Institute and Faculty of Actuaries

Plenary 3: Auto-enrolment and how the regime in the UK compares to international systems

Phil Simmance, Towers Watson
Rudi Smith, Towers Watson
Susan Thorp, University of Technology, Sydney

5-7 June 2013

Institute and Faculty of Actuaries

Speakers:

Rudi Smith, Towers Watson
Susan Thorp, University of Technology, Sydney
Phil Simmance, Towers Watson

Please note these materials are intended for general information purposes only and are not a substitute for specific professional advice.

5-7 June 2013

Auto-enrolment in the UK

Experiences so far

Rudi Smith

6 June 2013

TOWERS WATSON

Auto-enrolment's wide reach

Guidance on investment defaults

Ban on consultancy charging

Charge caps

Provider and consultant market consolidation?

Ban on short service refunds

Auto-enrolment

DWP Simplification consultation

Pot follows member

Suitability of small trust based pension schemes

DC Governance overhaul

DWP consultation on NEST constraints

towerswatson.com

What did the Government want to achieve?

The Government:

- "Ensures minimum income level through compulsory saving"
- "Encourages a baseload of earnings replacement through auto-enrolment, a modest compulsory employer matching contribution and enables saving at low cost"
- "Enables additional saving at low cost"
- Cost to be met through contributions phased in over time

Target benefits

- Targets based on the minimum income level for middle earners.
- Lower earners are expected to achieve their net replacement ratio with State provision.
- Higher earners are expected to make individual arrangements.

Retirement age	Replacement rate from NPSS for someone age 20 today (2005):		
	£10,000	£20,000	£30,000
65	11%	16%	17%
66	11%	16%	18%
67	12%	18%	19%
68	13%	19%	20%

- State provision for a middle earner was expected to produce a replacement ratio of around 30%.
- The figures are based upon an assumption of 3.5% real investment return (on average), contributions at 8% between the Primary Threshold and the UEL, an annual management charge of 0.3%. Earnings increase in line with average earnings increases

Source: Pensions Commission Second Report (2005)

Some key questions

- Will Governments aims/assumptions be borne out?
  - Real wage growth
  - Growing economy
  - Safe home for investments
  - Low charges
- Will auto-enrolment provide adequate benefits?
  - If not how do we increase contributions without causing mass opt-outs?
- Opt out rates are low now, but will they increase in future?
  - What will happen once contribution phasing kicks in?
- Will auto-enrolment lead to employers levelling down of contribution rates?
- Will the shape of the UK market change (e.g. growth of Master Trusts)?

Employer contributions: where will they come from?

"there is a good case that in the long term the effect of the cost on business will be offset by lower cash wages"

"there is a danger that some employers might choose to level down. We recognise this. But if we had to choose between the dangers of levelling down versus no action the social priority would surely have to be ensuring some pension provision for people who currently have none."

Pension Wage

Only join because of a-e

Pension Wage

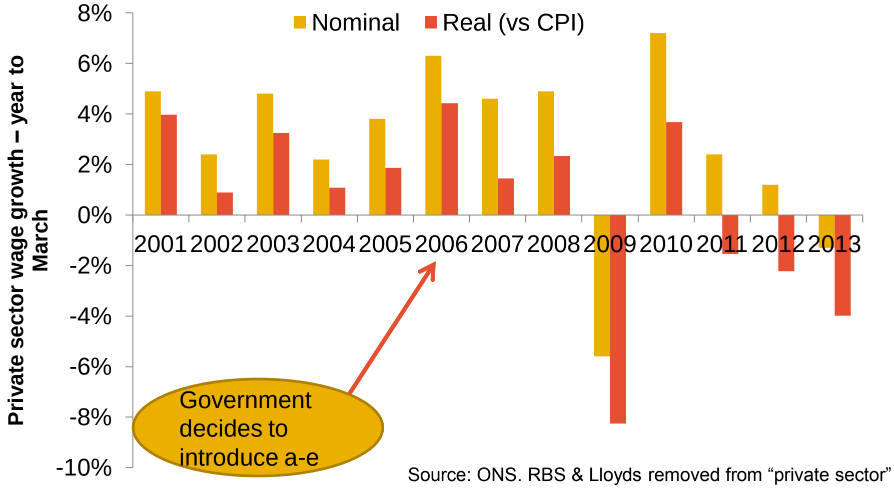
Opt out

Pension Wage

?

