employers on this journey. Supporting businesses which want the best for their people is what we do best.

Together we can help them build a better future.

Jamie Jenkins
Head of Pensions Strategy
Standard Life

¹ The Pension Regulator, Automatic enrolment - Declaration of compliance report, July 2012 - end September 2017

² Calculations based on The Pension Regulator, Automatic enrolment, Commentary and analysis: April 2016 - March 2017

³ The Pension Regulator, Automatic enrolment, Commentary and analysis: April 2016 - March 2017

⁴ The Pension Regulator, Automatic enrolment - Declaration of compliance report, July 2012 - end September 2017



A bit of background

It's been a hot topic now for half a decade and auto-enrolment continues to shape the pensions landscape.

This needed to happen - with average life expectancy increasing, combined with a low level of trust in the financial services sector, the UK Government was concerned that people are not saving enough for an adequate retirement and protective measures needed to be put in place.

Quick reminder

Auto-enrolment is part of a wider set of pension reforms designed to help people have a comfortable lifestyle in retirement.

Employers have to enrol all eligible employees into a qualifying workplace pension and make contributions. This applies to workers who are aged at least 22 but under state pension age, usually working in the UK and earning more than £10,000 per year, unless they're already a member of a pension scheme that meets certain criteria set out in law.

It's a big change and the Government was conscious of bringing in auto-enrolment at a time of economic uncertainty.

The solution was a staged approach, so that both employers and employees could build up contributions gradually. And it works: the proportion of employees participating in a workplace pension has increased sharply since 2012, thanks to auto-enrolment.

Celebrating the achievements

It's now five years since auto-enrolment was introduced - a good time to acknowledge its successes so far. Total membership of occupational pension schemes in the UK has increased from 47% in 2012⁵ to around 88%⁶.

We believe that's a huge achievement. But it's not just about numbers.

Everyone involved - especially employers and their employees - have played their part in a shift towards a culture of saving, one that will give people the opportunity to create a future they can look forward to.

⁵ The Office for National Statistics, "6 facts about pension membership", 5 March 2015

⁶ Calculations based on The Pension Regulator, Automatic enrolment, Commentary and analysis: April 2016 - March 2017



More than **8,707,000**⁷
employees have joined a workplace pension

The annual total amount saved by eligible savers in 2016 has increased by approximately



10%
estimated opt-out rates

significantly lower than the original expectation

4.3%

in 2016 comparing to 2015⁹

About

78%

proportion of UK employees are now in a workplace pension scheme



More than **807,810**⁸
employers have completed their declaration of compliance

The size of the average pension pot has ballooned from £29,000 to

£50,000 in the last two years¹⁰

7 The Pension Regulator, Automatic enrolment - Declaration of compliance report, July 2012 - end September 2017

8 The Pension Regulator, Automatic enrolment - Declaration of compliance report, July 2012 - end September 2017

9 Calculations based on The Pension Regulator, Automatic enrolment, Commentary and analysis: April 2016 - March 2017

10 <http://www.thisismoney.co.uk>, article "Do you have £50k saved for old age? Average pension pot swells 72% in just two years - but men have three times more than women"

11 The Pension Regulator, Automatic enrolment, Commentary and analysis: April 2016 - March 2017

Types of schemes used by employer size¹¹:

Less than 30 employees:

99% DC
1% DB/Hybrid



More than 30 employees:

91% DC
9% DB/Hybrid

What we've learnt so far

...that it's not rocket science

The reasons for so many people participating in auto-enrolment might seem complicated but they're not, it's just inertia. What people are doing is exactly what behavioural economics theories suggested they would.

...eliminating the decision works

Auto-enrolment is a very different way for people to make choices about their pension. That's because it's about opting people in automatically, which has eliminated the enrolment decision. And it's been a success.

...using procrastination makes sense

When people are automatically enrolled into pension schemes, although they can choose to opt out, they're more likely to stay in their pension scheme than if they had to actively opt in.

And it works. Opt-out rates are significantly lower than the original expectation.

Continuing the journey: contributions phasing

In February 2018, the current schedule for employers to meet their duties will end. This is when the last employers are due to stage. Auto-enrolment is slowly becoming 'business as usual' for most employers. So, what's next?

Let's build on the successes

Participation rates have increased and we've learned a lot from the first phase. But even if the size of the average pension pot has almost doubled in the last two years, the average pension pot in the UK is £50,000¹². That's still too low to retire comfortably.

