CBI
THE VOICE OF BUSINESS

A view from the top

The CBI 2011 pensions survey

Sponsored by

About the sponsor

Towers Watson is a leading global professional services company that helps organisations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefit programmes, talent and reward programmes, and risk and capital management.

For **Towers Watson**, contact:

David Robbins
Senior consultant
Towers Watson
21 Tothill Street
London SW1H 9LL

T +44 (0)20 7227 2973
E david.robbins@towerswatson.com
W www.towerswatson.co.uk

For **CBI**, contact:

Mario Lopez-Areu
Senior policy adviser, Employment affairs
CBI
Centre Point
103 New Oxford Street
London WC1A 1DU

T +44 (0)20 7395 8233
F +44 (0)20 7240 8287
E Mario.Lopez-Areu@cbi.org.uk
W www.cbi.org.uk

Contents

Foreword by **Katja Hall, CBI** 4

Foreword by **John Ball, Towers Watson** 5

Executive summary 6

1 Survey respondents 8

2 The backdrop to the survey: employers seek stability in a changing pensions landscape 10

3 Businesses remain committed to pensions 12

4 DB costs and uncertainty constrain business growth 14

5 Regulatory risk remains a leading concern for DB sponsors, with further threats looming ahead 18

6 Companies preparing for auto-enrolment 22

7 Towards a more flexible workplace saving model 28

Foreword
CBI

2012 will be a landmark year for the economy and for pensions. Growth is likely to remain sluggish, while the ongoing uncertainty about the future of the Eurozone continues to dampen business confidence. All this comes as businesses face new challenges on pensions, including the much-awaited start of automatic enrolment, reforms to the state pension, and proposals from Brussels threaten to ramp up the amount companies have to put into their schemes.

This year's A view from the top offers the opportunity to explore the views of senior directors across the country on issues that will – for good or ill – determine the way pension provision will evolve. We are delighted to have the opportunity once again to work with Towers Watson in delivering this important report.

Our survey is clear that defined benefit (DB) costs have become unsustainable for most firms. And with the economy taking longer than originally expected to recover, many senior executives are concerned that it is a major obstacle to realising their business's full potential. DB liabilities risk making company results volatile, holding back business investment, hampering reorganisations and constraining corporate borrowing.

And senior decision-makers do not see the situation improving as they expect the costs that come with DB continue to go up, not down. This is why the CBI has been working hard to stop EU solvency plans that would make matters worse, and pushed government to ensure state pension reform does not drive up costs by abolishing contracting-out. Employer affordability is crucial to avoid pensions becoming a roadblock for economic growth.

The decline of DB – driven by increased longevity, regulatory changes and market volatility – has put defined contribution (DC) provision in the spotlight. With auto-enrolment fast approaching for larger companies, chief executives want to ensure that the additional financial and administrative effort it entails pays back in terms of recruitment and retention.

The survey finds that employers are not only committed to providing good DC pensions but also in getting employees more engaged with them. But they are worried that, as has happened with DB, regulation might force them to level down or make DC more expensive and less flexible, reducing their ability to tailor schemes to the needs and demands of their workforce.

This is disappointing because this year, we have for the first time asked senior executives about more flexible saving vehicles. Many of them felt that these products could make workplace saving more attractive to employees in the future.

Katja Hall
Chief policy director, CBI

Foreword
Towers Watson

In 2011, the UK government confirmed that it wants to provide defined benefit pensions for its employees indefinitely, albeit on less generous terms than in the past. Few private sector employers have similar intentions.

Instead, as pension liabilities have grown relative to the size of companies' core business, reducing the uncertainty over how much promises made in the past will eventually cost is at the heart of pension strategy. Many employers feel they have been running to stand still, with higher contributions not plugging deficits in the way they were supposed to.

The survey underlines business leaders' concern about the prospect of market movements or further unanticipated increases in life expectancy forcing them to put their hands in their pockets again. This desire to fix pension costs has been a driving force behind the growing market in risk transfer. Despite difficult market conditions, pension schemes have continued to put bulk annuity and longevity swap contracts in place.

Even where the ultimate destination – making benefits secure so that no further demands need be placed on the sponsor – is some way in the distance, intermediate steps have the potential to shorten the journey. Some organisations may regret not having reduced risk at a lower cost than they could do today but volatility can bring new opportunities for those who are able to act quickly. Increasingly, companies and trustees are looking to monitor their funding status in real time and put in place triggers so they can act immediately when conditions are right.

Meanwhile, many companies face difficult negotiations with trustees now that agreed plans for repairing pension deficits have been blown off course. On both sides of the table, there will be careful scrutiny of the assumptions used to measure pension shortfalls and of how diverting more resources to the pension scheme would affect the employer's ultimate ability to stand behind it.

Of course, the risks that defined benefit pension schemes have exposed employers to are equally present in the defined contribution arrangements into which millions of people are due to be automatically enrolled. Here, however, it is employees' retirement dates and retirement incomes, rather than employers' costs, which may have to adjust. Higher contributions can improve the outcomes that employees can expect from defined contribution pensions but these outcomes will remain unpredictable.

John Ball
UK head of pensions consulting, Towers Watson

Executive summary

The CBI/Towers Watson Pensions Survey 2011

- This survey was conducted in the summer and autumn of 2011
- There were 160 respondents from businesses of all sizes and sectors across the UK employing more than 1.3 million people
- The survey had two parts. The first section was completed by chief executives and provides an insight into boardroom attitudes to pensions and saving. The second section, completed by pension managers, provides supporting technical data on more specific policy issues.

Businesses remain committed to pensions

- CEOs are strongly committed to pension provision for employees, with 89% pointing to the business case for spending money on pension benefits rather than just higher pay
- The positive impact of pension provision on staff recruitment, retention and motivation is the most widespread driver, cited by four fifths (80%) of chief executives
- Social and ethical considerations are also important, with 78% of chief executives believing companies should help equip employees to plan for retirement and 72% seeing pension provision as boosting corporate reputation.

DB costs and uncertainty constrain economic growth

- Two thirds of businesses (69%) say that DB provision is having a significant impact on the results in their company accounts. Some say it is hampering reorganisations and constraining corporate borrowing
- 85% of employers are worried about the impact of market movements on their funding level and 71% about unanticipated changes in longevity
- While just 6% of employers firmly expect to transfer risk to a third party through a bulk annuity or longevity swap in the next two years, 60% do not rule this out

- 62% of employers are concerned about contributions going up following their next negotiation with trustees. 45% say DB pension costs are having a significant impact on investment in their business
- 64% of employers with employees still accruing DB benefits expect to make some change to their schemes within the next two years.

Regulatory risk remains a key concern for DB sponsors, with further threats looming ahead

- Three quarters (73%) of employers say they would prefer a single-tier State Pension to the present system. However, the same proportion say this reform would lead to more DB schemes being closed to existing members unless adjustments to offset the resulting increase in NI contributions are available
- 44% of employers are satisfied with the Pensions Regulator's overall dealings with their company and only 12% say they are dissatisfied. However, a quarter of employers are concerned about its approach to recovery plan negotiations
- 69% are concerned that the European Commission's proposal to introduce a Solvency II-style funding regime for pensions will force them to put more money upfront to cover pension obligations
- 70% of CEOs fear that the size of the PPF levy their companies will have to pay in the future will be too high.

With the clock ticking, companies are waking up to the need to prepare for auto-enrolment

- With auto-enrolment less than a year away for larger companies, most employers (80%) have already had some discussions at board level about how to comply with the new regime
- 61% expect to enrol new members on existing terms and only 1% to level down contributions for existing members
- Practical administrative issues and communications are the biggest challenges for employers, with over half (55%) concerned about managing opt-outs/ins and 42% about communicating effectively about auto-enrolment with employees
- Private sector DC provision is the preferred vehicle for auto-enrolment, with 78% of employers choosing their existing scheme and 12% planning to set up a new scheme
- Employees are failing to make the most of DC schemes: less than half of employees (47%) contribute sufficiently to their DC scheme to benefit from their employer's maximum matching contribution
- Half (51%) of CEOs are concerned about the risk of regulation making DC schemes more expensive in the future.

Towards a more flexible workplace saving model

- The state of the economy, the pressures on businesses and trends in personal incomes have all changed radically since auto-enrolment was conceived
- Over half of CEOs (56%) believe offering a wider range of flexible workplace saving arrangements would be an attractive option, though immediate plans are limited
- The availability of a wider range of saving options is seen as likely to encourage more employees to take advantage of maximum employer contributions, according to more than half of pension managers (56%)
- Pensions remain the cornerstone of workplace saving, with 78% of employers telling us they would only offer additional arrangements to sit on top of a pension.

