UK Defined Contribution Pension Survey 2020

How do you measure up?

For professional clients only

Empower Results®

What are the desired outcomes?

SECTION 3

Fit for the future?

Q. What are the desired outcomes?

For members of DC schemes, good outcomes are about building an adequate level of savings to be able to retire at a time of their choosing.

For sponsors, the ultimate outcome is for employees to be able to retire, but shorter-term issues can sometimes take priority, such as benchmarking benefit levels to peers or controlling costs.

Contributions paid over time are one of the main drivers of the amount of pension fund for an individual. How that fund is used subsequently in retirement can also make a real difference to an individual's quality of later life, or even whether they can afford to retire at all.

Most individuals expect to rely on their company and State pensions in retirement (as found in our 2018 DC member survey – 'Living the Dream?'). Many will, of course, have other sources of income as well. It can be difficult for schemes to take these into account when considering retirement outcomes, we explore this more in Section 5 – Calibrate your comms.

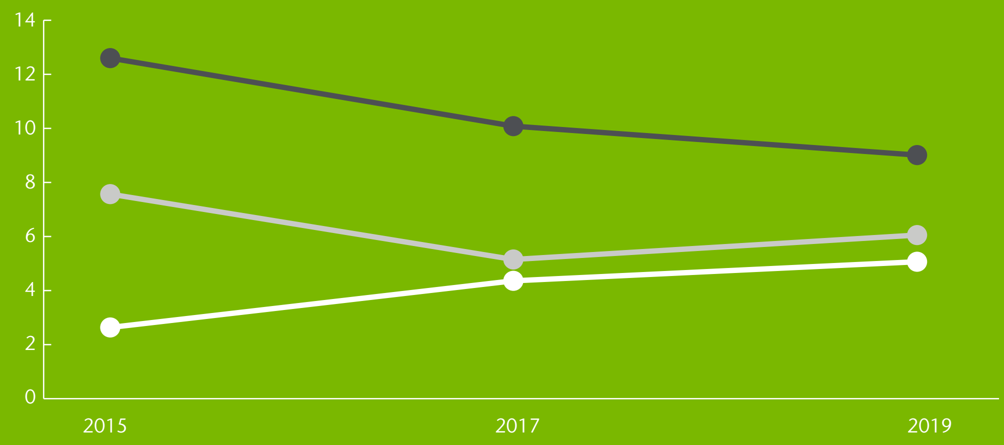
1 in 4

have employees on legacy DC contribution designs

Most schemes are not supporting members with drawdown solutions

There is still a lack of awareness of expected retirement outcomes among those running schemes

2015 vs 2017 vs 2019 Average company contributions



2017 vs 2019 Average member contributions

Sources: 2015, 2017 and 2019 Aon DC Pension Surveys

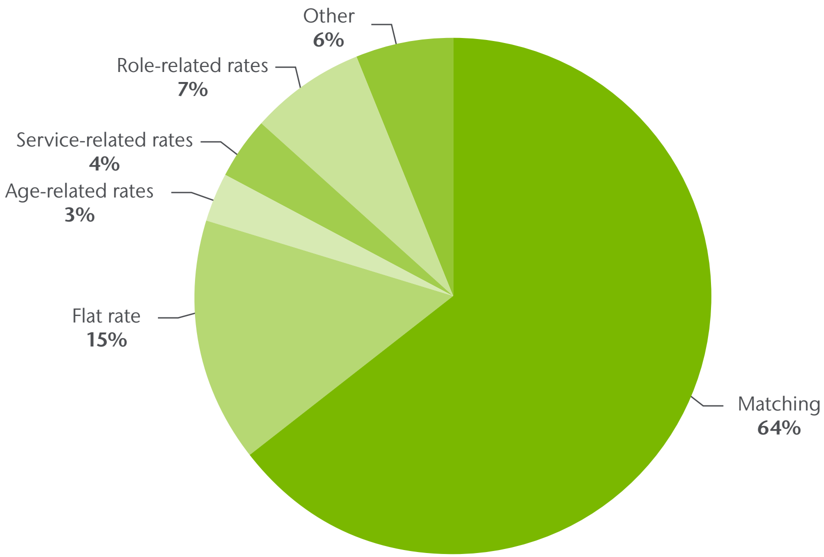
The level of contributions made by employers and members into DC schemes has a significant impact on outcomes at retirement.

Employers have had to meet the mandatory increases in minimum auto-enrolment contributions in 2018 and 2019, so we look at how that has affected both company and employee contribution rates.

Looking at contribution levels, our respondents' average default contribution rate is 10% (4% employee and 6% employer). This is higher than the average default found in our previous scheme survey in 2017, where it was 9%. However, the employer rate has remained stable at 6% while the employee rate has increased by 1%.