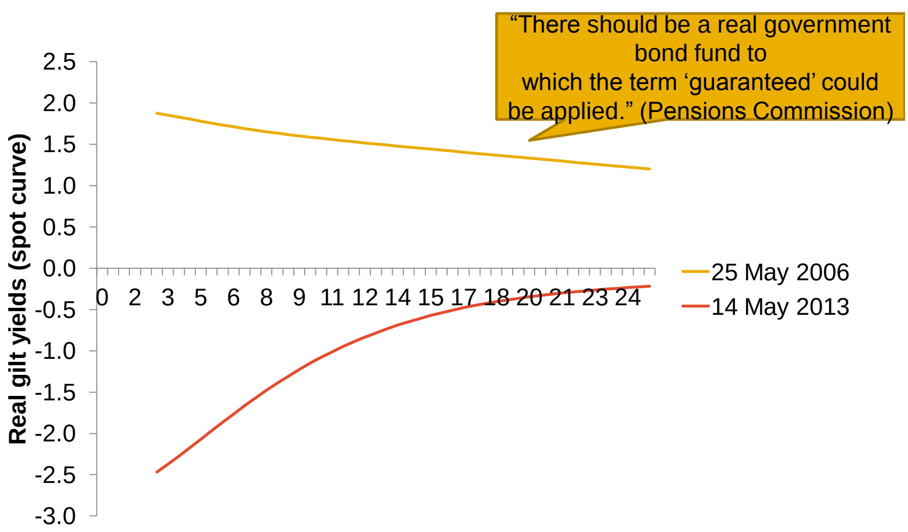
Would have joined anyway

The experience: Easy to save out of rising wages?



Source: ONS. RBS & Lloyds removed from "private sector" from 2009; FE colleges included in 2011 & 2012 only

Safe real returns?



Source: Bank of England yield curve

Employer approach to contributions for new employees

	Towers Watson seminars February 2012	Towers Watson seminars late 2012
At least in line with current rates	61%	58%
In between current and minimum rates	12%	12%
In line with a (current) minimum rate	27%	30%

Source: Towers Watson auto-enrolment seminars 2012

Actual experience so far: two-tiered strategies are common

Will opt out rates increase?

50% of employers in the FTSE 100 already use auto-enrolment. Their experience:

>90%	Take up in employers already using auto-enrolment
<60%	In employers who don't use auto-enrolment

Source: Towers Watson FTSE 100 DC Pension Scheme Survey 2013

Will this change as contribution rates increase? Will this experience be borne out for small employers?

What about charges?

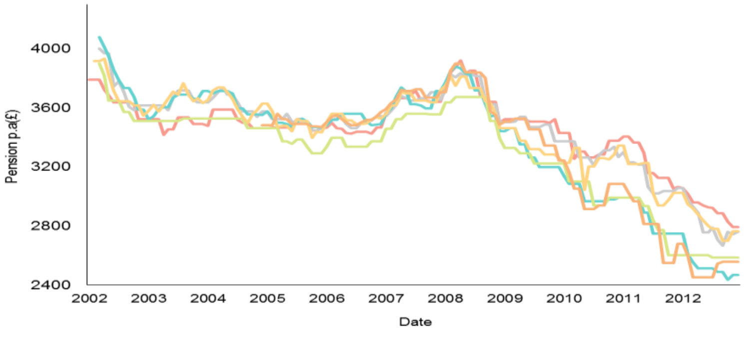
For large employers:

c.60%	Of trust-based schemes have an AMC for their core fund of 0.3% or less
c.50%	Of contract-based schemes have an AMC for their core fund of 0.3% or less

Source: Towers Watson FTSE 100 DC Survey 2013

Will many small employers need to enter collective schemes to achieve 'low' charges?

But what about at retirement?



The above chart has been generated using the following annuity basis: purchase price £50,000, level in payment, male annuitant aged 65, 5 year guarantee, single life, payable monthly in advance, standard commission terms

Source: Towers Watson, March 2013

Even amongst large employers, a quarter do not currently offer annuity broking services*

*Towers Watson FTSE 100 DC Pension Scheme Survey 2013

Conclusions

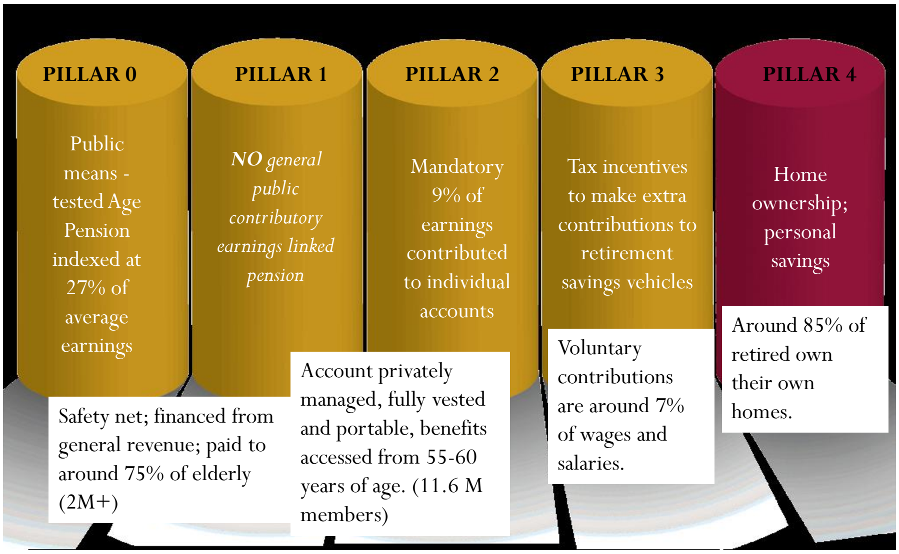
- Auto-enrolment appears likely to be ‘successful’, despite divergence of market experience from the original assumptions
- ‘Success’ is getting people to stay in pension schemes; benefit adequacy still needs to be addressed
- Market developments will tinker around the edges but not address the fundamental problem; not enough contributions
- Employers talk in principle about sharing the burden of risk, but appetite to meet the cost of this appears limited
- Employees understand the need to pay more, but where does the maximum contribution threshold lie?