1

Survey respondents

The previous edition of *A view from the top*[1] – published in 2009 – was dominated by the impact of the financial crisis on workplace pension provision. Two years on, the economic recovery remains fragile and the outlook volatile. At the same time, a series of regulatory changes are looming. The most important of these – auto-enrolment – comes into effect from October next year. This year's survey gathers the views of chief executives and pensions managers on these issues and provides an insight into how they see the occupational pensions landscape changing in the challenging times ahead.

The survey provides a unique perspective on occupational pension issues and the way thinking is developing in boardrooms. The main part of the questionnaire is filled out by the firm's chief executive, finance director or HR director, giving an insight into concerns and plans at the top of the company. This strategic view is then complemented by supporting, practical data provided by the firm's pensions team in a separate section of the questionnaire.

Respondents by pension scheme assets

The data for this year's survey was collected in summer/autumn 2011, exactly two years after data collection for the 2009 survey. In all, there were 160 respondent organisations, employing over 1.3 million staff. The participating companies have a total of £237.6bn of assets in their defined benefit (DB) pension schemes – some £86.6bn more than in the 2009 survey. While just over a third (36%) have assets of £100m or less, at the other end of the scale just under a third (29%) have assets of £1bn or more (**Exhibit 1**).

1 CBI/Watson Wyatt, *A view from the top: the 2009 CBI pensions survey, December 2009*

Exhibit 1 **Respondents by DB assets (£m)**

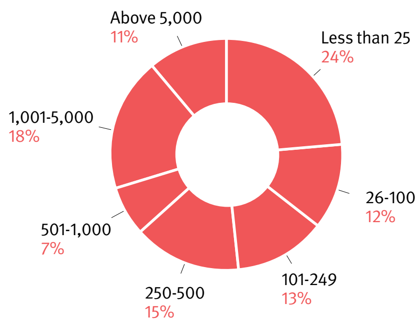
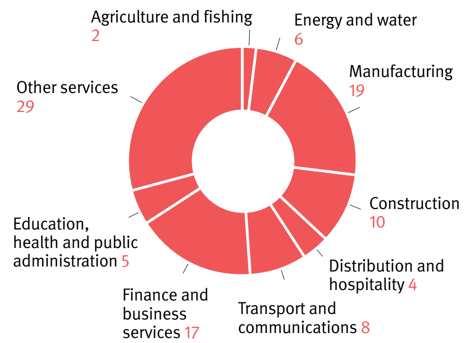


Exhibit 2 **Respondents by sector (%)**



Sectoral analysis

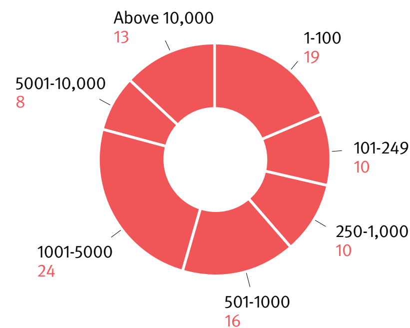
There was a wide spread of responses across all sectors, as **Exhibit 2** illustrates. In previous surveys manufacturing respondents have made up the single largest sectoral grouping. This year, respondents in manufacturing drop to second place, (making up 19% of the sample), while the 'other services' category represents the single biggest group of respondents (29%). Organisations in finance and business services are the third largest category (17%).

Respondents by company size

Companies of all sizes participated in the survey – 19% employed fewer than 100 employees, while 13% employed more than 10,000 (**Exhibit 3**). Based on the official definition of small and medium-sized enterprises (SMEs) as employing 250 or fewer employees, SMEs make up just under a third (29%) of participants.

While the survey has respondents of all sizes, it represents the views of the UK's larger firms particularly well, with over 62% of respondents having 500 or more employees. This is not surprising, as larger firms tend to be more likely to provide an occupational pension scheme for their employees.

Exhibit 3 **Respondents by number of employees (%)**



2

The backdrop to the survey: employers seek stability in a changing pensions landscape

Between the 2009 edition of *A view from the top* and this year's edition much has changed, and further major shifts in the pensions landscape lie ahead. Defined benefit (DB) pension schemes are closing rapidly while defined contribution (DC) provision continues to grow. The economic outlook, however, is putting pressure on household incomes, restricting the ability to save more. At the same time, major changes are in prospect in 2012, with the start of auto-enrolment, the design of a new state pension system and essential reform to public sector schemes.

The workplace pensions landscape is changing rapidly, with DC on the rise...

DB provision has been in decline in the private sector for decades. Higher life expectancy, lower investment returns over the long term and the growing impact of regulatory changes have all played their part in this decline. In this context, the recent economic downturn has not been the leading cause of continued DB scheme closures, but it has certainly accelerated the process.

With DB provision increasingly becoming a minority activity in the private and voluntary sectors, DC has now emerged as the dominant feature of the workplace pensions landscape. In 2010, almost a quarter of all private sector employees were members of a DC scheme, while only 11% were accruing benefits in DB schemes.

For employers, DC removes the uncertainty surrounding the cost of pensions, while allowing employees to make their own decisions about their pension savings, how they are invested, and how they are turned into income in retirement.

... and a large number of employees outside any occupational provision

Looking at overall trends, the critical issue remains that over half of private sector employees are not saving in a scheme. This is what makes the pensions reform programme, stemming from the Pensions Commission, an essential part of the policy mix. The costs of undersaving should be addressed now to avoid higher costs later.

Defined benefit schemes are increasingly a legacy issue

With costs and risks escalating rapidly, traditional final salary benefits have become unaffordable for most private sector employers and most have little appetite for taking on additional risk through the pensions they promise to employees.

However, despite scheme closures reducing the number of active members, employers have had to increase contributions in response to widening deficits caused by market turbulence. In 1998, the total funding required by DB pension schemes in the UK was less than £8bn a year. By 2010 it was around £36bn – or over £8bn a quarter.

Defined benefit sponsors face uncertainty about the cost of the benefits they will eventually have to pay out, for example because members might live longer than expected, and about whether assets will perform as expected. Such unpredictability makes it very difficult for companies to plan ahead financially, particularly in current circumstances where economic growth remains sluggish and trading conditions challenging. In addition, under mark-to-market accounting standards – FRS17 and IAS19 – the pension liabilities on companies' balance sheets are volatile, as illustrated in **Exhibit 4**. This volatility has been particularly marked during the eurozone crisis. In the space of just one month, FTSE100 companies' aggregate pension deficits, as measured under international accounting standards, are estimated to have fallen from £45bn to £8bn and then risen to £35bn.

In this context, most private sector employers have decided to close their DB schemes and instead offer their employees some form of DC provision. This move offers companies the opportunity to manage the risk they face while continuing to commit to offering a good pension scheme with an employer contribution.

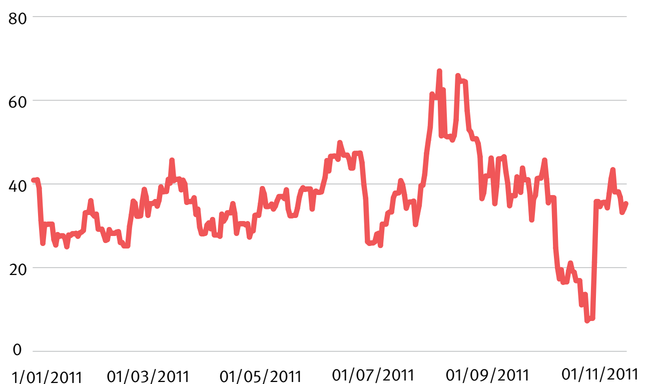
Savings rates are crucial for a good outcome in DC, but disposable incomes are under pressure

As people prepare to spend a greater share of their life in retirement in the future, it is essential that they start saving earlier and more towards their pension. Auto-enrolment has been set up to help achieve that aim by nudging more of those employees that are less likely to save for retirement into taking action.

The CBI supports auto-enrolment and its phased introduction from 2012. As we discuss in section 6, large companies' plans are more well-developed, while smaller companies – who will not be required to auto-enrol employees for a number of years – have some time left to ensure they are ready for the regime. The gradual increase in the minimum employer contribution and reforms enacted in 2011 – such as the three-month waiting period for new employees before they are auto-enrolled – are necessary and welcome measures that will ensure the system is affordable in the early years.