As more than 10% of employers are highlighting how to increase employee contributions as one of their biggest challenges in the next 12–24 months, whether this trend continues will depend on their success in overcoming this challenge.

How would you describe your contribution structure?



The default contribution level only tells part of the story on contribution rates, as the majority of schemes do not just offer a flat rate of company contributions.

A matching contribution design remains the most prominent scheme design, with around two-thirds of respondents offering members the option to increase their contribution levels and receive higher company contributions.

This type of design incentivises employees to save more and focuses spend on employees who are most engaged with the scheme.

Ranges of contributions offered

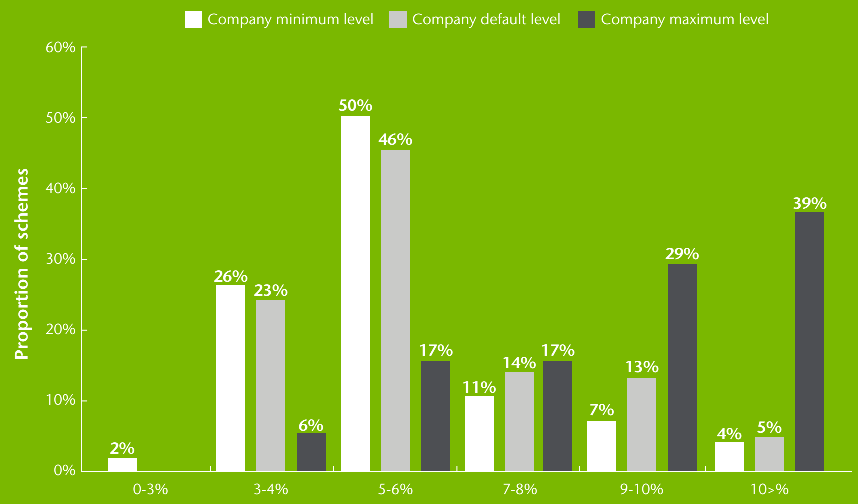
The spread of the minimum and maximum contribution rates (both employee and employer) has narrowed significantly since our previous survey.

Contribution rates are now more clustered around the median level. In part, this may be due to the auto-enrolment increases in the minimum levels, but it could also suggest that employers are carrying out more analysis of what competitors and the wider market are doing.

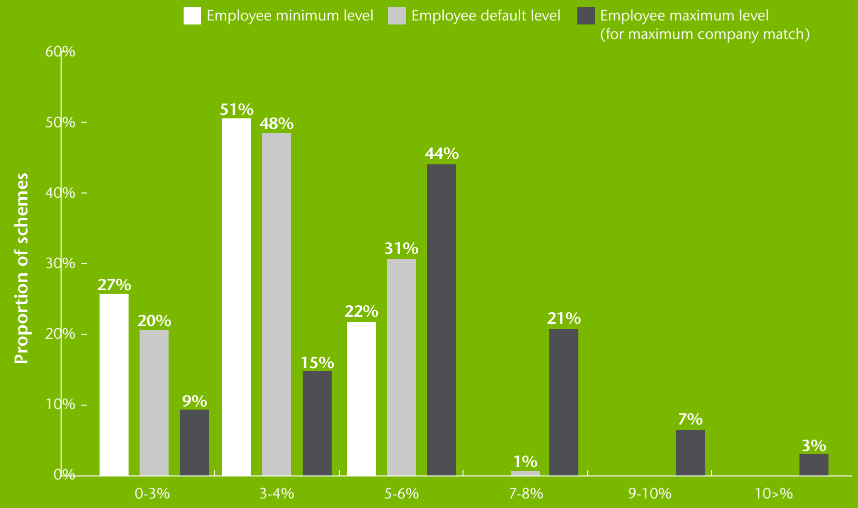
At Aon we have seen an increase in requests to benchmark pension contribution rates as well as other benefit levels.

This can be against a particular sector, a specified peer group or simply when compared with local competition for recruiting and retaining talented employees. Though the spread of contributions has narrowed, there is still a material difference between company contributions of 4% and 7%. Considering contribution levels without also looking at expected pension outcomes can be a risk for employers and will store up problems over the longer term.