Mandatory (auto-) enrolment in the Australian Superannuation System

Professor Susan Thorp
University of Technology Sydney

Institute and Faculty of Actuaries, Pensions Conference, June 2013

Australian retirement savings system



Outline

- Enrolment in the UK and Australia
- Mandatory enrolment – benefits and costs
  - Coverage (but more than needed?)
  - Adequacy (but too much for some?)
  - Industry structure and efficiency (but fit or flabby?)
  - Fiscal safety valve (but too much tinkering?)

Auto- versus Mandatory Enrolment

	United Kingdom	Australia
Who is enrolled?	Employees 22-65 years with earnings above tax threshold; can opt out	Employees 18-70 years earning at least $450 per month; cannot opt out
How much must be contributed?	2% of qualifying earnings increasing to 8% by 2018 (employer, employee, tax relief)	9% of ordinary time earnings increasing to 12% by 2020 (employer, tax relief)
Limits to tax relief?	£50K p.a.(£40K) limit tax concessional contributions; £1.5M Lifetime Allowance	$25K p.a. limit tax-concessional contributions; no tax on benefits for 60 years and over

Auto- versus Mandatory Enrolment

	United Kingdom	Australia
What scheme?	Employer's choice of scheme	Employee's choice of scheme or employer's default scheme
Default investment option?	Commonly life cycle strategy beginning 100% equity, ending 100% bonds and cash	Commonly 70:30 'balanced' diversified fund with equity, fixed interest, cash, property and alternatives.
How long?	Preserved to around 55 years	Preserved to 55-years rising to 60 years
Retirement income?	Limit of 25% as cash lump sum	No compulsory income stream; no limits on lump sum

coverage

Mandatory enrolment means high coverage and (probably) higher net savings.

- **Coverage** of employees: **96%** full time, **80%** part time, **73%** casual & self employed; around 11.6 million members
- **Net Household savings** has increased 1.5%-2% of GDP
- Superannuation is **largest financial asset** for most households
- **Sectoral total assets $1.46T (£970B)** September 2012
  - Approximately 100% GDP
  - Projected assets **$3T (£2T)** by 2025; **$6T (£4T)** by 2036

Mandatory enrolment means multiple accounts and losses.

- Around **2.7** accounts per member
- Fixed costs of around **£50** p.a. each account
- Employers tend to automatically enrol every employee, even casuals with low wages
- Funds have incomplete administrative records – difficult to contact members
- Regulations introduced to use tax file numbers to identify and consolidate accounts

adequacy

Adequacy: Projected replacement rates are good for median workers.

Income	Projected replacement rate	Proportion of retirement income from superannuation	Proportion of maximum Age Pension
Median income	77.7%	37.3%	94.5%
Average income	67.2%	46.0%	88.8%
2.5 x Average income	47.0%	76.5%	55.2%

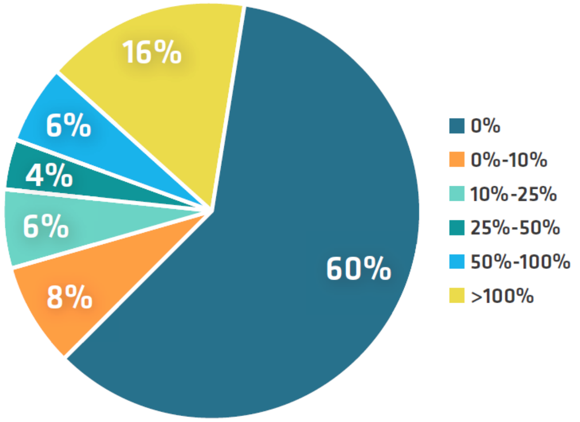
Source: RIM Group, Australian Treasury, Canberra

Account balances are low for the majority of members, especially women.