We believe that many people are only paying the minimum contributions of 1% matched by a similar employer contribution which isn't likely to provide enough in retirement.

What is the target replacement rate?

Replacement rates measure retirement income as a ratio of working age income.

According to the Pensions Policy Institute (Value for money in DC workplace Pensions, 2016), the target replacement rates for an average earner is about 67% of their working life income. For a higher earner the estimated target replacement rate is 50% of their working life income.

It's time to look at the successes so far - and build on them as the focus moves towards engagement. That means helping employees to understand the value of pension saving, so that they increase their pension contributions. We've all got a role to play in this, from providers and advisers to the Government, employers and the rest of the pensions industry.

¹² <http://www.thisismoney.co.uk> , article "Do you have £50k saved for old age? Average pension pot swells 72% in just two years - but men have three times more than women"



April 2018 - time for contributions to increase

Auto-enrolment was always intended to introduce gradual increases in minimum pension contributions, at set times. On the 6th of April 2018 contributions will increase from the current total minimum contribution of 2% of qualifying earnings to 5%. And employees will have to make up whatever shortfall remains of the new total minimum contribution.

The next increase will be in April 2019. Based on qualifying band earnings, contributions rise to a minimum of 8% total, with at least 3% from employers.

Date effective	Employer minimum contribution	Employee contribution	Total minimum contribution
Currently until 5 April 2018	1%	1%	2%
6 April 2018 to 5 April 2019	2%	3%	5%
6 April 2019 onwards	3%	5%	8%

Chart source: The Pensions Regulator, Ongoing duties survey - July 2017, Research report

The new minimum employer contribution will vary depending on the type of scheme, the rules of that scheme and the definition of pensionable pay used.

Employers who are not using qualifying band earnings as their pensionable pay definition will need to make sure that they're using the correct minimums and will also need to recertify their scheme.

Getting ready for the increases

While most employers acknowledge that current levels of savings are too low to ensure an adequate income at retirement and they believe that increasing contributions is the right thing to do, this change also raises some concerns for employers:



1. Small and medium size employers are concerned that their employees would find it difficult to afford the new contribution levels and are more likely to opt out of their workplace pension.



2. Large employers might be less concerned about affordability, but they perceive this change as an extra cost. That's because, with employee retention and engagement being in top three priorities for their workplace pension, it's frustrating for them to see that employees don't value it.

At Standard Life, we believe that auto-enrolment contributions phasing is an opportunity to help members take the right next step for their retirement and to improve engagement.

That's why we encourage employers to focus their efforts, energy and resources on the opportunities generated by this change - not on potential problems.

Efficient planning, effective communications and the right partners to support them can mean employers minimise opt-outs and can use the minimum contribution increase as an opportunity to increase employee engagement.

This report is a way of taking a closer look at employers' attitudes and concerns around minimum contributions increase. Once we've done that, we can suggest solutions - to transform the April 2018 increases into an opportunity.

Knowledge is power

Based on feedback received from our existing clients, we believe that most large employers are aware of - and ready for - minimum contributions to increase. "The Pensions Regulator, Ongoing duties survey - July 2017" research report shows that medium and small size employers' knowledge of the level of the April 2018 increase was lower and awareness of the date even lower.