Company contribution levels



Employee contribution levels



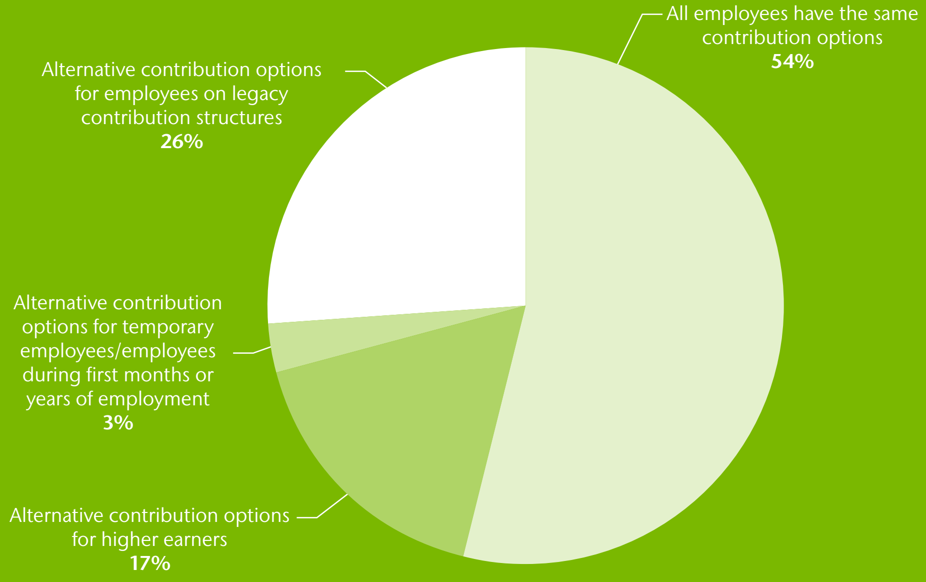
Q. Are all employee options equal?

We asked whether all employees are offered the same level of DC pension contributions.

Perhaps surprisingly, only around half of companies offer a consistent contribution design for all employees. Around a quarter have legacy contribution designs, in which the benefit level available for two employees in the same role could be different simply because of when they started work with the company.

17% have alternative options for higher earners. This may be to offer flexibility to those impacted by the annual allowance and tapered annual allowance restrictions on the tax relief available on pension contributions for higher earners.

There are schemes where higher contributions are offered to those at more senior role levels (around 7% of schemes as shown on page 21); these designs are becoming less common as the tax relief restrictions impact more individuals.



Thinking about the future – measuring the outcomes

We asked what the expected replacement ratio (pension income in retirement compared to pre-retirement earnings) would be for a typical lifetime member of their scheme.

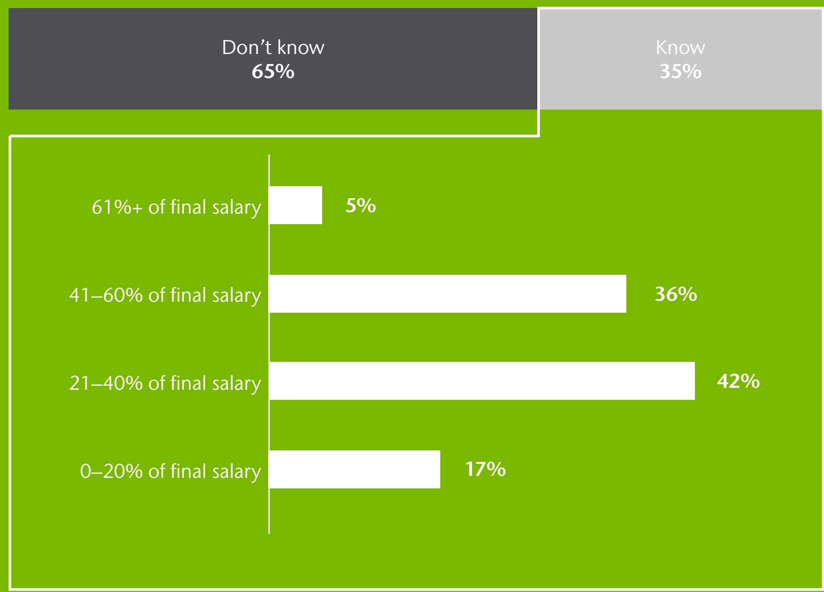
Two-thirds of respondents did not know what the ratio would be. Interestingly, most of these responses were from pension and HR managers.

Our 2018 DC member survey – 'Living the Dream?' – found that around two-thirds of employees rely on their employer when deciding how much to save towards their retirement.

As noted earlier, employers not thinking about contribution levels in the context of whether their employees will be able to afford to retire could be storing up a huge problem for the future.

Of the respondents who did know what the expected replacement ratio was, most of them are expecting a typical employee to receive between 21% and 40% of their final salary.

What is the expected replacement ratio (excluding State pension) for a typical lifetime member?



Aon point of view

We believe that most individuals and schemes focus too strongly on what contributions are being paid rather than how much they might receive in retirement.

Looking at projected outcomes across a scheme's membership using tools like Aon's DC Analytics can help those running schemes to identify how many are on track for an adequate retirement and which groups need more help.

Encouraging members to set a target to work towards, such as the PLSA/Loughborough University Retirement Living Standards (see next page), is an important step in helping them to understand their pension and how it fits into their wider retirement savings.