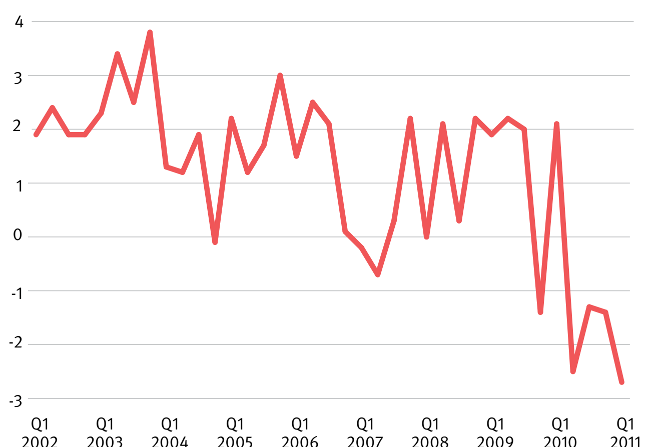
Nevertheless, auto-enrolment was conceived in very different economic circumstances from today. Employees' need to save clashes with the pressure they are experiencing on their incomes. As **Exhibit 5** shows, real household disposable income is down by an annualised 2.7% in the first quarter of 2011 and it looks set to remain under pressure for some time to come. This contrasts with the consistently rising disposable incomes seen in the years before automatic enrolment became Government policy in 2006. Younger generations of employees, in particular, will face greater financial pressures during their working life, such as higher tuition fees repayments and home deposit rates for example. These pressures on disposable income will have an impact on individual pension contributions. The CBI expects to see more people opting-out of auto-enrolment than Lord Turner's commission envisaged in better economic times. This is a temporary phenomenon, however, and re-enrolment every three years should help address this in better times.

Exhibit 4 **FTSE companies' IAS19 pension deficits during 2011 (£bn)**



Source: Towers Watson

Exhibit 5 **Year-on-year growth of real disposable income (2002-2011)**



Source: ONS

Auto-enrolment will over time help get more people engaged with pensions and savings and offer companies an opportunity for employers to review their wider reward packages and consider how best to encourage people to save for their pensions, while also recognising that employees also need savings which they can access for other purposes in the short term.

3 Businesses remain committed to pensions

The most consistent single finding in successive *A view from the top* surveys since the first was conducted in 1994 has been the commitment of senior business leaders to offering good quality pension provision for employees where they can. While the design of schemes has changed as regulation, markets, economic conditions and life expectancy have shifted, the principle of commitment to providing good quality workplace pensions has remained constant.

Key findings

- CEOs are strongly committed to pension provision for employees, with 89% pointing to the business case for spending money on pension benefits rather than just higher pay
- The positive impact of pension provision on staff recruitment, retention and motivation is the most widespread driver (cited by 80% of chief executives)
- Social and ethical considerations are also important, with 78% of chief executives believing companies should help equip employees to plan for retirement and 72% seeing pension provision as boosting corporate reputation.

Employers are committed to pension provision...

Our survey results show that employers remain committed to offering pension provision where they can – both for practical reasons and on principle (**Exhibit 6**). The vast majority of employers (89%) take the view that there is usually a good business case for offering pension benefits to employees. A particularly important part of the business case is the impact on workforce management, with four out of five organisations (80%) believing that a company pension scheme helps recruit, retain and motivate staff.

Social and ethical considerations also play a big part. Nearly four fifths (78%) of business leaders consider that a company should help equip its employees to plan for retirement, while only a slightly smaller proportion (72%) see the provision of a company pension scheme as enhancing their corporate reputation. Half of employers (48%) take the view that there is a paternalistic obligation on employers to contribute to employees' pensions (only 17% disagree with this opinion).

... and that is not weakening

Looking back to previous surveys allows us to see how employers' commitment to pension provision has altered over recent years, in the face of tough economic conditions and shifting regulatory obligations (**Exhibit 7**). Reviewing results for the past five years shows the proportion of chief executives seeing a business case for offering quality workplace pension schemes to their employees running at high levels and, if anything, becoming stronger. Nine in ten (89%) believe there is a good business case for offering pension benefits as part of their company's reward package in 2011, up from 84% in 2007.

While chief executives' perception of the business case has strengthened, the paternalistic perspective has tended to weaken a little – down from 56% in 2007 to 48% in 2011.

Exhibit 6 **Reasons for offering employee pension provision (%)**

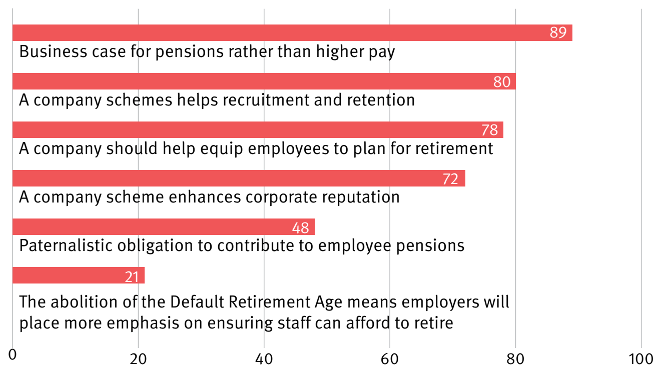
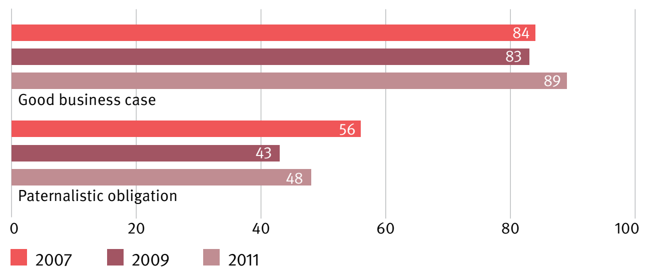


Exhibit 7 **Reasons for offering pension provision over time (%)**



4

DB costs and uncertainty constrain business growth

One of the starkest messages from this year's survey is the impact DB pension schemes and liabilities are having on businesses. The size and uncertainty of DB pension costs can constrain business activity and hold back growth. This is leading employers to take action to curb their risks.

Key findings

- Two thirds of businesses (69%) say that DB provision is having a significant impact on the results in their company accounts. Some say it is hampering reorganisations and constraining corporate borrowing
- 85% of employers are worried about the impact of market movements on their funding level and 71% about unanticipated changes in longevity
- While just 6% of employers firmly expect to transfer risk to a third party through a bulk annuity or longevity swap in the next two years, 60% do not rule this out
- 62% of employers are concerned about contributions going up following their next negotiation with trustees. 45% say DB pension costs are having a significant impact on investment in their business
- 64% of employers with employees still accruing DB benefits expect to make some change to their schemes within the next two years.

Chief executives' top DB concern is risk

In previous editions of this survey, the cost of funding their company's DB pension scheme has been the main worry for chief executives. This remains a key concern: three quarters (71%) of CEOs are concerned about their company's scheme funding levels and the impact it has on their business in 2011 (**Exhibit 8**).

But even more widespread is the fear among business leaders about the risk that the situation could deteriorate in the future. More than four out of five respondents (85%) are concerned about significant market movements having the potential to worsen their scheme's funding position. For many, this worry will have been realised over recent months. Slightly fewer (71%) are concerned about the potential impact of future unanticipated changes in life expectancy even after the substantial strengthening of assumptions in this area seen in recent years.

DB costs impact on the wider business

Accounting standards for pensions – IAS19 and FRS17 – have long been the subject of heated debate in corporate circles. Many argue that the marked-to-market methodology used by these standards fails to take into account the long-term nature of pension liabilities. Instead, it injects short-term volatility into company balance sheets, distorting measurement of company trading performance in unpredictable ways and damaging a firm's ability to attract and retain investors. Over two thirds of chief executives say that DB pensions are having a significant impact on their company accounts (69%), making this the most commonly cited impact of DB pensions on the wider business (**Exhibit 9**).

Almost half (45%) of corporate decision-makers also tell us that DB costs are leading to a reduction in the level of investment available to grow the business. This has been a major cause for concern to the CBI for some time now. With company cashflow still recovering, additional scheme funding means much needed cash being diverted away from investment, to the detriment of future growth. This impact could be exacerbated if, as many executives fear, deterioration in funding positions leads to significantly higher deficit-recovery contributions in coming years. While 44% express concern about the level of contributions being paid in 2011/12, 62% are worried about contributions going up when they have to agree a new recovery plan with their schemes' trustees.