- Average account balance in large funds in 2012, **£21 K**
- Average account balance in self-managed funds, **£320 K**
- Males hold more than **60%** of assets; females hold less than **40%** of assets
- Average balance at retirement around **£170 K** for males and around **£100 K** for females

Debt may be a ‘work around’ for mandatory savings.

Percentage of survey respondents, 50-70+, by ratio of debt to superannuation assets



Industry Super Network (2010) Retirement Intentions, Research Paper, August 2010

industry structure and efficiency

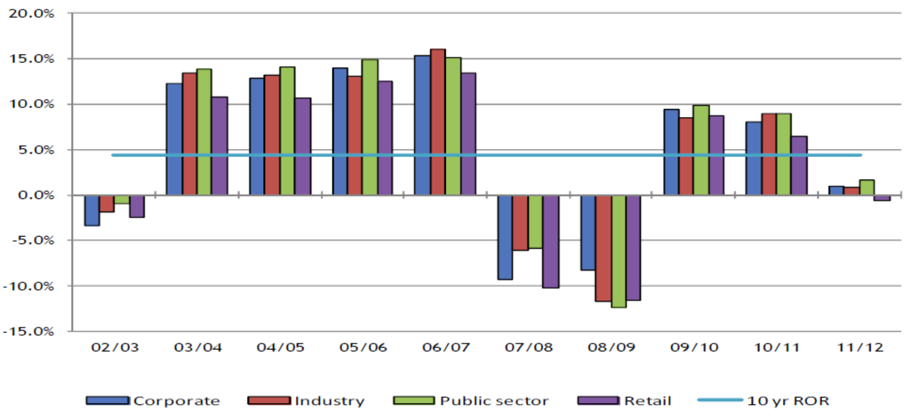
There are six types of 'complying' superannuation funds.

- **'Sole purpose' of all funds is to provide retirement benefits**
- **Not-for-profit superannuation funds**
  - Corporate funds *(employer-sponsored, often DB, not public offer, equal representation trustees)*
  - Industry fund *(multi-employer, DC, public offer, equal representation trustees)*
  - Public sector fund *(federal or state government established, DB/DC)*
- **For-profit superannuation funds**
  - Retail fund *(banks and life insurers, public offer, DC, corporate trustees)*
- **Small superannuation funds**
  - Small APRA funds
  - Self managed superannuation funds (SMSF) *(<5 trustee-members, not public offer, DC)*

Characteristics of superannuation funds – by functional classification, June 2012.

	No. funds	No. accounts '000	Average balance $000	Assets, $ bill
Corporate	122	551	101.8	56.1
Industry	56	11,664	22.9	267.3
Public Sector	39	3,371	66.1	222.7
Retail	135	15,408	24.1	371.4
Small APRA	3,201			1.8
Self managed fund - SMSF	**478,263**	918	**480.4**	**439.1**
Other	141			129.8
Total	481,957	31,911		1,400

Real rate of return has averaged 2-2.5% p.a. over 10 years.



Source: APRA Annual Superannuation Bulletin June 2012

Costs and charges differ across sectors of the industry and persist.

Fees and charges

- Differs by fund type. eg (total operating expense + investment expense)/assets 2011
  - Industry fund: 0.7% assets
  - Public sector fund: 0.5% assets
  - Retail fund: 0.9% assets

Net performance

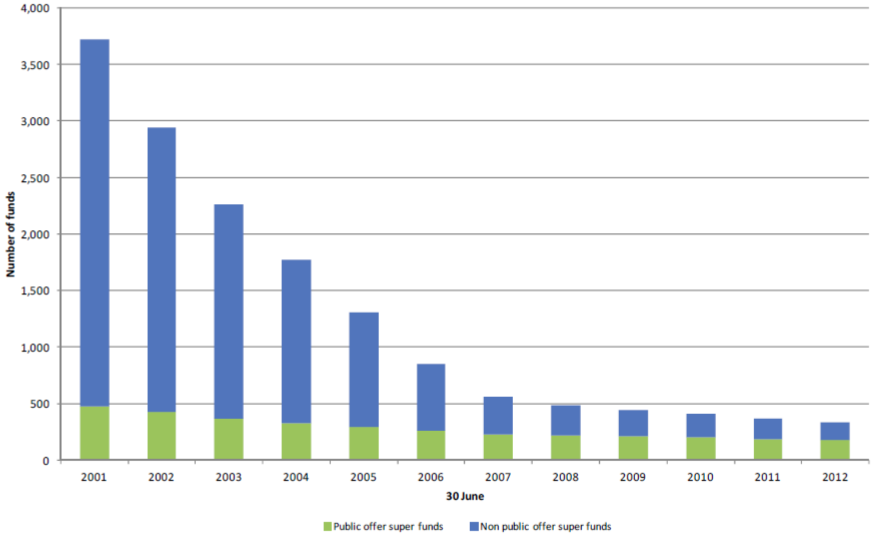
- Differs by fund type. e.g. Rate of return 2002-2011
  - Industry fund: 4.9%
  - Public sector fund: 5.2%
  - Retail fund: 3.3%

Transfers between funds by members

- Choice of fund by employees allowed in 2005 – no significant change in transfers
- Transfers do not follow performance

32

The number of large funds has continued to fall but concentration is still low.

