PENSIONS
INVESTMENTS
LIFE INSURANCE

A GUIDE TO DEFINED CONTRIBUTION PLAN CONTRIBUTION STRUCTURES

CONTENTS

FOREWORD

HELPING PEOPLE BUILD BETTER OUTCOMES AT RETIREMENT

As the market leading provider of occupational Defined Contribution schemes in Ireland, we at Irish Life are uniquely placed to provide insights into how Irish people are saving for their retirement. The way Irish people are saving into workplace pension plans has evolved, with Defined Benefit plans having largely been replaced by Defined Contribution (DC) plans for the vast majority of employees in employer-sponsored pension plans.

Therefore, we've put this report together to inform on how DC plans across the country are structured and what they're actually offering for members of those plans. We've looked at the most common contribution structure being provided by employers, and we've also looked at the factors that are impacting employer decisions when setting those structures. We take an in-depth look at matching contribution structures, the variations of structures, and which of those variations work best for plan members. We also highlight the importance of the 'default' contribution rate whilst examining the possibility of incorporating automatic increases into contribution structures. Finally, we question the merits of service-related contribution structures and probe whether these types of structures really deliver what sponsoring employers want to achieve with them.

> "Workplace pension plans need to be structured in such a way as to maximise the outcomes for members when they reach retirement.

The lack of pension coverage in Ireland, and the fact that those in pension plans are not saving enough for a decent pension, is well documented. Specifically looking at workplace pension plans, we need to ensure they're structured in such a way as to maximise the outcomes for members when they reach retirement. With that in mind, we hope you find this report useful. If you have any questions or feedback on the report, please get in touch.

John Alford
Irish Life EMPOWER Research and Insights
December 2018

EXECUTIVE SUMMARY

Defined Contribution (DC) schemes are now the company pension plans of choice for most companies looking to help their employees save for retirement and possibly the most important differentiating factors when comparing Defined Contribution plans is the contribution structure on offer to employees.

This guide has looked at what makes up these contribution structures and has come to the following conclusions when it comes to putting in place a great DC Plan contribution structure.

KEY ACTIONS

The most common contribution structure of 5% Employer/5% Employee plan will not differentiate a company when it comes to pension plan offering. Nor will it deliver an adequate outcome at retirement for members at retirement.

A total contribution amount of 15% is required to deliver adequate outcomes for members at retirement if they start saving in their 20s.

Defaulting employees into the plan at a high contribution level works better than forcing employees to make an active decision to increase their contributions.

Matching contribution structures lead to more engagement in terms of savings rates/ Additional Voluntary Contributions (AVCs).

Service-related contribution structures have little impact on staff retention rates and could lead to inferior outcomes at retirement with a higher employer cost when compared to a fixed-level structure.

This report takes a closer look at DC plan contribution structures in Ireland, covering the following:

1. How do DC contributions work and what factors combine to create the contribution structures?
2. An examination of the most prevalent contribution structures across the DC plans that Irish Life administer.
3. An examination of matching contribution structures, including which types of matching structures deliver best member savings rates based on our experience of DC plans.
4. An examination of service-related contribution structures – the merits of these structures and whether they're delivering what employers and employees want.

DC PLANS

CONTRIBUTION STRUCTURES EXPLAINED

Within a Defined Contribution Plan, there is normally a contribution structure consisting of:

AN EMPLOYER CONTRIBUTION

This is the contribution the sponsoring employer of the plan is willing to pay on behalf of employees within the plan. This is usually set as a percentage of the employee's basic salary.

This can be a set/fixed level of contribution, or a variable level of contribution based on different factors such as the level of contribution the employee is willing to pay, the age of the employee or the employee's length of service.

AN EMPLOYEE CONTRIBUTION

This is the contribution that employees who are members of the DC plan will pay.

Usually expressed as a percentage of basic salary, this rate can be a fixed level or a variable level, depending on the rules of the scheme.