Exhibit 8 **Employer concerns about their DB scheme (%)**

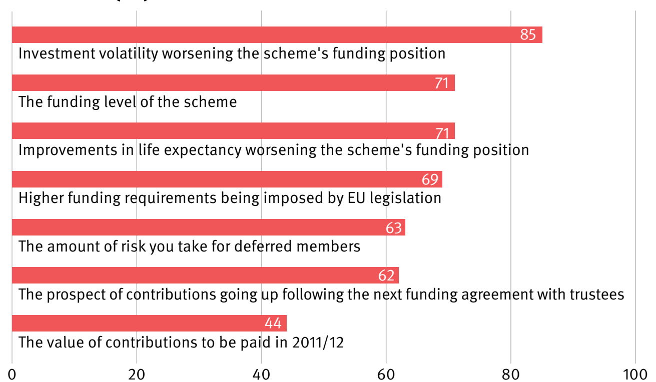
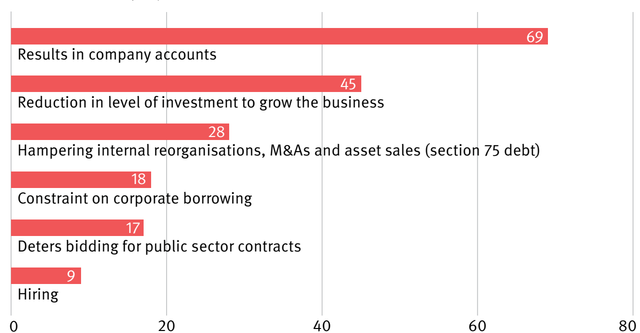


Exhibit 9 **Impact of DB pensions on the wider business (%)**



In addition, 18% of respondents report DB costs and liabilities are making credit access more difficult, further reducing their liquidity.

The emerging picture is that the impact of DB no longer just concerns higher employer contribution rates. Large and variable liabilities are also damaging firms' ability to attract investors and raise capital for investment. DB schemes are additionally hampering business restructuring, with more than a quarter (28%) reporting them as having a severe or significant impact on organisational change, though the pace of growth of concerns on this issue has slowed following recent legal changes.

Scheme closures mean DB costs are increasingly detached from employee reward

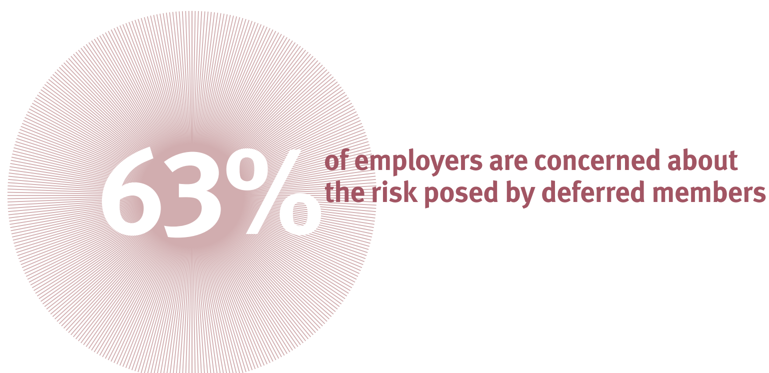
Most employers have already taken some steps to cap their exposure to risk by closing their DB scheme to new entrants, with many also either changing the terms on which existing members accrue benefits or freezing their schemes altogether. This trend is expected to continue.

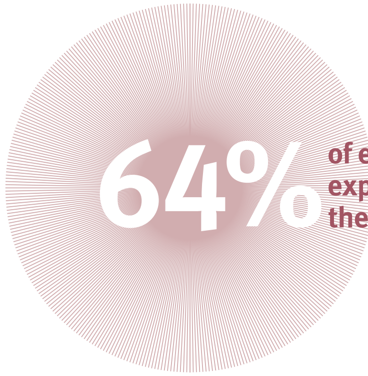
Further scheme closures will increase the extent to which DB pensions are a legacy issue rather than part of today's reward strategy. For the first time, we asked respondents about their attitude to the risks that companies continue to shoulder in relation to former employees. Nearly two thirds (63%) of chief executives told us they are troubled by this. This is symptomatic not only of the strongly held view at boardroom level that DB pensions are excessively expensive, but also that the lion's share of the cost does not benefit current employees any more.

With DB pensions increasingly divorced from the core business, business leaders are concerned about unexpected increases in pension costs eroding the businesses' ability to be profitable, invest and reward current staff. This has led to many companies paying a premium to third parties to take this risk off their hands by buying bulk annuities or longevity swaps. More than twice as many executives said they thought investors reward companies for reducing risk in this way (19%) as say that investors punish companies for paying this premium (8%). However, the vast majority either said they didn't know how investors would react if they made this decision (52%) or said that they would expect investors to be neutral on the subject (22%).

While respondents' concern about risk suggests that these solutions should have some appeal, at the moment most appear to be monitoring affordability rather than preparing to carry out a deal. While only a few respondents (6%) said it was very likely they would transfer risk to a third party in the next two years, 60% do not rule it out.

Another way in which some companies have sought to reduce risk is by offering scheme members more options about the form of their retirement income. 12% said they were very likely to offer incentives for deferred members to transfer their pensions out of the scheme within the next two years, and 6% that they were very likely to offer a higher starting pension to retirees who give up some inflation-linked increases. Again, higher numbers ruled out these options (29% and 40% respectively). The government is considering whether these options should be subject to further regulation. CBI members strongly believe such de-risking options should be open to businesses, but that scheme members should be properly protected and offers must always be genuinely fair to scheme members. We are ready to work with government to achieve this balance.





of employers with an open DB scheme expect to make some changes to it within the next two years

Employers are revisiting their DB pensions offer to limit costs and risks

29% of defined benefit schemes in the survey are already closed to future accrual by existing members. Based on respondents' reported intentions, this is expected to rise to 43% in next two years.

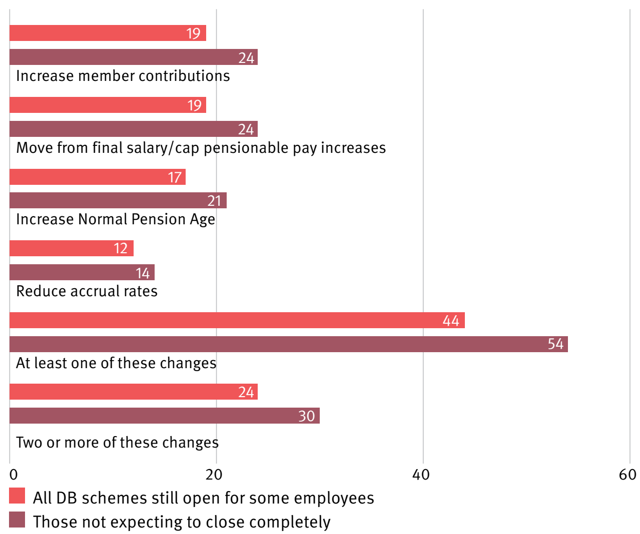
Perhaps more striking is the fact that, among those employers who intend to keep their schemes open for existing members, a majority (54%) expect to make some changes to the terms of the pensions deal (**Exhibit 10**).

The sort of changes proving so controversial in the public sector are therefore far from uncommon in the private sector – especially as the results do not show how many schemes have already made these changes. The difference is that only a minority of private sector employees are accruing defined benefit pensions to start with, and few of those who are will currently have a normal pension age of 60.

Taking these two findings together, nearly two-thirds (64%) of employers who have not yet completely closed their DB schemes expect either to close them or to make some other change within the next two years: around a third (36%) thought they would not close their scheme to existing members, nor change the terms on which these members continue accruing benefits, nor (where still relevant) close the scheme to new members or change the terms on which they can join.

The changes outlined above do not reduce the pension entitlements that employees already have. However, one change made by the Government has automatically reduced the cost to some employers of discharging their existing pension liabilities.

Exhibit 10 **Percentage of DB schemes expecting changes (%)**



Some schemes which were previously required to provide annual pension increases based on RPI inflation now have to provide pension increases based on CPI inflation, which is usually lower. However, this varies according to how a scheme's rules are written. 41% of respondents say this will affect their pension increases. It will be more common for schemes to use CPI to uprate benefits between the time a member leaves service and their retirement.