The Standards are the property of and are provided by the Pension and Lifetime Savings Association and Loughborough University. https://www.retirementlivingstandards.org.uk

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

The Pensions and Lifetime Savings Association (PLSA) recently launched its Retirement Living Standards. These are the levels of income required to achieve a defined standard of living in retirement – Minimum, Moderate or Comfortable. The moderate level was determined to be around £20,000 per year for a single person living outside London. The State pension will likely make up a portion of this, but most employees will be looking to their company pension plan to make up the rest.

Section 5 – Calibrate your comms, looks in more detail at how you can use these Standards to support members.

The Retirement Living Standards aim to encourage individuals to think about how much they will need to save for retirement, but are employers considering whether their employees will have enough?

Astonishingly, only 25% of our survey respondents said that the employer had considered pension retirement outcomes in future workforce planning. This is a high-risk approach for companies as reliance on DC pensions grows over time.

The inability of members to afford to retire is likely to lead to an ageing workforce, with potential benefit cost implications. This could also limit career progression opportunities for younger employees and cause succession challenges.

At retirement

We know that drawdown is becoming the most popular method of taking DC pension funds at retirement. Our 2018 employee survey found that over three times as many employees expect to access their DC pension using drawdown (65%) compared to buying an annuity (20%) or taking a single cash lump sum (14%).

This is an area where many schemes are still lagging behind their members' needs. Most have not put a preferred drawdown solution in place for their members, and those who do have one often rely on whatever their current provider offers. This may not always be the most suitable solution for their members. Some schemes may only have a few members retiring at the current time, but those that are accessing DC funds will still need support to get the best outcome.

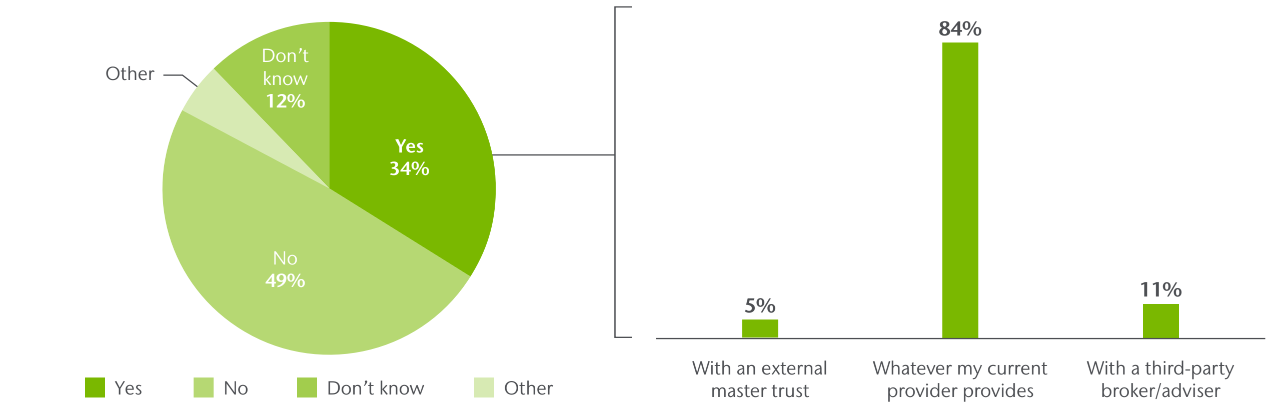
Quick win

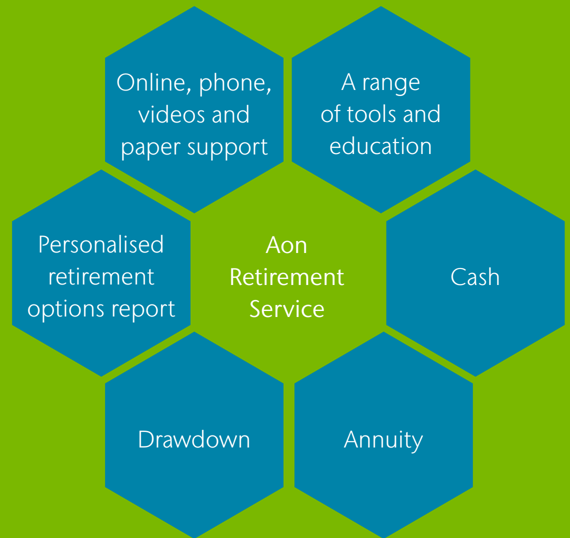
Ask your DC adviser to update you on what retirement support for members is available in the market, including drawdown solutions. Compare this with what is offered by your current DC provider to understand whether this is the best option for your workforce.

The Aon Retirement Service is a multi-platform support service for scheme members approaching retirement.

It provides education on the different options available, allows members to speak to an expert for guidance, to transact for best-buy annuity purchase or a default drawdown option.

Have you put a preferred drawdown provider in place?





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