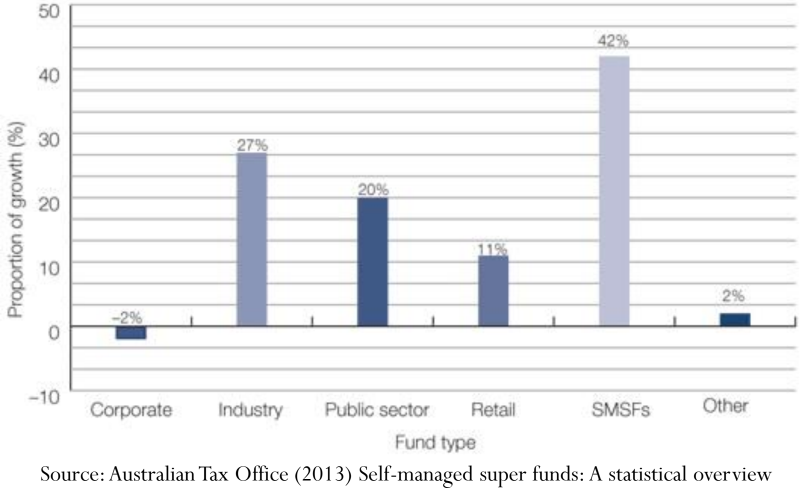


[a]excludes small funds and pooled superannuation trusts

Source: APRA Annual Superannuation Bulletin June 2012

Self-managed sector grows rapidly at the expense of large funds.

Proportion of 2008 to 2012 total superannuation asset growth by fund type



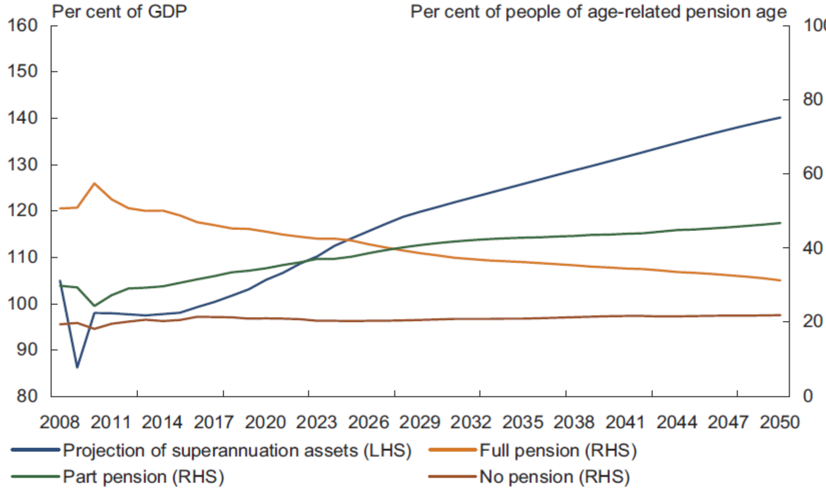
Source: Australian Tax Office (2013) Self-managed super funds: A statistical overview 2010-11. Canberra, ACT.

Member knowledge and awareness of the system is low.

Question	Correct	Incorrect	DK
For most people, superannuation is taxed at a higher rate than similar investment outside superannuation. T/F	**60%**	10%	30%
If your superannuation account is in a 'balanced' investment option, this means that it is invested exclusively in safe assets such as savings accounts, cash management accounts and term deposits.	**38 %**	27%	35%
Do you know the minimum age at which you can spend the money in your superannuation account? Yes or No	**52%**	48%	-

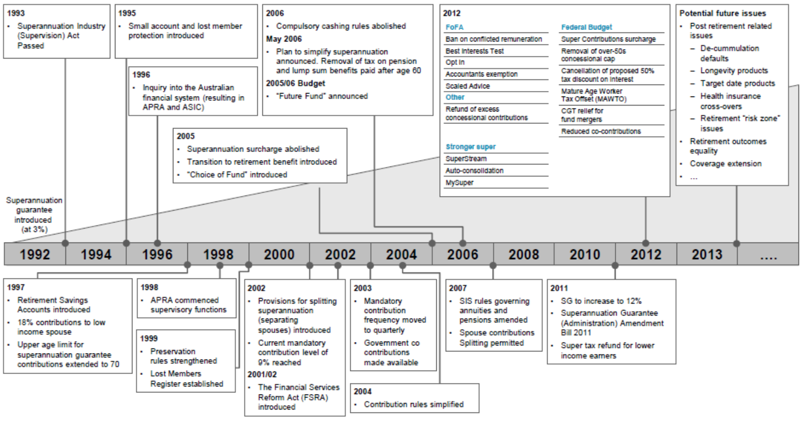
fiscal pressures

Superannuation accumulations will relieve some pressure on public pensions.



