

Pensions, benefits and social security colloquium 2011
Lawrence Churchill, Chair, NEST Corporation



Automatic enrolment, participation, and adequacy

26 September 2011

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Agenda

- International comparisons
- The UK, automatic enrolment and NEST
- Adequacy
- Security
- Conclusion

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Melbourne Mercer Global Pensions Index

Country	Overall index value	Sub-index values		
		Adequacy	Sustainability	Integrity
		40%	35%	25%
Netherlands	78.3	76.1	71.6	91.4
Switzerland	75.3	73.1	71.8	83.5
Sweden	74.5	72.8	72.9	79.5
Australia	72.9	68.1	71.7	82.4
Canada	69.9	75	56.8	80.1
UK	63.7	64.9	47.1	85.3
Chile	59.9	52.1	54.7	79.8
Brazil	59.8	72.9	29.1	81.7
Singapore	59.6	43.7	63.6	79.5
USA	57.3	54.3	59	60
France	54.6	74.9	29.7	56.8
Germany	54	64.1	42.3	54.4
Japan	42.9	42.2	27.9	65.2
China	40.3	48.3	29	43.4
Average	61.7	63.1	51.9	73.1

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Global Aging Preparedness Index

Fiscal Sustainability Index	Income Adequacy Index
1 India	1 Netherlands
2 Mexico	2 Brazil
3 Chile	3 US
4 China	4 Germany
5 Russia	5 UK
6 Poland	6 Australia
7 Australia	7 Sweden
8 Japan	8 Chile
9 Canada	9 Spain
10 Sweden	10 India
11 UK	11 Canada
12 Korea	12 Japan
13 Switzerland	13 Poland
14 Germany	14 Switzerland
15 UK	15 Russia
16 Italy	16 France
17 France	17 Italy
18 Brazil	18 China
19 Netherlands	19 Korea
20 Spain	20 Mexico

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The UK system

- Vibrant Private System – DB and DC
- Market failure for below average earners
- State Pension set around the poverty line
- Byzantine Complexity of means tested benefits
- Regulatory divide between contract and trust based schemes

SO policy intervention required to:

- Simplify complexity
- Increase participation rates
- Address adequacy from private provision

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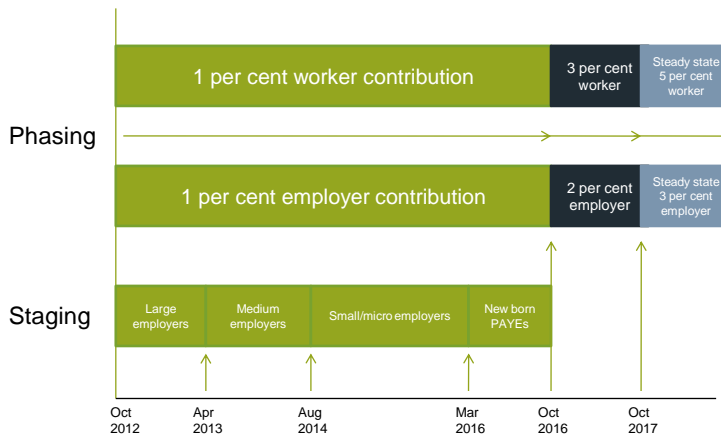
Automatic enrolment in the UK

- From 2012, all UK workers will be enrolled automatically into a pension, if they:
 - are aged between 22 and SPA
 - Earn £7,475+ (pre MAEW review: £5,035+)
 - employed for 3 months (pre MAEW review: immediately)
 - are not already in a suitable pension

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DWP's staging and phasing



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Automatic enrolment – impact on participation

- **Pre-reforms:**
 - (private sector) saving 6m, not saving: 14m
- **Post-reforms:**
 - Estimated 5-8 million people newly saving or saving more in all forms of workplace pension schemes
 - Estimated 2–5 million individuals saving in NEST

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NEST target market demography

30 per cent under 30 years of age

Two-thirds male

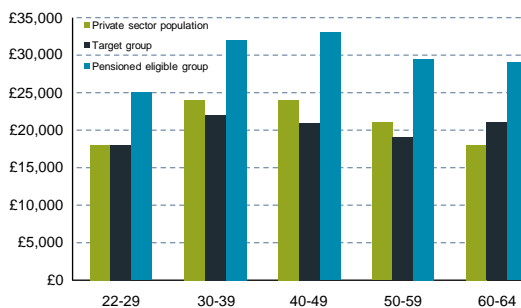
91 per cent are full time workers

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NEST target market demography - earnings

- Median earnings around £20k per annum
- 4 per cent on National Minimum Wage (around £12k)
- 33 per cent on less than £15k per annum



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NEST target market demography – labour market

- 1.3 million employers
- 1.25 million employ less than 50 workers
- 33 per cent of target group work for employers of 500+
- 60 per cent employed in just three industries

Ways of looking at adequacy

- Relationship to poverty line?
- Replacement of DB?
- Industry estimates?
- Turner Commission?
- New research needed?