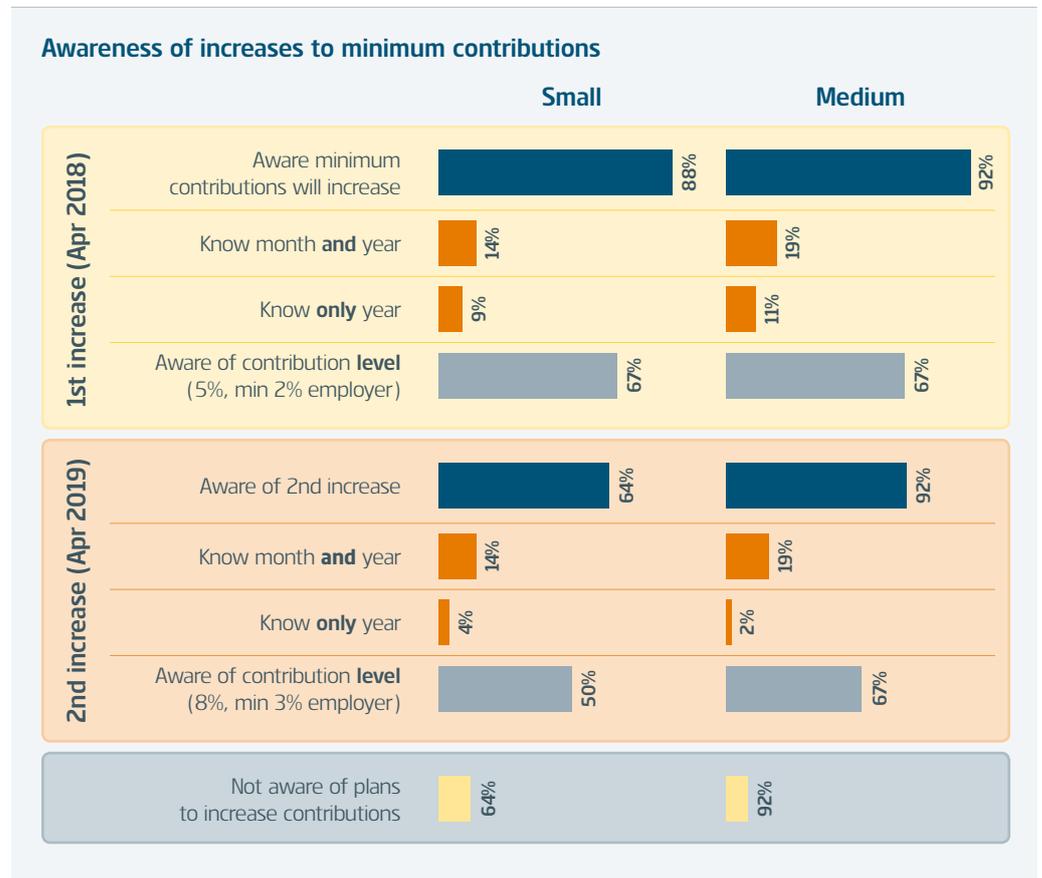


Chart source: The Pensions Regulator, Ongoing duties survey - July 2017

Employers are responsible for ensuring that the pension scheme they use to meet their duties is a qualifying scheme, and that pension contributions are deducted correctly. But pension scheme trustees and providers, and payroll providers, have a key role in making the process work smoothly.

Preparation doesn't just make things easier - it's essential. For example, for trust based schemes, increased minimum contribution levels will need to be reflected in the pension scheme's rules and other governing documentation and employers must ensure that payroll providers will be ready to calculate and deduct the increased contributions when they rise.

While a significant number of employers aren't aware of the date and the value of the increase, with support from pension providers, advisers and The Pensions Regulator, these knowledge gaps can be closed.

How will this affect employers?

Large employers are half way there already

Research shows that most large employers, including FTSE 350 firms, are already contributing over the minimum rate required for April 2019. For FTSE 100 companies, with a matching design, the average maximum overall contribution rate is 16.5%, employers typically willing to commit up to 10%¹³.