5

Regulatory risk remains a leading concern for DB sponsors, with further threats looming ahead

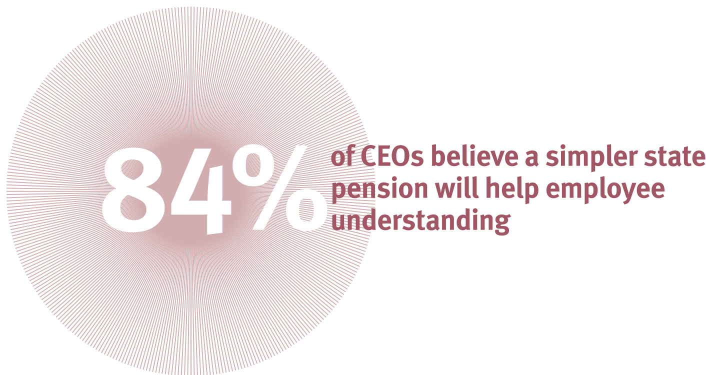
Key findings

- Three quarters (73%) of employers say they would prefer a single-tier State Pension to the present system. However, the same proportion say this reform would lead to more DB schemes being closed to existing members unless adjustments to offset the resulting increase in NI contributions are available
- 44% of employers are satisfied with the Pensions Regulator's overall dealings with their company and only 12% say they are dissatisfied. However, a quarter of employers are concerned about its approach to recovery plan negotiations
- 69% are concerned that the European Commission's proposal to introduce a Solvency II-style funding regime for pensions will force them to put more money upfront to cover pension obligations
- 70% of CEOs fear that the size of the PPF levy their companies will have to pay in the future will be too high.

State pension reform depends on solving DB contracting-out problem

While 27% of respondents would prefer to retain the present State Pension system than to introduce a single-tier system, nearly three-quarters of businesses support the thrust of the Government's proposals. In all, 84% agree that a simpler State Pension system would make it easier for employees to understand the need to contribute towards a private pension because they would have a clearer idea of how much they could expect to receive from the State.

Despite strong boardroom support for reforming the State Pension, there is one aspect of it that is very concerning for employers. By abolishing the Second State Pension (SSP), the government will effectively also be abolishing contracting out for DB schemes. Removing the contracted-out rebate will see employers' NI costs increase significantly – for example, in 2011/12 the value of the rebate is worth up to £1,285 per



employee. Take-home pay for employees would fall by a similar amount. Three quarters (73%) of survey respondents told us that removing contracted-out rebates would lead to DB schemes closing to existing members, unless they are enabled by law to adjust their schemes to offset the cost of the lost rebates. This would deliver the government policy aims and the same level of pensions, at no upfront cost to employer and employee. Respondents indicated that, if it is possible to redesign the scheme to offset higher national insurance contributions, a majority would look to do that for existing members rather than close the scheme (**Exhibit 11**).

The Pensions Regulator needs to adapt to changing times

Six years on since its creation in 2005, the Pensions Regulator has become the cornerstone of the UK's pensions regime. The relationship between the Regulator and employers has also stabilised over time. The financial crisis was the greatest test so far of the robustness of the regime. Despite some upheavals, in particular the Regulator's slow initial response to the effects of the credit crunch on the ability of employers to afford recovery plans and run their businesses, the regime remained stable during the crisis.

This generally positive record is reflected in this year's survey finding that 44% of respondents are satisfied with the Regulator's interaction with their company, with only 12% dissatisfied. Satisfaction levels are up 18% from 2009 when the financial crisis was in full swing. When asked about their opinion on specific regulatory activities, however, some less encouraging numbers emerge (**Exhibit 12**), with one in four employers not or not at all satisfied with the Pension Regulator's approach to recovery plan negotiations (25%) and its approach to corporate transactions and clearance process (26%).

Exhibit 11 **Responses to aboliton of the DB contracted-out rebate (%)**

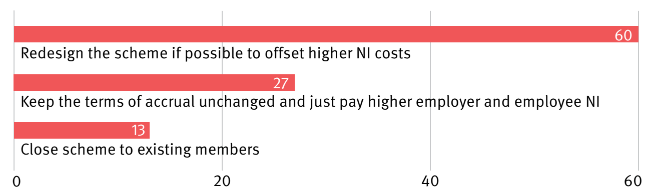
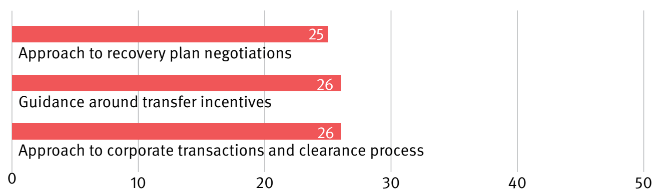
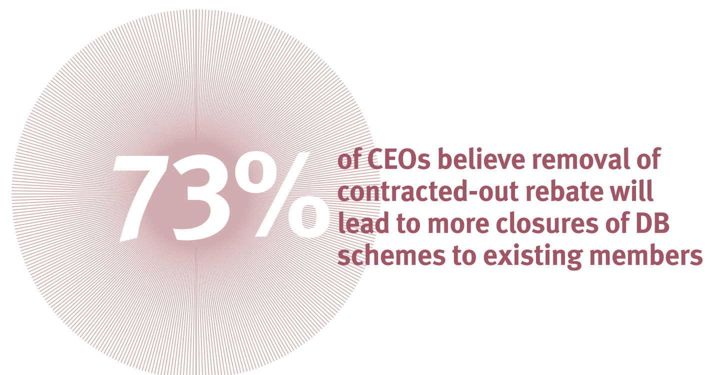


Exhibit 12 **Employer concerns about the Pensions Regulator (%)**





Concerns remain about PPF levies

Businesses have always accepted that some form of vehicle was required to safeguard people whose occupational pensions are underfunded at the point of corporate insolvency. Over time, employer support for the principle of the Pension Protection Fund (PPF) has increased. In 2009, our survey found 69% of respondents were either content or neutral about the idea of the fund.

However, that does not mean employers are content with the levies they have to pay. One issue that has always been a major worry for them is the unpredictability of the PPF levy. In the 2009 survey, 95% of pension managers told us they did not know what the level of their 2010 levy would be. To make this more predictable, the PPF Board intends to fix some elements of this calculation for three years at a time. The new formula, coming into force in 2012/13, will make individual scheme levies more predictable, which is welcome.

In 2011, 70% of respondents say they are dissatisfied with the expected size of their firm's future PPF levy. This might be ameliorated by news that PPF will seek to raise £550 million in 2012/13, down from £620 million in 2011/12. However, the new levy formula will see a greater share of the total levy paid for by less well-funded schemes with strong sponsors. Over time – as most schemes close and reach wind-up – the CBI wants the total levy to continue to fall, while ensuring risk is realistically and fairly priced.

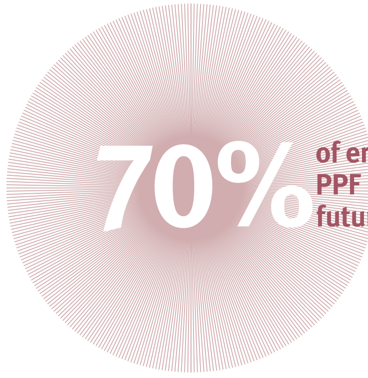
EU plans for a Solvency II-style regime for pensions would be disastrous

The prospect of an EU legislative double-whammy of higher deficit repayments over a shorter period is cited as a concern by more than two thirds of chief executives (69%).

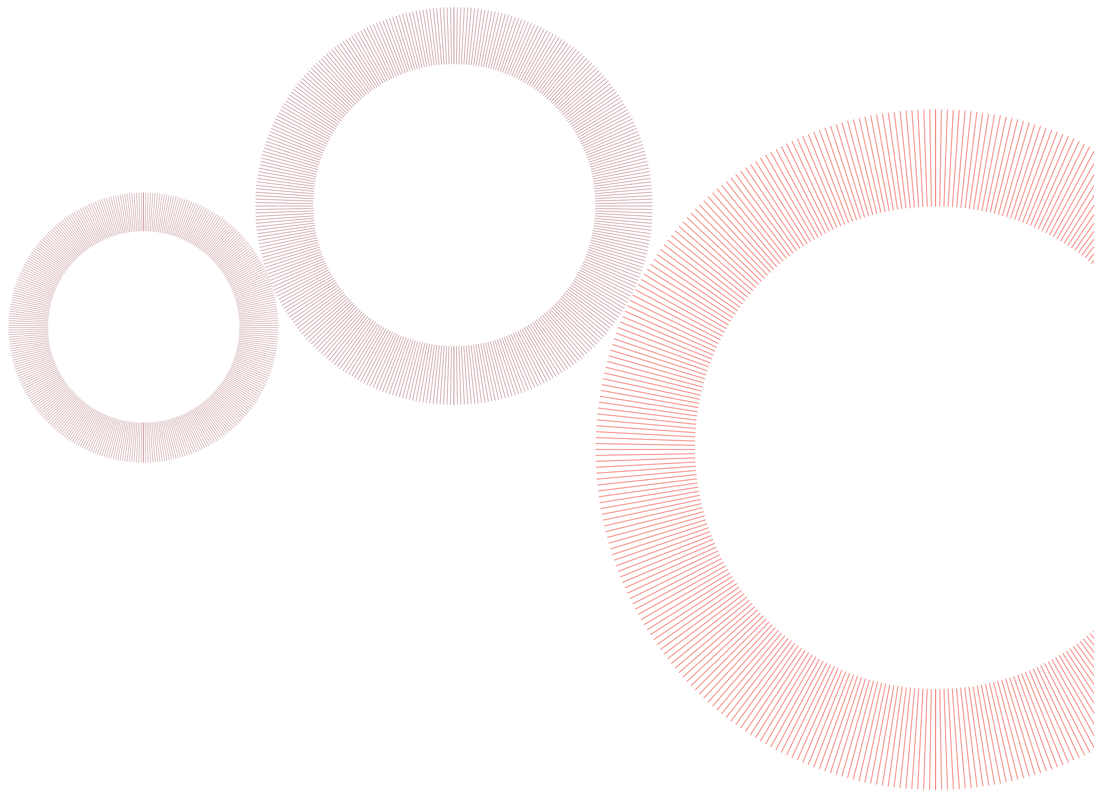
In summer 2010 the European Commission published its much-awaited green paper on the long-term sustainability of pension provision in the EU. In it, the Commission revived its proposal to introduce a Solvency II-style funding regime for pensions through a review of the 2003 Directive governing Institutions for Occupational Retirement Provisions (IORPs) in 2012.