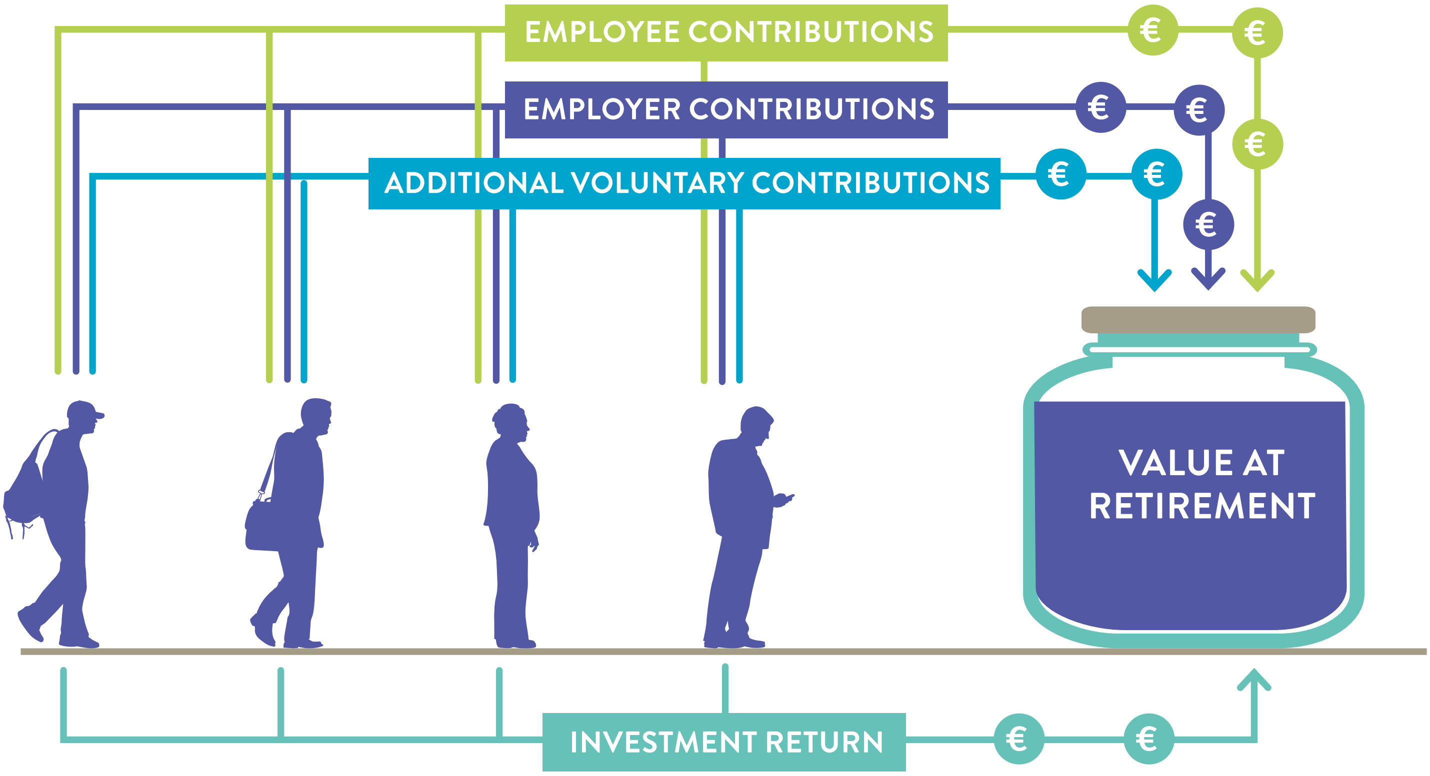
An employee contribution is any contribution employees are obliged to pay in order to be included in the plan or any contribution which impacts on the employer's contribution in the plan.

AN ADDITIONAL VOLUNTARY CONTRIBUTION (AVC)

An AVC is an extra contribution made to the DC plan by members that they are not obliged to pay under the rules of the plan.

This extra savings amount by the member has no impact on the contribution that the employer is paying.

Employee contributions as well as AVCs qualify for tax relief for the employee, within Revenue limits.



OTHER FACTORS

The above elements are the key factors of any DC plan contribution structure, but are often not the only factors that make up a plan's structure. Other elements that can often come into play include (but are not limited to):

Is plan membership and a minimum level of contribution into the plan compulsory for employees?