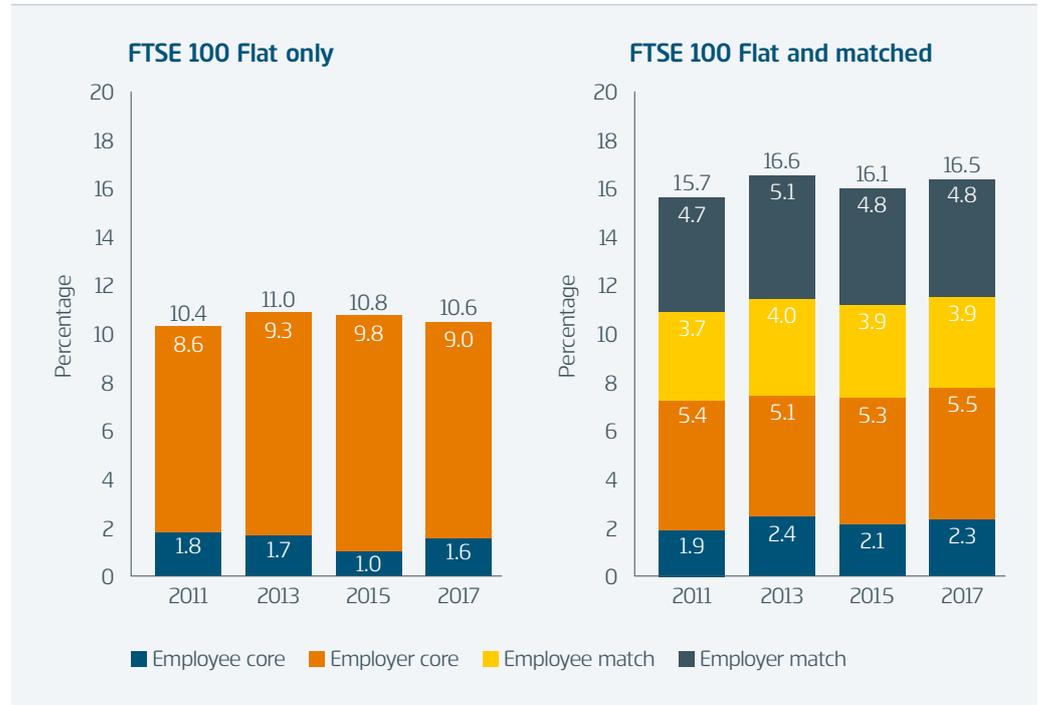


Chart source: Willis Towers Watson, FTSE 350 defined contribution pension scheme survey 2017 infographic

This doesn't mean that the minimum contributions increase won't affect them. It just won't affect them as much as it will small and medium size firms.

That's because most FTSE 100 schemes enrol members at the lowest rate available¹⁴. We believe employers are using this approach in order to avoid rising opt out rates.

- ▶ 89% of FTSE 100 and 94% of FTSE 250 companies auto-enrol members at the lowest rate available
- ▶ 25% of employers may need to increase contributions for some of their workforce

Most large employers are ready for the change and the focus is now on making the most of it.

While flat rate contribution structures continue to be a dominating trend, the proportion of FTSE 350 schemes using a "flat and matched" design has increased noticeably, from 57% to 64%. This could indicate that employers are targeting higher contributions at employees who are also willing to commit their own savings¹⁵.

In the absence of a good communications strategy, members can miss out on nearly half of the employer contributions available.

But although contributions are high, most large employers say that it's a lack of employee engagement that's their biggest challenge. Contributions phasing could be an opportunity to remind their employees about the competitive package they benefit from. And it could also be an opportunity to start seeing some returns on their workplace pension investment by driving engagement. All this can be achieved through a good communications strategy.

¹³ Willis Towers Watson, FTSE 350 defined contribution pension scheme survey 2017 infographic

¹⁴ Willis Towers Watson, FTSE 350 defined contribution pension scheme survey 2017 infographic

¹⁵ Willis Towers Watson, FTSE 350 defined contribution pension scheme survey 2017 infographic

Small and medium size employers - the majority only pay the minimum contribution

The proportion of employers reporting that they currently pay more than the minimum contribution of 1% decreases along with size.

Only approximately 30% of small and medium-sized firms are currently paying more.