If implemented, the Commission's policy would lead to major changes to the UK's scheme-specific funding regime – potentially increasing the funding targets set for defined benefit pension plans and reducing the length of time that sponsors have to make good any shortfall.

Yet, this funding would be unnecessary, and have significant negative effects on both the competitive position of DB sponsors, forced to pay more, and the wider economy as there would be less funding for equity capital available as schemes moved into, theoretically, more secure assets.



of employers fear the size of the PPF levy they will have to pay in the future



6

Companies preparing for auto-enrolment

As the deadline approaches, employers are now developing their plans to comply with the impending obligation to automatically enrol most staff into a pension scheme. This follows significant efforts on the part of the Pensions Regulator and others to alert firms to the new regime. As they continue preparations, the overwhelming majority of companies are planning to auto-enrol their employees into a defined contribution (DC) pension scheme. But they are concerned that employees do not value these schemes as much as they should.

Key findings

- With auto-enrolment less than a year away for larger companies, most employers (80%) have already had some discussions at board level about how to comply with the new regime
- 61% expect to enrol new members on existing terms and only 1% to level down contributions for existing members
- Practical administrative issues and communications are the biggest challenges for employers, with over half (55%) concerned about managing opt-outs/ins and 42% about communicating effectively about auto-enrolment with employees
- Private sector DC provision is the preferred vehicle for auto-enrolment, with 78% of employers choosing their existing scheme and 12% planning to set up a new scheme
- Employees are failing to make the most of DC schemes: less than half of employees (47%) contribute sufficiently to their DC scheme to benefit from their employer's maximum matching contribution
- Half (51%) of CEOs are concerned about the risk of regulation making DC schemes more expensive in the future.

Auto-enrolment starting date is a key driver for employers' level of readiness

Four fifths (80%) of chief executives tell us that company plans for complying with auto-enrolment have been discussed at board level to at least some extent. While 27% of them tell us they have done so in detail, half (52%) have yet to hold a detailed discussion on plans for auto-enrolment. A fifth (20%) of chief executives say directors have not yet discussed plans (**Exhibit 13**). Much of the detailed preparation work is being led further down organisations, and 79% of pensions managers report that they are now very or fairly well-prepared, and will be ready for their auto-enrolment date.

The biggest companies (120,000 employees or more) will be subject to the new legislation on 1 October 2012. The smallest companies, on the other hand, will not auto-enrol until 2015 at the earliest. An updated timetable is expected from DWP in January 2012. Breaking down the data by company size shows that the staging date for implementation of auto-enrolment is a key driver in determining an employer's level of readiness, as might be expected.

Of those companies with 10,000 or more employees, 70% have already discussed plans in detail at director level and only 5% report that they have not yet discussed the issue. At the other end of the scale, only 20% of SMEs have discussed plans at director level in detail, while half (53%) have had initial discussions and nearly a quarter (23%) have not yet discussed plans.

Although those companies with starting dates further down the line are less likely to have detailed plans in place, the fact that most companies have already had discussions at senior level means that decision makers are aware of the changes ahead.

Admin issues and communications are the biggest challenges

It is clear from the survey findings that administrative capacity will be crucial to the success of auto-enrolment (**Exhibit 14**). When asked what the main challenges are in complying with the new regime, over half (57%) of pension managers said managing opt-ins and opt-outs would be challenging or very challenging. A third

Exhibit 13 Director-level discussion of auto-enrolment (%)

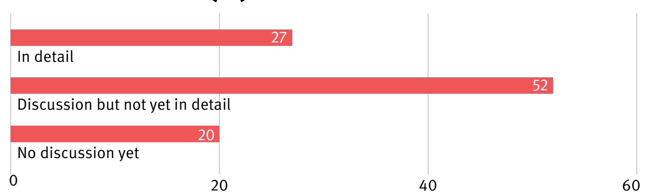
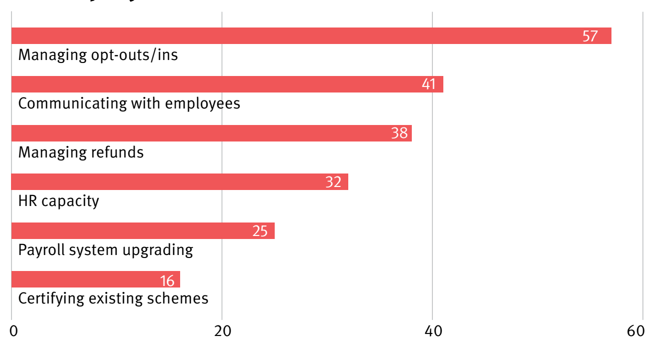


Exhibit 14 Main challenges of auto-enrolment for employers (%)



(38%) identify the related issue of managing the refunds due to members who opt out as a major challenge. In some cases, these challenges will be made more difficult because employers cannot supply opt-out notices directly and because employees will not always be able to opt-out before payroll cut-off dates and stop contributions being deducted from their pay. 32% of firms are concerned about overall HR capacity to manage the auto-enrolment system. The three-month waiting period, proposed by the CBI and introduced by the government in the Pensions Act 2011, will, help mitigate some of the impact of these challenges, however, especially for those employers with high turnover of staff.

Only 16% of companies see certifying their existing schemes as a major challenge, thanks to the simplified self-certification test. Employers appear to have heard the message from ministers that continuing to operate a good quality scheme will be made easy. The CBI has been trying to ensure that the final regulations, and the way the Pensions Regulator applies them, will reflect this intention. If the self-certification process is too onerous, it could lead to companies choosing to apply the minimum requirements instead, leading to a levelling down of contributions.

The other big area of challenge relates to employee engagement and getting the message of auto-enrolment across to employees. In all, 41% of pension managers identify communicating the change to employees as one of their main challenges in the lead up to auto-enrolment.

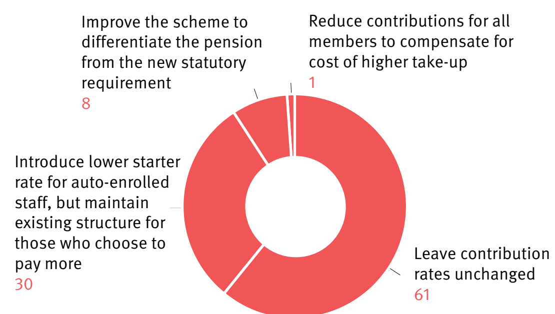
Most employers are not planning to level down contributions

The threat of a levelling down of existing contributions has been a much debated topic in the run up to October 2012. Some commentators fear companies could reduce contributions as a way to offset the additional cost of an increase in scheme membership.

Looking at **Exhibit 15**, only 1% of respondents who already provide employer contributions have told us they are planning to reduce contributions across the board to compensate for the cost of anticipated higher take-up. On the other hand, 61% of respondents expect to leave existing contribution rates unchanged, while 8% say they will increase their own contributions to differentiate their offering from the new statutory minimum. A third (30%) are planning to introduce a new lower starting rate for automatically-enrolled staff, while maintaining existing rates for those individuals who choose to pay more.

The figures do, however, show some variation depending on a firm's level of readiness for auto-enrolment. A small but larger proportion of those firms that have discussed plans in detail at director level are planning to lower contributions across the board to manage the

Exhibit 15 **Plans in response to auto-enrolment (%)**



increase in pension spend – 5% compared to 1% overall. Similarly, while 49% of those firms that have discussed auto-enrolment plans in detail say they are planning to leave contribution rates unchanged, that figure stands at the higher level of 56% among those that have not yet had detailed discussions and 79% for those that have not yet had any discussion at boardroom level.