Is there a minimum age or service requirement prior to becoming eligible for contributions?

Are employer contributions linked to a matching structure in order to encourage higher employee contributions?

MOST PREVALENT

CONTRIBUTION STRUCTURES

As the market leading provider of occupational Defined Contribution schemes in Ireland, Irish Life's experience of administering DC schemes gives a unique insight into how Defined Contribution schemes around Ireland are operating. Our experience shows that the range of contribution levels and structures that exist within the Irish DC market is quite diverse.

AVERAGE CONTRIBUTION RATES

The average contribution rate across all DC schemes managed by Irish Life in terms of average at scheme level and average at member level is shown in the table here:

	Employer Contribution Rate	Employee Contribution Rate	Additional Voluntary Contribution Rate
Average at scheme level	5.1%	3.3%	0.7%
Average at member level	6.1%	4.0%	0.7 %

Source: Irish Life data, 2018

MEDIAN CONTRIBUTION RATES

The median contribution rate across all DC schemes managed by Irish Life is shown in the table here:

	Employer Contribution Rate	Employee Contribution Rate
Most Common Scheme Contribution Structure	5%	5%

Source: Irish Life data, 2018

The most common contribution structure across all schemes is a 5% Employer contribution with a 5% Employee contribution, with any additional contribution from employees being classified as an Additional Voluntary Contribution.

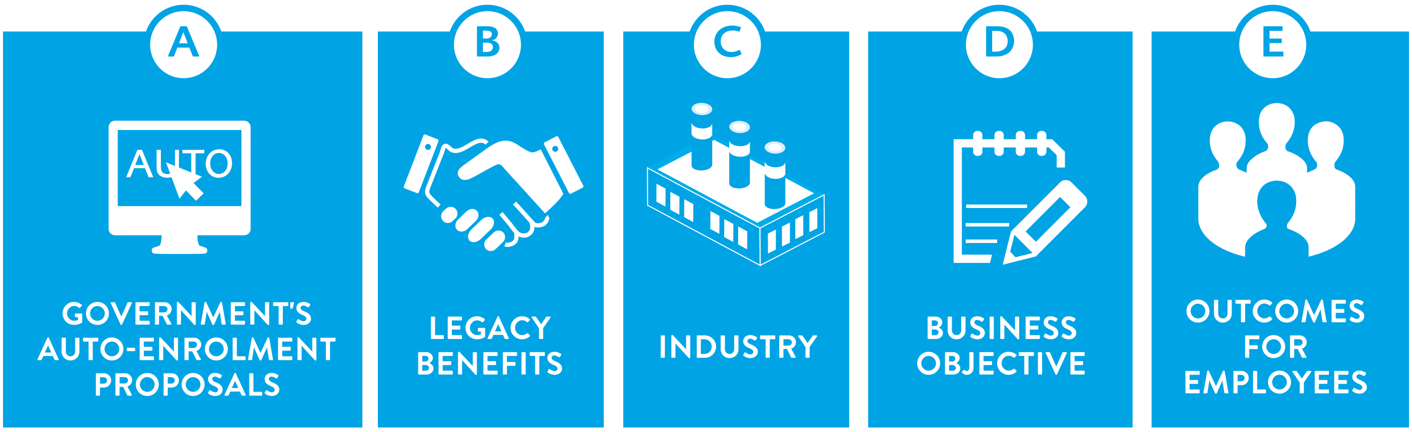
However, the most common contribution structure is not a once size fits all solution and doesn't work for all companies, nor will it differentiate a company when it comes to their pension plan offering.

IMPACT FACTORS

SETTING CONTRIBUTION LEVELS

There are a number of factors to consider when deciding on the contribution level of a company pension plan which is why there are a wide range of structures used by Irish employers operating DC schemes.

As choice architects of DC plans, trustees and employers play a vital role in setting savings habits and guiding employees to better outcomes at retirement. Below, we examine some of the factors that an employer will take into account when setting their plan contribution structure.