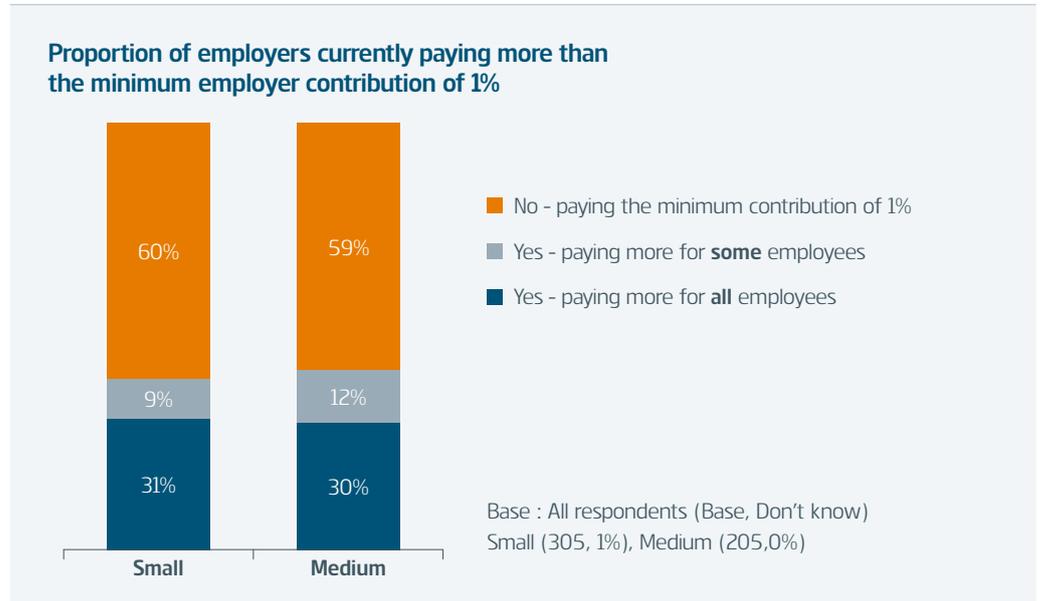


Chart source: The Pensions Regulator, Ongoing duties survey - July 2017

Exploring attitudes and concerns

Most employers think that future increases to contribution rates are a good idea. But there are still causes for concern - and these vary depending on the size of the organisation.

Small and medium sized employers

Small and medium sized employers are concerned that increases will mean more employees opting-out. They're worried about employees being able afford the new minimum contributions. TPR research also shows that a quarter of employers felt they would find it difficult to meet minimum contributions.

