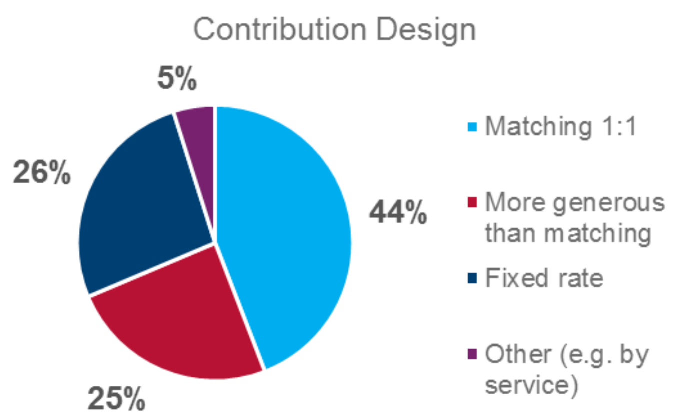
Housing Briefing – November 2019

“How competitive is your DC pension scheme?”

Most employers offer a defined contribution (DC) scheme as an option for their staff to save for retirement.

There are certain minimum contribution requirements set out in legislation but provided these conditions are met, employers can choose to structure contributions and pay whatever level they like.

Whilst contribution freedom is largely welcome, the challenge for employers is to offer DC contributions that are affordable yet attractive enough to recruit and retain talented staff. To help you review how your DC scheme ‘measures up’, our latest briefing discusses the range of DC contributions paid by over 100 UK Housing Associations who are advised by First Actuarial. As the leading pension advisor in the social housing sector in the UK, this survey of our clients provides a comprehensive picture to allow you to benchmark your DC scheme.



DC contribution structures

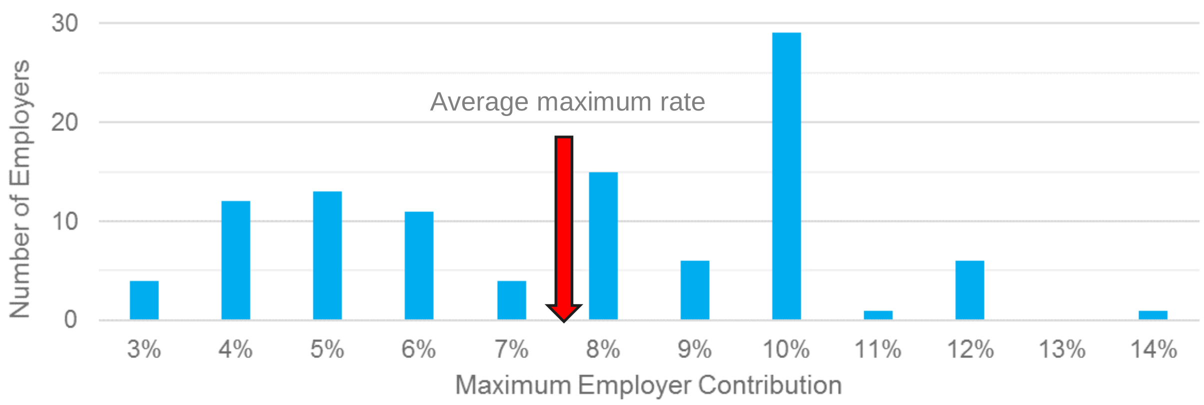
The chart on the left shows that nearly half of Housing Associations offer a “Matched 1:1” DC structure, where an employer pays into DC at the same level as employees pay (subject to a cap – the maximum DC rate, see below)

A quarter of Housing Associations offer a more generous matched structure, such as a 2:1 match, again up to a specified cap.

Fixed rate contribution structures with a single employer DC rate are the simplest design and account for around another quarter of DC contribution structures.

Maximum contributions – the “top end of the range”

The following chart shows the maximum DC rate offered by over 100 UK Housing Associations as part of their overall contribution structure.



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The average maximum rate in 2019 is **7.6%.** This represents an increase from the **6.9%** average maximum rate we observed following our 2016 Housing Survey. So why have maximum DC rates trended up in the last three years?

- The legal auto enrolment minimum employer rates have risen from 1% in 2016 to 3-4% from April 2019. The maximum DC rates paid by a small number of employers are set at these auto enrolment minimums, so consequently their maximum DC rates have increased over time;