A IRISH GOVERNMENT'S PROPOSAL FOR AUTO-ENROLMENT PROGRAMME

A factor that needs to be taken into account by a sponsoring employer looking at its DC plan's contribution structure is the new pension auto-enrolment regime that may be introduced in Ireland over the course of the next few years. In 2018, the Irish Government issued a set of proposals as to how the new auto-enrolment system may work, and a part of these proposals was a contribution structure set out in the table below:

Year of Implementation	Compulsory Employer Contribution Rate	Compulsory Employee Contribution Rate	Government 'Top-up'
2022	1%	1%	0.33%
2023	2%	2%	0.66%
2024	3%	3%	1%
2025	4%	4%	1.33%
2026	5%	5%	1.66%
2027	6%	6%	2%

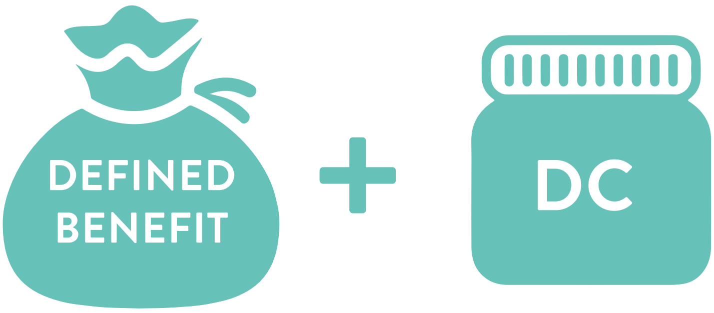
The current proposed end-point for an auto-enrolment compliant scheme is a 6% employee contribution being matched by a 6% employer contribution with a 2% Government top-up. These figures are currently just proposals and what is actually implemented may vary from these proposals. However, employers do need to take these rates into account when reviewing their current contribution structure or especially when they are putting a contribution structure in place for a newly-established scheme. The proposal by the Government is likely to become the new standard contribution structure that companies will offer.

(B) LEGACY PENSION BENEFITS

What legacy pension benefits (if any) were in place within the company previously?

Often the biggest influence on the contribution structure on offer within a DC plan is what (if anything) has come before in terms of pension provision.

For many companies, the DC plan they now have in place for their employees is a direct or indirect replacement for a Defined Benefit (DB) plan that has been partially or fully closed down. This means that employees may find themselves in a position of having retirement benefits from multiple arrangements within the company.



Defined Benefit plans, which provide a proportion of an employee's earnings for every year of service within the company, have traditionally required a high employer contribution.

Companies setting up a DC plan to replace a DB plan often offer relative high employer contribution rates to the replacement DC plan.

The table below compares Irish Life's entire DC plan book with the Irish Association of Pension Funds (IAPF) figures from a survey of 60 DC schemes which were replacement plans for legacy Defined Benefit plans. It illustrates the increased level of employer contribution on offer in DC schemes that have been put in place to replace DB schemes.

	All schemes administered by Irish Life	IAPF 2018 Survey of DC Schemes that replaced DB Schemes
% of Employers contributing 6% or more	33%	86%
% of Employers contributing 8% or more	19%	68%
% of Employers contributing 10% or more	10%	50%
% of Employers contributing 15% or more	less than 2%	8%

Source: Irish Life & IAPF Survey 2018

C INDUSTRY

What industry does the company operate in?

The industry a company is operating in also has a big impact on the contribution level on offer within a DC plan. Within some industries, such as pharmaceutical or financial services, the level of employer contributions to company pension plans has traditionally been higher than the average.

There are a number of potential reasons for this:

1. A prevalence of DB schemes within the industry in the past.
2. A dominant company within the industry setting a high bar for contribution levels and effectively forcing all competitors to follow suit with a strong pension plan offering.
3. Or a limited labour supply which is only attracted by a top class benefits package including pensions.

These are just some of the potential reasons why DC plans within a particular industry might be more likely to offer above average contribution structures. Whatever the reason, the industry a company operates in has a major bearing on where they pitch their contribution structure.