Source: Treasury projections.

Fiscal 'tinkering' produces complexity and compliance costs.



Discussion

- Mandatory enrolment ensures high coverage, creates a substantial pool of savings and relieves pressure on government revenues
- It does not ensure competition, efficiency or engaged and informed members
- Superannuation-related tax changes are not very visible to tax payers and therefore politically tempting

Global pensions solutions

Auto-enrolment outside of the UK

A presentation to UK Pensions Conference
by Phil Simmance
6 June 2013

TOWERS WATSON

The main pillars of retirement provision

Total provision for retirement

Social security	• Fixed and/or earnings-related • Diversions to individual accounts • Means-testing
Company (retirement) plans	• Government regulations • Infrastructure and safeguards • Tax incentives
Personal (retirement) savings	• Government regulations • Infrastructure and safeguards • Tax incentives
- Other savings; - Support from others, eg family	• Eg downsizing of house, ISAs, etc • Family support reducing in importance but this varies by country

So do any other countries have auto-enrolment?

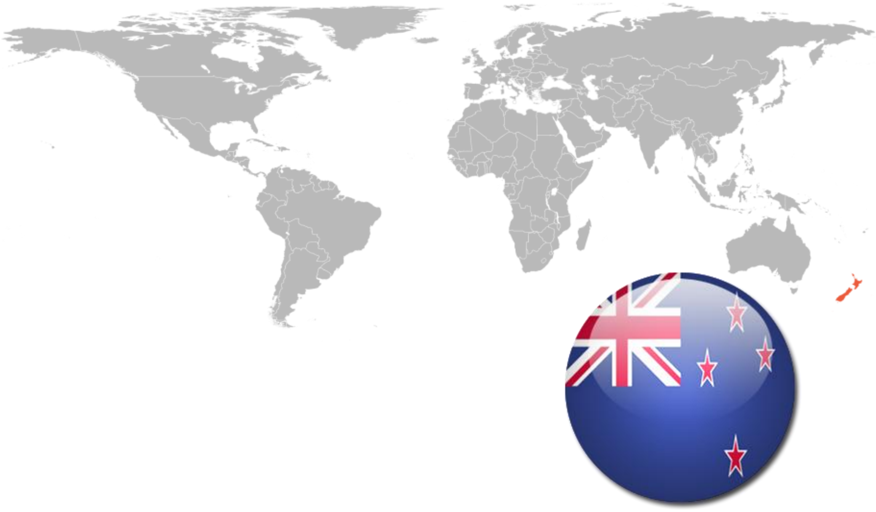
I know of only one (outside of a mandatory provision environment). Any guesses?

New Zealand

Other countries that are considering implementing auto-enrolment legislation in the future include:

Ireland

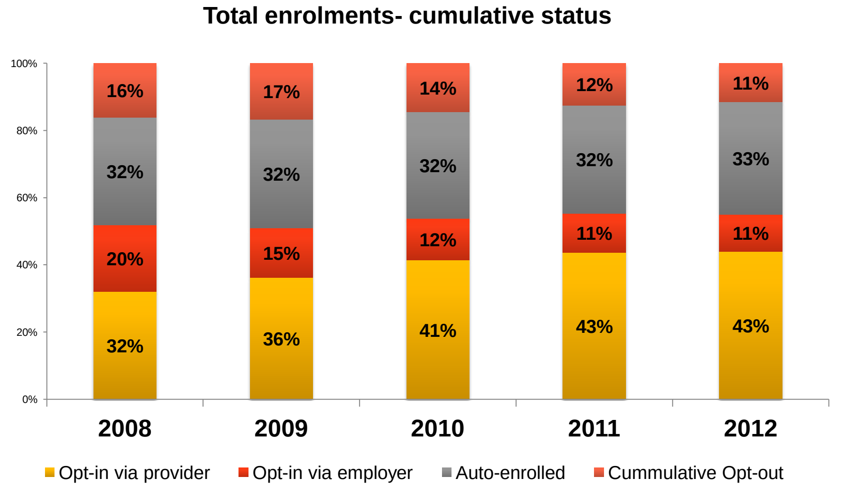
New Zealand



New Zealand – "Kiwisaver" – how does it work?

- Most employers are obliged to offer Kiwisaver membership to their employees.
- Employees can opt-out within an 8 week time period.
- Employers must contribute at a minimum of 3% of total cash remuneration.
- Benefits paid as a tax-free lump sum from 65.
- Most employees are auto-enrolled in to Kiwisaver.
- Employees can contribute at 3% (default), 4% or 8% of total cash remuneration.
- Contribution holidays allowed under certain conditions.
- Minimal universal SS pension also paid of NZD270-360 (circa £140-£190) per week.