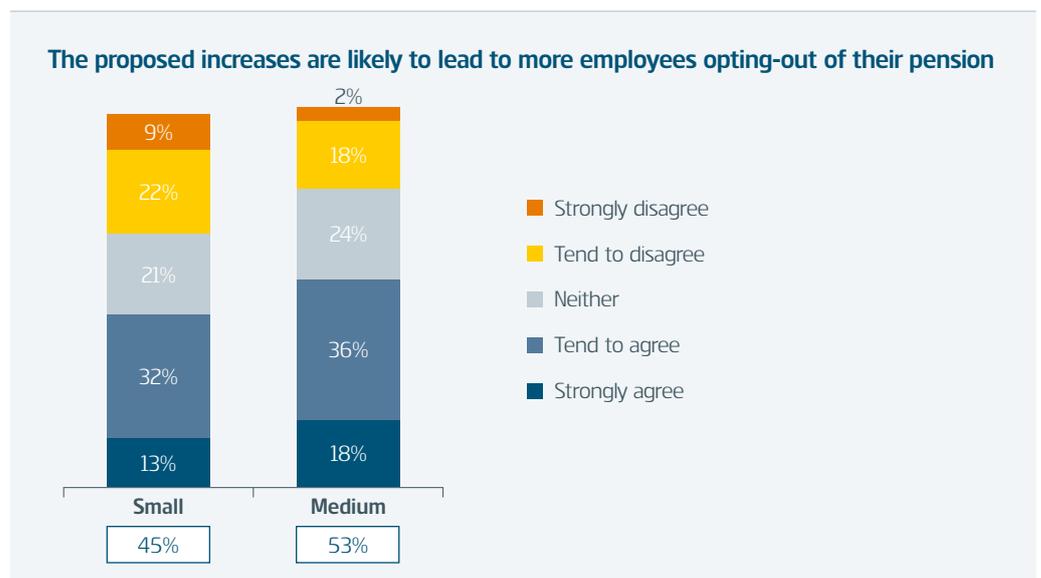


Chart source: The Pensions Regulator, Ongoing duties survey - July 2017

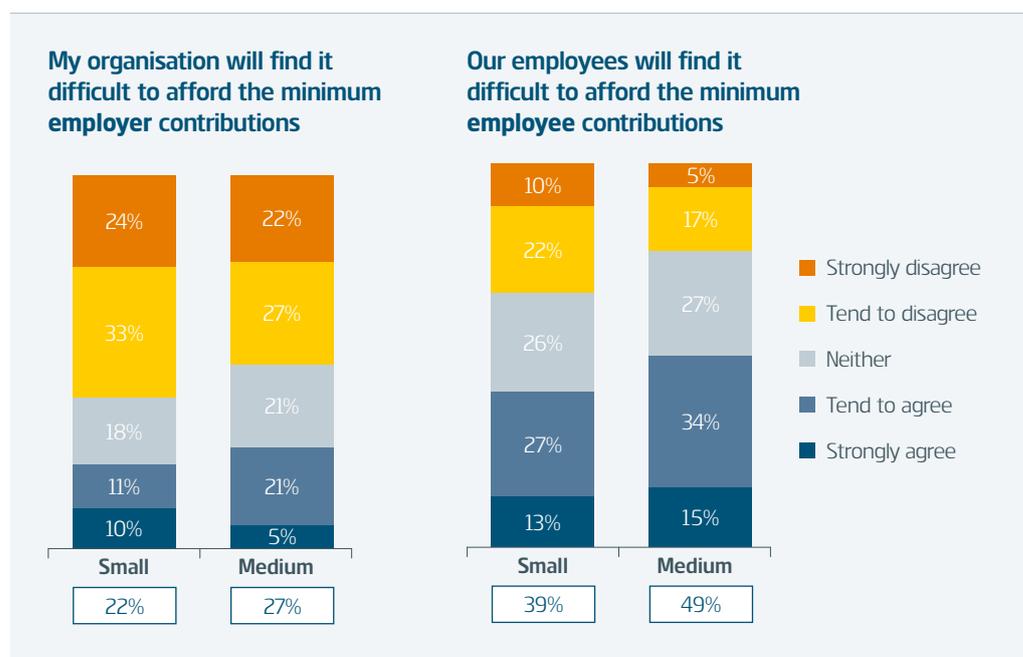


Chart source: The Pensions Regulator, Ongoing duties survey - July 2017

For large employers, a different type of concern.

A recent study conducted by Standard Life in collaboration with Barnett Waddingham reveals that 67% of large employers don't think that the increases in minimum employee contribution rates in April 2018 will increase opt-out rates¹⁶.

They're more concerned about getting better returns: the workplace pension is one of the biggest benefits costs - but despite offering generous contributions, employees aren't engaged and don't value this benefit enough. With minimum contributions increasing, costs will increase but they don't expect to see any better returns.

23% auto-enrolled members don't know their employer makes contributions to their workplace pension. Now's the time to let them know¹⁷.

Employees who are engaged and interested to contribute more as well can benefit from generous contributions from their employers. But in the absence of a good communications strategy, members can miss out on nearly half of the employer contributions available.

Most employers already contributing over the April 2018 levels are not considering further increases¹⁸.

This can be because their current contribution structures often offer employees the option to "opt-up" or "max-match".

Staying on top of the administration

At Standard Life, we understand from our own clients that some employers are concerned about the administration side of the auto-enrolment minimum contribution increases.

Increase in administrative burden is the second biggest challenge to running your DC scheme¹⁹.

For a smooth process, early preparation is needed. But with support from payroll and pension providers, this can be a simple task.

There are ways to reduce the burden. Employers can tailor the way they phase their pension contributions to suit their business by aligning the phasing date with other key company dates. This will avoid potential duplication of efforts.

¹⁶ "Employers' attitudes to the changing DC pensions landscape", a report from Barnett Waddingham and Standard Life, August 2017

¹⁷ "Customer Measures, Quantitative Research" Standard Life, August 2017

¹⁸ Research conducted by Standard Life in collaboration with Centaur Media, August 2017

¹⁹ "Employers' attitudes to the changing DC pensions landscape", a report from Barnett Waddingham and Standard Life, August 2017

Early preparation, robust administration systems and having the processes in place to ensure the correct contributions are deducted at the right time - all these will help employers effectively manage the additional administration required.

TPR has asked providers to support employers with template letters for member communications. At Standard Life, we go one better, offering additional support through our ready-made communications focused on the minimum contributions increase.

For trust based schemes, the increased minimum contribution levels will need to be shown in the pension scheme's rules in time for 6 April 2018 (and 6 April 2019), as well as any other governing documentation. In most cases, this is the responsibility of the pension scheme trustees or managers.



It's important that pension schemes and payroll products support the contribution increases. Communicating with your pension and payroll providers well in advance will ensure they'll be ready to calculate and deduct the increased contributions when they rise in April 2018 and 2019.

Minimum contribution increases are a way of helping employees to save more and build a better future. Let's continue the journey of auto-enrolment success - together.



Making the most of this change and overcoming challenges

Minimum contributions are increasing - and employers play a critical role in making sure this doesn't lead to higher opt-out rates. How? By driving up employee engagement with their pension savings.

Auto-enrolment has been a great success so far. But members who have been automatically enrolled might be less likely to actively engage with contribution decisions.

Once enrolled in their workplace pension, people need incentives and motivation to encourage them to increase their contributions.