Adequacy – other considerations

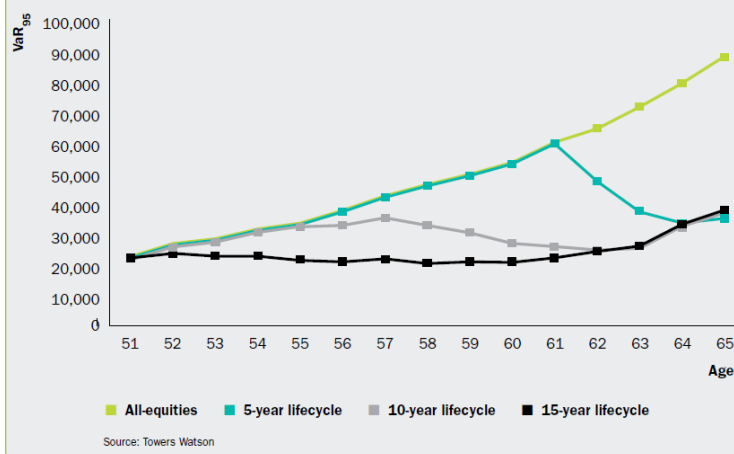
- Consolidating small pots
- Impaired life annuities
- Low charges
- Working longer – phased retirement
- Risk transfer to the state
 - level vs. indexed annuities
 - long term care

Certainty and security

- Reducing volatility in the accumulated fund
- Reducing volatility of the retirement income stream
- An “insurance” solution through pooling risk

Choice of glide paths

Figure 06. Spread of Investment risk over members' savings life

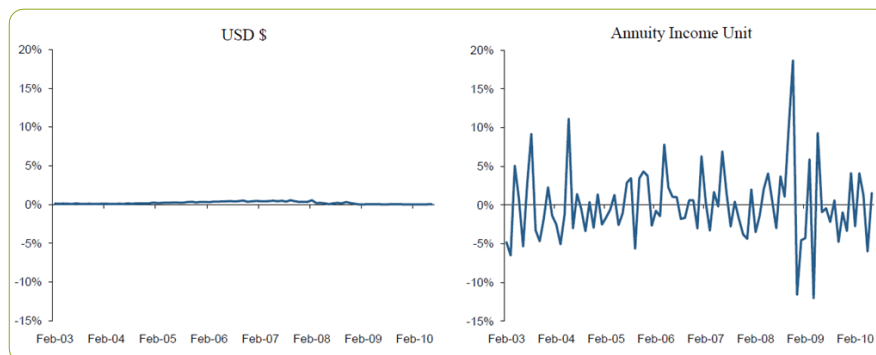


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Dimensional: T-Bills Monthly Returns

Stable returns do not provide certainty about reaching income goals

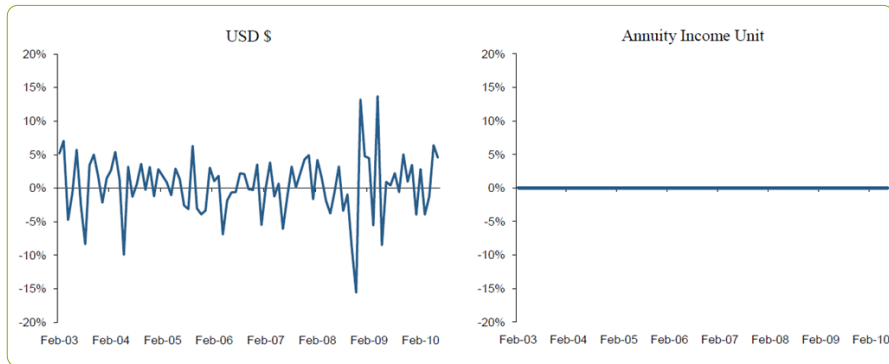


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Dimensional: Deferred Annuities

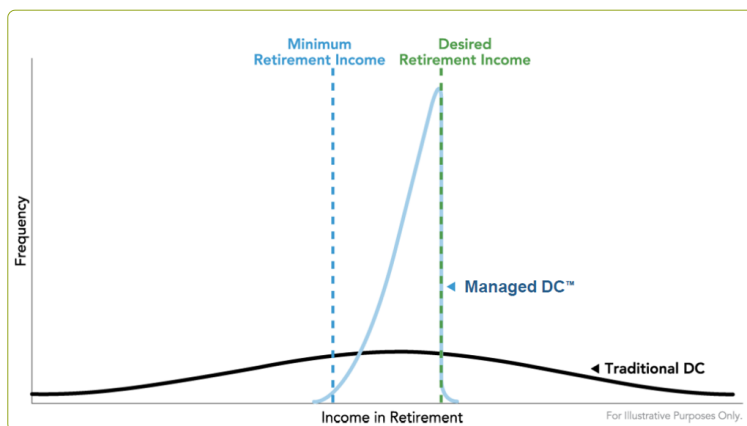
High risk in value terms, but low risk in income terms



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Dimensional: Focuses on maximising the chances of success



- Gives up upside beyond the goal to improve the chances of achieving the goal.
- Manages downside risk by setting a minimum-risk income level.

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“Insurance” risk pooling

- Pooling risk for cohorts
- Levy premium varies with investment strategy
- Target retirement income calculated by neutral model
- Maybe compulsory?
- Pricing? [PPF averages about 30 bps]
- Proof of concept needs to be developed

International study recommendations

- UK should:
 - ✓ raise minimum pension for low income earners
 - ✓ ? introduce a level of mandatory funded contributions
 - ✓ increase coverage of employees in occupational schemes
 - ✓ raise the level of household saving

Conclusions

Participation

- Consensus over automatic enrolment and NEST
- Opt out risk, but prospects look good for the UK

Adequacy

- Need for framework to agree
- The next big thing?