It seems that the more advanced plans are, the more likely it is that firms will make adjustments to their pension contributions to take account of the additional financial and administrative costs of auto-enrolment in the current environment. Having said that, most employers do not expect to level their contributions down to absorb these costs, and even where this does happen, contributions will usually remain far above the minimum level.

Privately provided DC is the scheme of choice for most

Once auto-enrolment comes into force, firms will have a choice between enrolling their employees into a privately-provided pension scheme or the government-established National Employment Savings Trust (NEST). Competition will certainly be fierce as between four and eight million employees currently outside occupational provision begin to save for their pension.

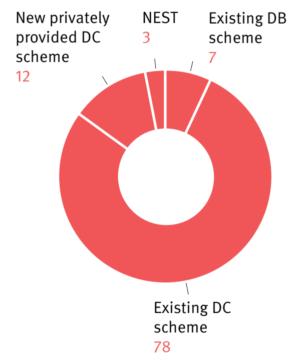
This year's survey findings indicate that privately-provided DC schemes (whether trust- or contract-based) are by far the preferred choice for employers (**Exhibit 16**). The vast majority of respondents (78%) told us that they will be using their existing DC scheme to auto-enrol employees, and a further 12% will be using a new privately-provided DC scheme. Only 3% of respondents say they are planning to use NEST as their auto-enrolment vehicle, while 7% will be using their existing DB scheme. The handful of respondents intending to use NEST includes employers from a range of size bands. This is not surprising, as we expect the bulk of NEST's custom to come from smaller firms, and those not currently providing pensions.

High quality DC is widely available but employees do not make the most of it...

Only 8% of respondents told us they do not offer a DC scheme of any type. Of those that do have DC schemes, around two-thirds (68%) say their main DC offering is a contract-based arrangement – either a group personal pension or a stakeholder pension, while 32% provide schemes overseen by trustees. Predictably, large employers are more likely to take on the governance requirements involved with trust-based schemes, and the split is much more even amongst large organisations: 53% of DC schemes attached to employers with 1,000 or more employees are contract-based and 47% trust-based. DC schemes operated by SMEs, on the other hand, are far more likely to be contract-based (85%).

DC provision is sometimes perceived as a step below DB schemes in terms of the final pension it provides. The reality is that contributions matter, and most employees do not contribute sufficiently, often not taking full advantage of their employer's DC offer. While the average employer contribution to DC schemes in the survey is almost 10%, the average employee contribution is only 5%. The average maximum employer contribution available to members who contribute enough to benefit from full matching is 12%, up 2% from 2009. In practice, however, less than half (47%) of employees contribute enough to be able to benefit from the maximum available employer contribution, the same figure as two years ago.

Exhibit 16 **Employers' choice of scheme to auto-enrol staff (%)**



With life expectancy increasing rapidly, starting to save earlier and saving more is crucial if employees are to achieve their desired income in retirement. As an essential part of that, employees need to take full advantage of the pension contributions their employers are prepared to make.

Businesses feel employees need help to manage their pension choices

While most companies (78%) take the view that they should help equip employees to plan for retirement, they have greater reservations about whether employees are really able to manage pension options effectively alone. When asked for their view on whether they think that, if employees are left to make choices about their pension, they will generally make the right decisions, fewer than two in ten (17%) are confident employees will. This points to the scale of the challenge we still face in educating employees about pension issues and ensuring default strategies are appropriate.

The same risks that have made DB provision onerous for employers are also present in DC schemes. The difference is that these risks lie with the scheme members. Even where generous employer

contributions are available and default funds are well-designed, DC places the onus on employees to engage with their pensions and be prepared to adjust the amounts they save, when they expect to retire or the amount of risk they are prepared to take.

Exhibit 17 shows that the need for active engagement with DC has not yet been taken on board fully. 39% of chief executives are concerned or very concerned that not enough of their employees either join or take full advantage of the scheme on offer. As a consequence, employees face the prospect of being unable to retire on an adequate income. They may well have to continue working out of necessity rather than choice.

While DC arrangements put the individual employee in control, many executives feel employees need support to manage their pensions well. Over half (53%) of top managers are concerned that while the employee bears the investment risk, they are not well-equipped to take investment decisions. More than a third (39%) of chief executives also fear the company could be blamed if the default investment option performs badly.

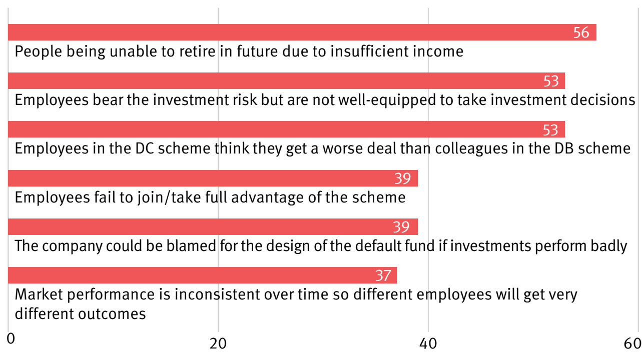
Although the contribution rates available in respondents' DC schemes are typically much higher than new statutory minimum levels, 53% are concerned that employees in the DC scheme feel they get a worse deal than colleagues in the DB scheme, potentially leading to friction and resentment. This may be one further driver of DB closure. Only 36% of employers are happy with the value that employees place on their DC pensions, compared with 68% for those employees who continue to accrue DB benefits. However, only 37% express concern about the difference in outcomes for individuals depending on when they save and when they retire.

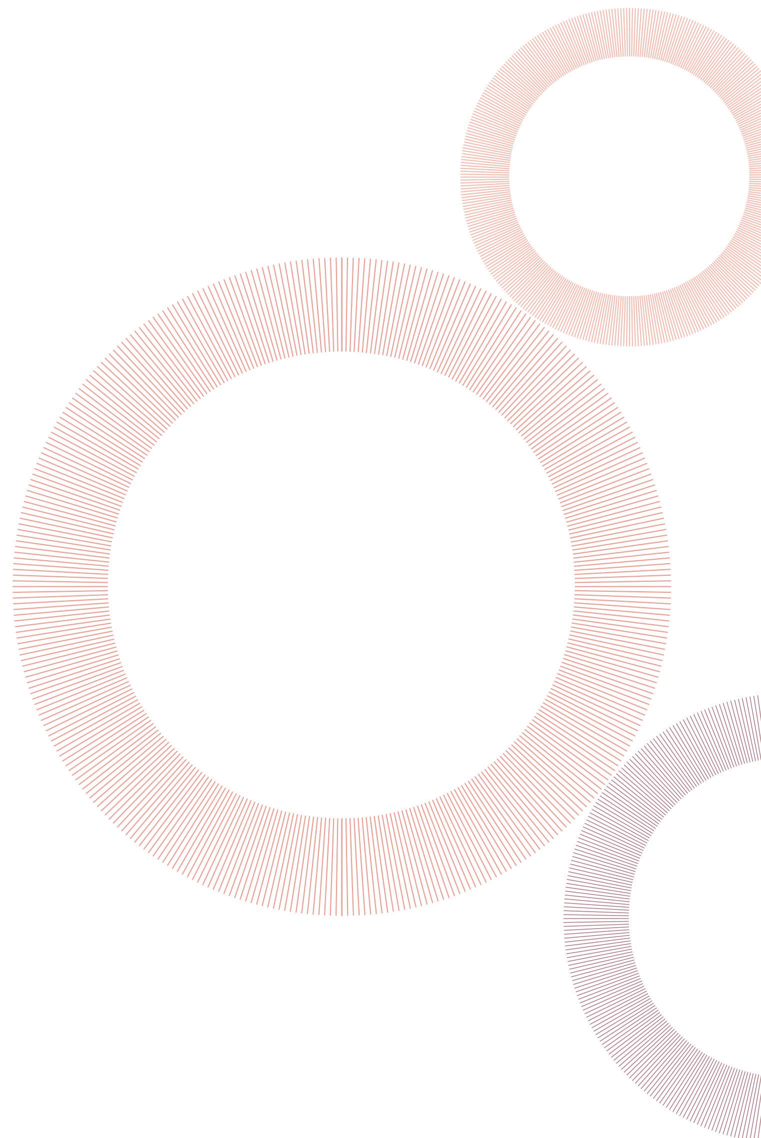
Good DC provision at risk from the threat of regulation

The challenges of relatively low appreciation of DC pensions among employees and their lack of engagement with their pension provision are concerning for employers. As DC moves centre stage, it is also attracting more attention from regulators. Half (51%) of the chief executives responding to the survey told us that they are concerned or very concerned about the possibility of an increase in the regulation of DC schemes raising the cost of their scheme. The Pensions Regulator's January 2011 DC strategy review[2] and the European Commission's green paper on pensions are often cited by CBI members as their main sources of worry.