Kiwisaver opt-out statistics



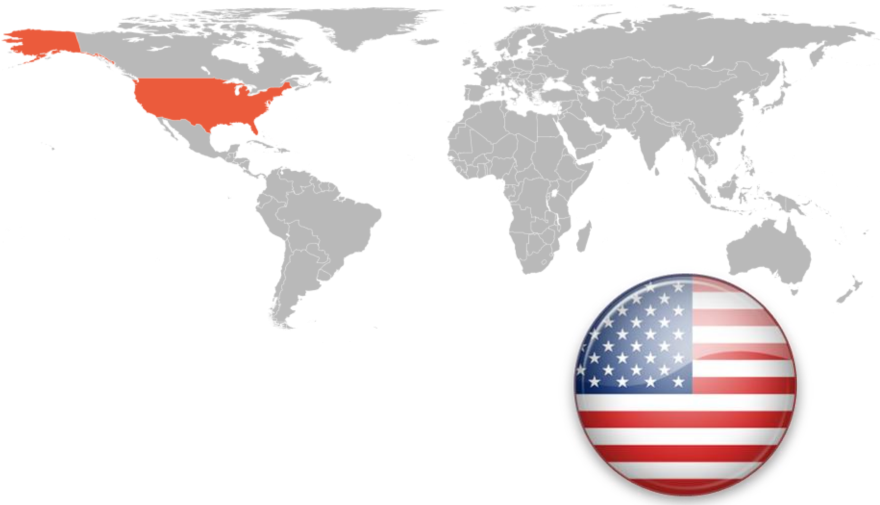
So auto-enrolment may not be the answer everywhere….

Why? Various influences which differ by country:

- Historical development of pensions environment
- Tax environment
- Culture, eg family values
- Economic conditions
- Political considerations

- Governments and individuals deploy the tools in different ways in different countries. It seems there are three main approaches:
  - Compulsion
  - “Nudge”, perhaps with sweeteners
  - Free choice (perhaps with tax incentives)
- Let’s look at a few examples of what countries do in practice…..

Example 1: USA



Example 1: USA

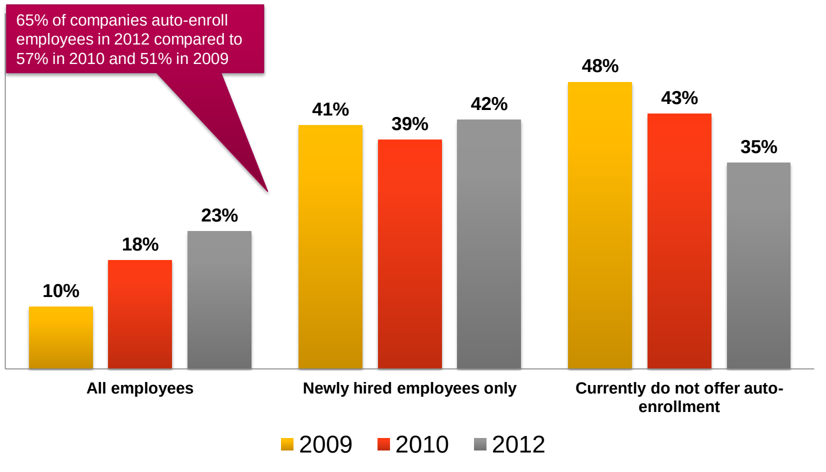
State pension

- Virtually all employees in the private sector including the self-employed are covered.
- The pension is based on career average earnings with a maximum pension around USD 29k (circa £19k) for high earners.

Company & personal retirement plans

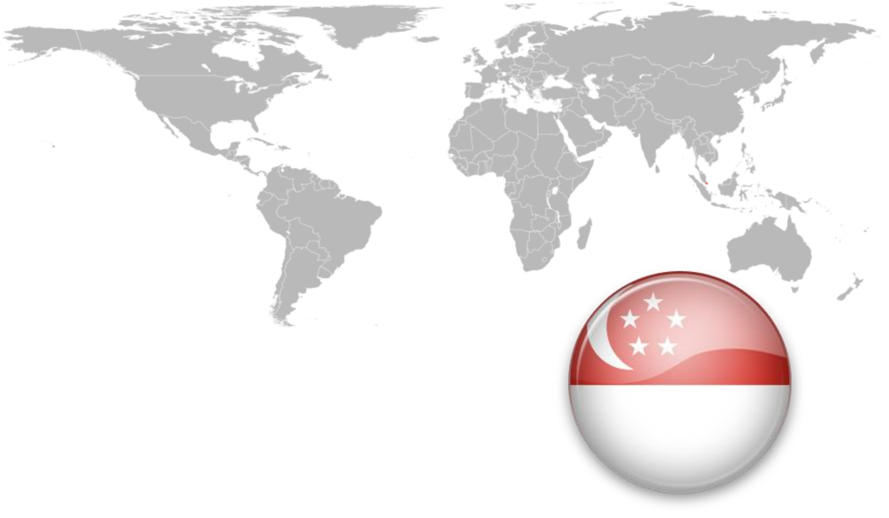
- Due to the relative paucity of state pensions, particularly for mid to high earners, supplementary retirement provisions are essential to ensure a reasonable standard of living in retirement.
- There are no auto-enrolment requirements currently in place but many employers are adopting this practice in their 401(k) schemes (see graph on next slide).
- Furthermore, non-discrimination legislation seeks to ensure that all employees are offered membership to company schemes.
- According to the 2012 National Compensation Survey by the Bureau of Labor Statistics (BLS), 79% of full-time workers in private industry had access to a retirement plan. Prevalence for employees of small firms (less than 100 employees) is much less common (50%). Around 20% of employees typically decline to participate.