Average contributions by industry (looking at all schemes with 50-plus members)

	Employer Contribution	Employee Contribution	AVC Contribution
Financial Services	8.9%	3.5%	0.8%
Pharmaceuticals	7.9%	4.6%	0.9%
Construction	6.9%	4.4%	0.8%
Manufacturing/Mining	6.7%	3.9%	0.8%
Transport/Logistics	5.8%	4.7%	0.6%
Food & Drink	5.6%	3.6%	0.6%
IT/Tech	5.6%	3.8%	1.3%
Private Hospital	4.6%	3.4%	1.0%
Retail	4.5%	3.6%	0.8%

Source: Irish Life data, 2018

Ⓓ BUSINESS OBJECTIVES OF PENSION PLAN

All companies who operate company pension plans for their staff have certain objectives in terms of what they want that plan to achieve. Operating and sponsoring a DC plan on behalf of employees represents a significant cost to employers. It is only natural to expect a return for that investment. How a company structures their DC plan in order to achieve that return will depend on the company's overall business objectives.

These are some examples of business goals from a sponsoring employer's point of view, and how these may impact the structure of the company pension plans:

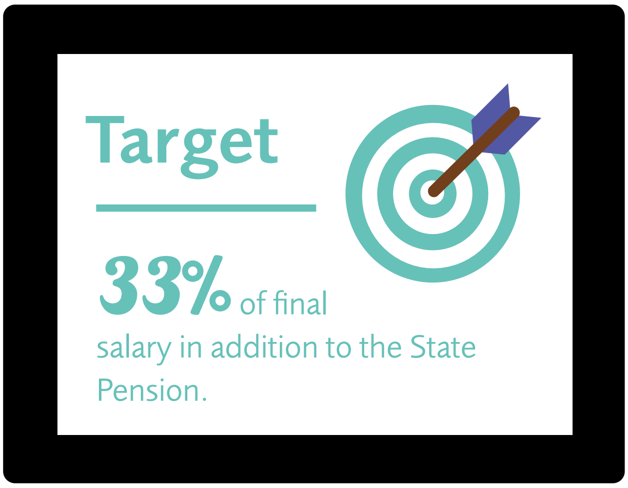
Business Objective	Impact on DC Plan Structure
Attracting new staff	Ensure contribution structure is generous compared to industry competitors.
Rewarding long-serving staff	Set contribution structure where employees are entitled to a higher employer contribution rate once they've attained a certain length of service with the company.
Ensuring older staff can retire at a reasonable age with a good pension	Ensure that the contribution structure in place is likely to deliver adequate outcomes for employees when they reach retirement.

Once an employer has a clear idea what they want to achieve, creating a DC plan structure becomes easier.

E OUTCOMES FOR EMPLOYEES

Whilst the previous section outlines what employers who sponsor DC plans are aiming for in terms of outcomes from the DC Plan they're sponsoring, employees who participate in those plans will have their own goals also. From an employee's point of view, a satisfactory outcome from their DC plan is an adequate pension when they reach their retirement age.

Everyone's idea of 'adequate' is likely to differ somewhat but, at Irish Life, we feel that members of DC plans should be aiming for a pension of 33% of their salary plus the State Pension at retirement.



In reality, many contribution structures across company pension plans will not yet deliver this level of pension for plan members so it's important to outline the type of structure that is capable of delivering that sort of outcome. The table below outlines the level of contribution required to hit that 33% target depending on when an employee enters employment.

Percentage of salary needed to meet 33% target pension of salary at age 65

Age of joining	25	35	45	55
Employer contributions	7.5%	11%	17.5%	38%
Employee contributions	7.5%	11%	17.5%	38%

Source: Irish Life data, 2018

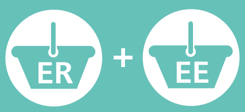
Assumptions for calculations:
These figures assume a salary at age 25 of €35,000, salary increases of 2% per year, 40% tax relief, and investment growth of 4% per year. Based on this worker contributing 10% of their salary to their pension (5% employee + 5% employer), this worker would retire at 65, with an escalation of 1.5% p.a., an interest rate of 2% p.a., no spouse pension, and a 5-year guaranteed period. Annual income would be payable for life. This annuity rate is calculated in line with guidance from the Society of Actuaries in Ireland.

