Can your scheme afford (not) to increase contributions?

Steven Leigh of Aon looks at the company's *DC Scheme Survey 2017* and the light it shines on how defined contribution schemes are tackling the challenge of auto-enrolment

Aon's *DC Scheme Survey 2017* helps schemes to understand how other schemes plan to navigate the future. A key challenge for over 40% of schemes is how they can increase contributions in either April 2018 or 2019 to stay legally compliant for auto-enrolment.

40%
of schemes need to increase contributions before April

With the introduction of auto-enrolment back in 2012, most larger employers were set for a huge increase in employee participation in their company pension schemes. This led to many adopting one of the minimum levels available under the legislation, in order to restrict the cost of the extra company contribution rates. There was some logic behind this as employees had often already forgone the opportunity to join the pension scheme – so the thinking was that they would not appreciate the extra company expenditure on their pension provision.

We are now approaching April 2018 and the first mandatory increase in minimum levels, followed by a further increase in April 2019. Aon's survey found that over 40% of schemes will need to take action to meet the increased levels.

Many companies are already reviewing the design of their pension contribution structure, and recognising that the higher auto-enrolment rates may necessitate replacing a two tier system by bringing all employees into a 'main scheme' structure for defined contribution (DC). It is important not to leave it too late to review as changes requiring employees to increase their own contributions may trigger a 60-day consultation requirement.

What outcomes will your members receive?

Disappointingly, we found that less than half of those running DC schemes knew the expected outcome for their typical member, although this is still an improvement on two years ago.

Over half of respondents do not know how much their members will get at retirement

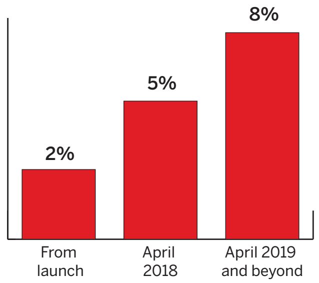
The most common expected outcome was a replacement income of between 21-40% of final earnings. However, will this be enough for employees to be able to afford to retire? This is a question starting to keep HR directors up at night. We are now seeing more companies engaging with their pension schemes to understand whether the existing design is right for their needs or whether changes are needed now in order to prevent a generation of workers being unable to retire.

Increasing contributions is one of the most effective ways to increase projected pension sizes at retirement. This could be done by design. For example:

Typical replacement ratio
21-40%
of pay

- By automatically increasing contributions each year (potentially in line with pay increases)
- By defaulting employees in at higher rates
- Or by engaging with employees to encourage them to choose for themselves to save more for retirement.

Minimum total contributions under AE rules based on qualifying earnings



How much will it cost?

Members do not look closely at the costs so scheme managers need to do so. The increasing size of DC schemes and the introduction of the charge cap mean that the average charges paid by DC members are continuing to fall, with the average found to be around 0.40% per annum. However, a focus on charges in isolation means that schemes and therefore their members may miss out on opportunities for better investment returns.

Average charges reported for default funds were around
0.4%

DC success

What will be the key to successful DC in 20 years' time?

Despite the biggest impact on the outcome for a member often simply remaining the level of savings they put in, savings rates were only fourth in the respondents' list of what was needed.

They saw success being driven by improving member engagement and financial education, while integrating pensions with other savings products.

Aon's survey shows DC schemes are certainly moving in the right direction to deliver better outcomes for members, but it is clear that there is work to be done to deliver adequate retirement provision.

For a copy of Aon's DC Scheme Survey 2017 visit aonhewitt.co.uk/dcpensions

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