US: more companies now auto-enroll employees into their DC plan than before



n = 124 in 2009, n = 300 in 2010, n = 371 in 2012

Example 2: Singapore



Example 2: Singapore

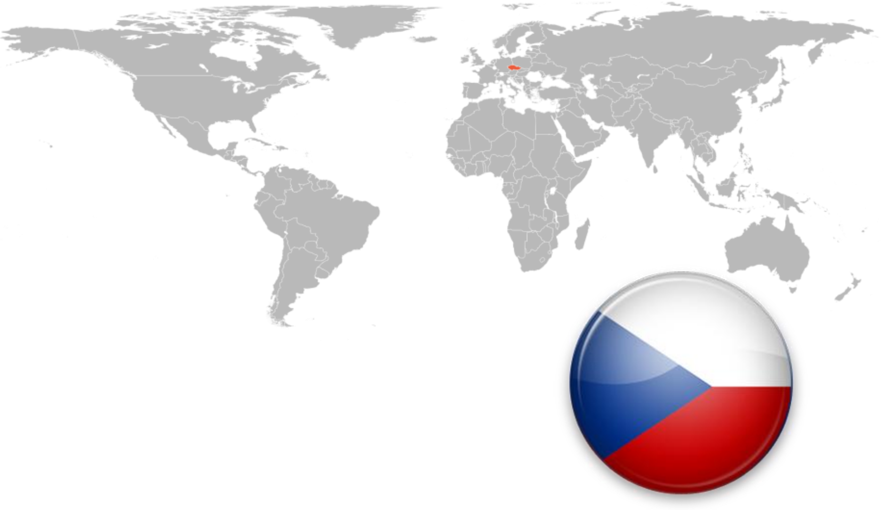
Social Security (Central Provident Fund system)

- No (defined benefit) base social security pensions payable.
- Defined Contribution CPF system in place.
- Relatively high contributions rates payable up to a cap.
- Benefits payable as a lump sum.

Company & personal retirement plans

- Supplementary occupational retirement plans are not commonplace.
- Employees cannot contribute to tax-favoured retirement plans.
- Individually, employees may open a tax-favoured Supplementary Retirement Scheme (SRS) to top-up the CPF.

Example 3: Czech Republic



Example 3: Czech Republic

State pensions (First Pillar)

- Fairly modest universal flat-rate pension paid to all pensioners.
- Earnings-related pension equal to 1.5% of the so-called personal assessment basis for each year of insurance. This does not include 100% of all salary. Rather, a decreasing sliding scale is applied to higher tranches of salary.

Personal accumulations (Second Pillar)

- Quasi-voluntary system of diversions of Social Security contributions to personal pension accounts now in place.
- Employees also make additional explicit contributions.
- Four investment profiles will be offered, one of which will be exclusively in Czech state bonds and state bonds of a number of other European countries;
- Benefits payable as a pension (not lump sum).

Supplementary corporate pension schemes (Third Pillar)

- Minimal tax advantages are available to encourage supplementary schemes.
- No obligation on employers to provide such a plan. Around 50% of large and/or multinational employers have a supplementary scheme in place. (Source: Towers Watson's General Industry Survey (Czech Republic) 2012)

So what can we take from this?

Auto-enrolment is ***the*** answer and will eventually be rolled out in every country in the world?

Such fundamental differences exist between countries that we cannot learn anything from each other and we should not try?

All individuals and governments are ultimately trying to achieve the same aim so resources and expertise should be pooled from all over the world to find a single solution which all countries should adopt?

Something else?

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

Text or tweet your comments to the chair

Tel: +44 (0)7950081329

Tweet: #pensionconf13

ertise Sponsorship Thought leadership Progress Community Sessional Meetings Education Working parties Volunteering Research Shaping the future Networking Professional support Enterprise and risk Learned society Opportunity International profile Journals Suppor