FOCUS ON

MATCHING CONTRIBUTION STRUCTURES

There is a trend amongst larger employers operating DC plans to put in place contribution structures with a matching element. That is a structure where employers match or partially match employee contributions up to a certain percentage of salary.

Even amongst matching contribution structures, there are quite a few variations. For example:

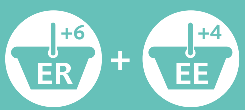


EMPLOYER MATCHING EMPLOYEE RATE

The employer matching exactly the employee contributions
(e.g. Employer matches Employee rate up to 5%)

EMPLOYER MATCHING MULTIPLE OF EMPLOYEE

The employer matching a multiple of employee contributions
(e.g. Employer pays twice Employee's rate)



EMPLOYER MATCHING EMPLOYEE PLUS AN ADDITIONAL PERCENTAGE

The employer matches the employee contribution plus x%
(e.g. Employer pays 6% if employee pays 4%, Employer pays 7% if employee pays 5%)

EMPLOYER MATCHING A FRACTION OF EMPLOYEE

The employer matching a fraction of employee contributions
(e.g. Employer pays half the Employee's rate)

A matching contribution structure promotes an element of engagement from employees and encourages employees to take responsibility for their own pension outcomes at retirement. From an employee's point of view, a high employer contribution is obviously important.

Traditionally in Ireland, an employer partially (rather than fully) matching their employees' contribution leads to less employees availing of the maximum available employer contribution. However, as we've already seen, this type of matching by an employer is less common in Ireland than it is in other countries. In the US for example, where employers commonly match 50% of what employees are paying, employees are very likely to go to the contribution rate required to get the maximum available employer contribution.

Employers generally want a structure which encourages employees to avail of the maximum available employer contribution whilst not discouraging employees from making AVCs on top of those contributions.

The table below is an analysis of DC plans administered by Irish Life:

Structure	% of Members in schemes making AVCs
Employer Matches Fraction of Employee Contribution	7.5%
Employer Matches Multiple of Employee Contribution	5.7%
Employer matches Employee contribution exactly	13.5%
Employer matches Employee contribution exactly plus a fixed extra %	8.2%

Source: Irish Life data, 2018

The straight matching structure is the one that leads to the highest rate of AVCs amongst members. Part of this is likely due to the fact that the other structures have higher employer contribution levels which may mean employees getting this higher employer contribution don't see the need to make AVCs. This may lead to a level of complacency on the part of employees who feel that the additional employer contribution being made negates the need for AVCs, when in reality that may not be the case.

FOCUS ON

DEFAULTING TO HIGH CONTRIBUTION LEVELS

Inertia can be turned into a positive when employers are considering default contributions for their staff. Contribution levels are a good starting point when considering how to boost payments towards a pension. In the following example, companies A and B both offer contribution systems in which the employer is matching employee contributions by up to 7%.

In **Company A**, staff start paying the default 5% of their salary. They can increase the level of payments to avail of up to 7% of matching contributions paid by the employer. In **Company B**, all staff are automatically added at the maximum contribution rate of 7%, matched by the employer.

EMPLOYER	A	B
CONTRIBUTIONS AVAILABLE	UP TO 7% FROM EMPLOYER	UP TO 7% FROM EMPLOYER
DEFAULT CONTRIBUTION RATE FOR MEMBERS JOINING THE PENSION PLAN	MID-RANGE 5%	MAX 7%
STAFF AT MAXIMUM CONTRIBUTION RATE	32%	88%

Source: Irish Life data, 2018

The result of being automatically enrolled at the higher contribution rates are remarkable:

- In **Company A**, only 32% of people decided to pay the higher contributions needed to get the maximum employer matching contribution of 7%.
- In **Company B** however, 88% of people stayed with the default decision, at a higher cost level.

This shows that most people will not deviate from the decision that the employer has made for them, they stay in the plan and make the higher contributions.