2 The Pensions Regulator, *Enabling good member outcomes in work-based pension provision*, January 2011

Exhibit 17 **Employers' concerns surrounding their DC scheme (%)**





7

Towards a more flexible workplace saving model

Auto-enrolment is an opportunity for companies to review the role of their pension arrangements as part of their wider reward package. At a time when cashflow is under pressure, ensuring that employee benefits represent value for money in terms of the impact on recruitment, retention and motivation is crucial. With personal incomes significantly stretched, employers are beginning to consider exploring more flexible workplace saving arrangements that could allow employees to build up a pension while providing access to short-term savings at the same time. This could help drive up saving rates and improve employee appreciation of occupational saving arrangements more broadly.

Key findings

- The state of the economy, the pressures on businesses and trends in personal incomes have all changed radically since auto-enrolment was conceived
- Over half of CEOs (56%) believe offering a wider range of flexible workplace saving arrangements would be an attractive option, though immediate plans are limited
- The availability of a wider range of saving options is seen as likely to encourage more employees to take advantage of maximum employer contributions, according to more than half of pension managers (56%)
- Pensions remain the cornerstone of workplace saving, with 78% of employers telling us they would only offer additional arrangements to sit on top of a pension.

Austerity is likely to stay with us, so maximising value for money is critical

The introduction of auto-enrolment from October 2012 is an opportunity for companies to review the role of their pension arrangements as part of their wider reward package. Crucially, the economic outlook has changed radically as a result of the crisis in the banking system and the economic downturn.

While auto-enrolment into pensions will get more people saving, it does not mean it will get more people to save adequately. Employers need to ensure they use the coming into force of auto-enrolment as an opportunity to review their reward strategy, on the one hand to maximise employee appreciation of all its elements, but also to improve contribution rates among employees and their levels of practical engagement. Auto-enrolment is a keystone in rebuilding a culture of saving in the UK, but on its own it is not the whole edifice.

Reconciling short-term and long-term economic needs is a crucial challenge

In recent times, a debate has begun among pensions professionals on the need to respond to the conflicting short-term and long-term economic needs of employees. At the same time, a number of more flexible workplace saving products have emerged in the market.

These products are designed to offer employees different benefits according to the stage in their career they find themselves in. They range from corporate ISAs to maturing share-save schemes and they can benefit from an employer contribution. It has been argued that offering these products alongside pension provision could help convince employees to save both for the short- and the long-term.

More than half of chief executives (56%) take the view that opening up a wider range of workplace saving options as part of the employee reward package would be attractive, including 10% who say it would be very attractive (**Exhibit 18**).

However, just over four out of five pension managers (81%) think it is not likely that their firms will be offering one of these products in the next two years (**Exhibit 19**). This may be for a variety of reasons, including the greater urgency of complying with automatic enrolment, the relatively recent entry into the market of these products, and a desire of pension and reward managers to evaluate the costs and benefits of these products and how the employees of early adopters react.

While pension managers may be cautious about the new products, they agree that increasing the workplace saving offer could increase employee engagement with pensions. More than half (56%) of pension managers think that sharing the employer contribution between more flexible saving products and a DC pension would be more attractive to employees than a simple pension contribution. Moreover, as **Exhibit 20** shows, 53% of them think that the combination would make it more likely to drive employees to take advantage of maximum matching employer contributions, with just 2% thinking it would discourage employees.

Exhibit 18 CEOs' views on attractiveness of a wider range of workplace saving options (%)

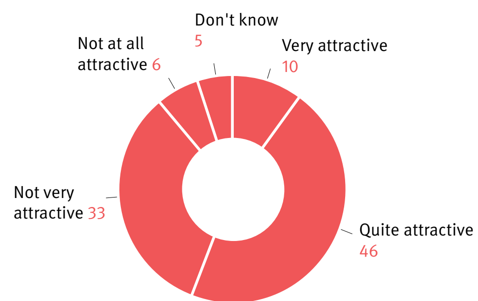


Exhibit 19 Pension managers' views on likelihood of introducing a wider range of workplace saving options in next two years (%)

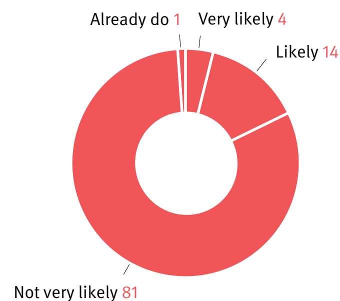
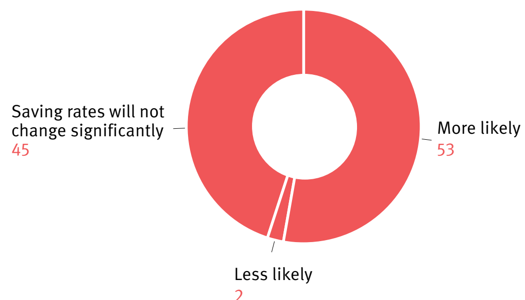


Exhibit 20 Likelihood of a wider range of workplace saving options driving employees to take advantage of maximum employer contributions (%)



Crucially, employers do not see this type of product as an alternative to pensions saving. 78% of respondents tell us that they would only introduce something to sit on top of the pension and not as an alternative option (**Exhibit 21**).

New pension choices for DC savers if they meet the Minimum Income Requirement

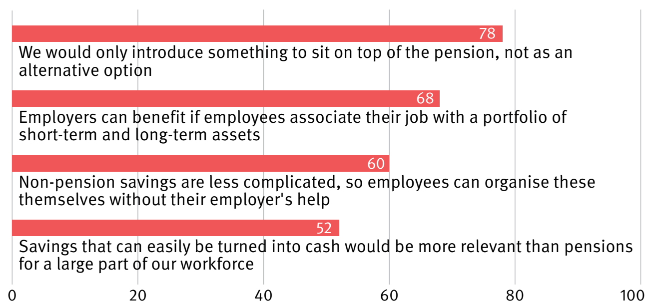
The Finance Act 2011 relaxed the requirement for DC savers to use most of their pension pot to buy an annuity. Individuals satisfying a new Minimum Income Requirement (MIR), will be able to access any additional savings as they wish in retirement. State Pensions, DB pensions and annuity income all count towards the MIR, which has initially been set at £20,000 a year, provided they have come into payment.

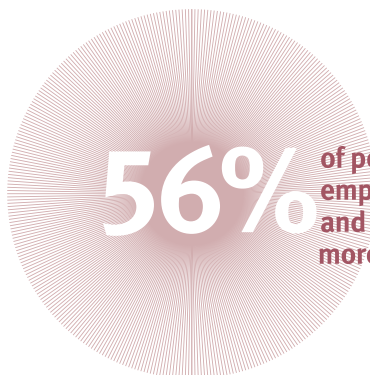
Potentially, this makes DC pension saving a more attractive option for some employees. For example, those who are reasonably close to retirement and already expect to satisfy the MIR may be able to benefit from tax relief while only locking up their money for a few years.

83% of employers with DC schemes say they expect to communicate with members approaching retirement to explain the new options that some will have and 60% that they will communicate with employees to help inform their savings decisions. 31% say they are likely to offer a drawdown facility within their DC scheme, so that members wishing to take advantage of this new flexibility do not need to transfer.

Almost half of employers with DB schemes (49%) say they intend to communicate with members who might want to transfer or reshape their pension so that they have more choice about how to receive that part which is not needed to satisfy the MIR.

Exhibit 21 **Employers' attitudes to more flexible workplace saving products (%)**





of pension managers believe that sharing the employer contribution between a DC pension and other types of savings products would be more attractive to employees than DC alone

CBI
THE VOICE OF BUSINESS

For enquiries about this report or a copy
in large text format, please contact:

Mario Lopez-Areu
Senior policy adviser
Employment Affairs
CBI

T: +44 (0)20 7395 8233
E: Mario.Lopez-Areu@cbi.org.uk

December 2011

© Copyright CBI 2011
The content may not be
copied, distributed, reported
or dealt with in whole or in part
without prior consent of the CBI.

Product code: HRE_HRE_183

CBI
Our mission is to promote the conditions in which
businesses of all sizes and sectors in the UK can
compete and prosper for the benefit of all.

To achieve this, we campaign in the UK, the EU and
internationally for a competitive business landscape.

www.cbi.org.uk