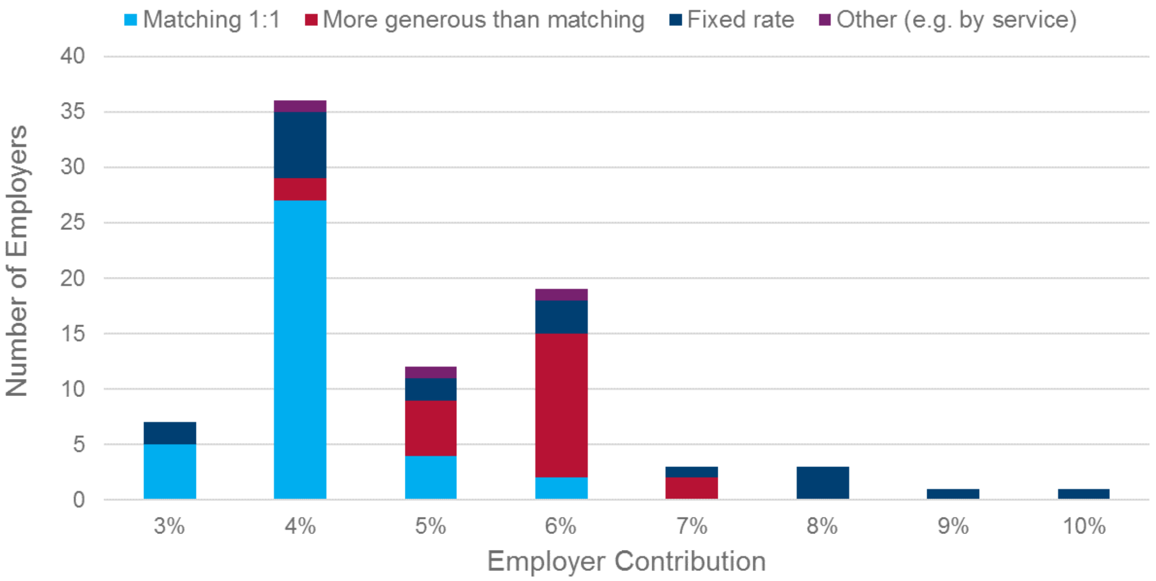
- Some employers with open defined benefit (DB) sections have improved their DC contribution structures in recent years. For example, following the 2017 SHPS valuation, some employers increased their maximum DC rates at the same time SHPS DB (Final Salary / CARE) section employer contributions were increased.

- Some employers who recently closed SHPS DB to accrual increased their maximum DC rates in order to make their DC scheme more attractive to staff. Without DB, having a competitive DC scheme with better outcomes became more important.

We expect this trend of higher maximum DC contributions to continue. We are working with several Housing Associations who aspire to increase their DC contributions, if and when their DB costs are more under control.

Auto enrolment contributions – the "bottom end of the range"

The below chart shows that most Housing Associations auto enrol at 4% pa employer, 4% pa employee. This most commonly observed employer rate is above the auto enrolment minimum contribution of 3% pa with many Housing Associations auto enrolling at "4 and 4" for simplicity.



1:1 Matching at 3% employer contribution implies the employee contributes 5% to meet minimum auto enrolment requirements. True 1:1 matching then occurs at higher contribution rates.

However, several employers do auto enrol at higher rates, with 6% being a popular employer contribution – in particular, a 2:1 matched contribution of 6% pa employer, 3% pa employee. Higher auto enrolment contributions are particularly common where employers offer a "fixed rate" DC structure, where the employer pays a flat % contribution rate to all staff – as shown by the dark blue bars.

How much is enough?

It is a common misconception that just taking part in a pension scheme will result in a decent retirement income. Perhaps true for many DB schemes, but a comfortable retirement is unlikely to be the end result for staff in DC who only pay (and receive from their employer) the legal minimum of pension contributions. Therefore, in our view, auto enrolling staff at a higher rate than the minimum is both **paternal** and **progressive** as it gives all staff – and in particular, the lower paid – the benefit of the same employer contribution rate.

Whilst designing a maximum contribution rate helps to recruit and retain senior staff, it is therefore important not to forget the minimum contribution rates paid by employers too.

The Pensions and Lifetime Savings Association (PLSA) has recently launched the **"Retirement Living Standards"**, which aims to explain what life in retirement looks like at three different levels www.retirementlivingstandards.org.uk

Whether you think your DC scheme will provide employees with a "Minimum", "Moderate" or "Comfortable" life in retirement will depend on the contribution rates being paid (but also what assumptions you make for how DC pots will grow in the future and be used in retirement).

The importance of DC

DB pensions tend to give employers the greatest headaches, particularly after triennial valuations when costs are re-evaluated and employers wait with bated breath for the impact on their contributions (praying that they won't go up again!)

But for many Housing Associations, the majority of their staff aren't in a DB scheme – they're in DC. It's vital for employers to assess whether their DC contribution structure and design is consistent with their organisation's objectives, to consider whether their staff will be able to afford to retire one day… and, of course, to have an eye on what others in the sector are doing.

How First Actuarial can help

First Actuarial provide independent advice to more Housing Associations than any other firm.

If you would like to discuss the areas explored in this briefing, in particular:

- DC contribution design;
- DC retirement projections (assessing member outcomes);
- DC benchmarking exercises; and
- DC employee communication and education projects.

And anything else DC or DB pension related, then please contact your usual First Actuarial consultant or any of the First Actuarial Housing Team.

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