I) Affordability is not always the main barrier; perceptions have a big impact on their choices as well.

- ▶ An effective communications strategy might help overcome these concerns. The quality of employee communications is very important, just communicating the increase is not enough. Giving clear information on why this increase is necessary - and explaining the difference it could make to the final size of their pension pot is extremely important.
- ▶ Helping people understand how resisting short-term impulses can lead to long-term gratification can also contribute to keeping opting-out rates at low levels.

Employers plan to communicate the increased contribution levels to their staff before they take effect. The most common planned method of communication by small and medium size businesses was by email or letter²⁰. Based on the feedback received from some of our existing large clients, face-to-face communication is also considered.



II) Sometimes there's a gap between how much people think they should be saving and how much they actually do save.

- ▶ The right tools can help members plan how much they need to save and how long it will take for them to achieve their desired retirement lifestyle. Tools like this could help employers demonstrate to their employees that the current savings rate is not enough and that further increases are necessary.



III) Psychologically, people are more likely to agree to save tomorrow than to save today.

- ▶ Timely communication can prepare employees for the upcoming change. Employers can choose to align the phasing dates with other key company dates and through campaigns such as our "Save More Tomorrow campaigns" schedule increases in contribution rates to coincide with pay rises.



IV) Employers can choose to contribute more than 2%.

- ▶ Matching what employees contribute can be an option (for example: the employer contributes 2.5% and the employee 2.5%). We believe that the match threshold could have a positive effect on employees' perception with only a little more cost to the employer.

We also understand large employers' concerns around facing increasing workplace pension contributions costs, while levels of employee engagement continue to be low.

It's time for employers to see some returns on their workplace pension benefit spend. And we believe that the minimum contributions increase is a great opportunity to start boosting engagement.

Retention ranks in the top three key benefits of DC schemes²¹ and this second phase of auto-enrolment is an opportunity for employers to start seeing some return on their workplace pension investment through increased employee engagement.

Large employers are partially affected by the second auto-enrolment phase because they are already contributing over the April 2018 minimums. However some of their new members have been enrolled at the lowest rate available.

So they will have to communicate different messages to the different segments of the workforce.

- ▶ Targeted communications can help employers communicate the relevant messages to the relevant people.

Auto-enrolled employees and knowledge gaps²²:

- ▶ 17% don't know who provider is
- ▶ 23% auto-enrolled don't know employer makes contributions
- ▶ 52% not aware can choose how pension invested at any point
- ▶ 40% don't know they benefit from tax relief

Increasing awareness and improving members' relationships with their pensions is not an easy task but it's an achievable goal.



Education makes a huge difference.

Employers, supported by providers, can improve member engagement and address knowledge gaps through new engagement techniques such as:

- ▶ behavioural techniques such as nudge techniques
- ▶ improved presentation of information; reduced text, reordering of information so key facts are easier to find, greater use of digital media, use of easily understood infographics
- ▶ more frequent communication at key points in a member's life
- ▶ a range of media to interact with and through, including paper, online, apps, and phone, to meet the needs of different members at different points.

At Standard Life, we've seen real success with our clients in this area.

One way to help employees understand the value of their pension is to stop talking in percentages and start using values.

²¹ "Employers' attitudes to the changing DC pensions landscape", a report from Barnett Waddingham and Standard Life, August 2017

²² "Customer Measures, Quantitative Research" Standard Life, August 2017

What's next?

This report is the first of a two-part series focused on auto-enrolment contributions phasing. The goal of this first part of the report was to take a deep dive into employers' attitudes and concerns around minimum contributions increase.

Don't miss the second report. Standard Life is conducting a research focused on identifying solutions to transform April 2018 increases into an opportunity.

About Standard Life

Standard Life is one of the leading providers of defined contribution workplace pensions in the UK.

Pensions are a core part of our business and heritage and we have a track record of contributing to the development of the pensions industry.

We believe we have the experience and expertise to help you build a future to look forward to, for your people and your business.

Over time we have listened to our clients, understood their challenges and adapted our solutions to meet their needs. Our workplace pension solution is the result of that learning and success. It is designed to provide an efficient and well-governed framework for you and great outcomes for your employees.

Our portfolio of clients includes some of the biggest organisations nationwide. As of June 2017, we have set up pension schemes for more than 30% of FTSE 350 companies.

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