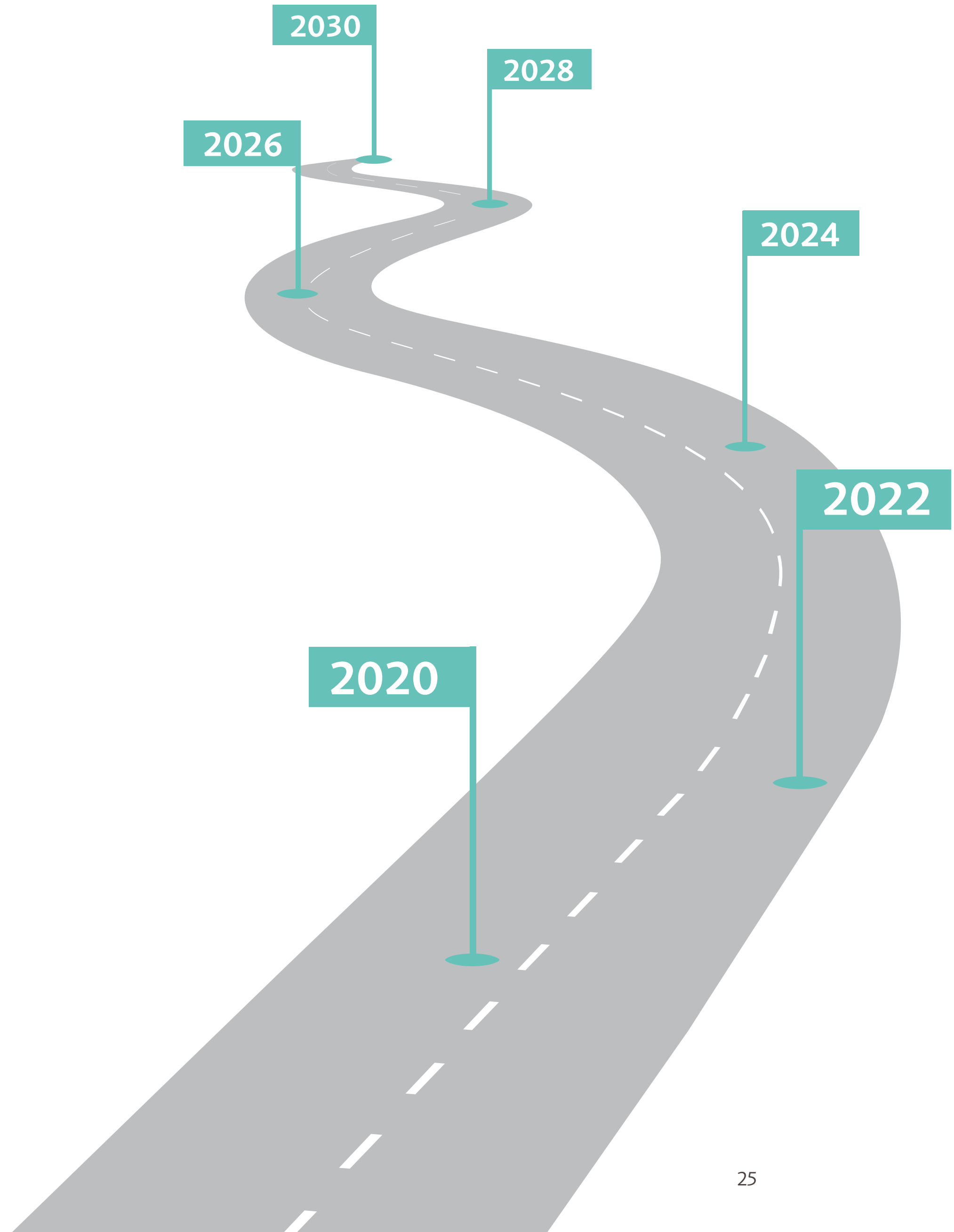
It's important to default people to high contribution rates right from the start.

FOCUS ON

COMMITTING TO FUTURE CONTRIBUTION INCREASES

What if employees could commit now to increasing their pension contributions at some point in the future.

- One way to encourage people to save more is to let them ear mark future salary increases as increased pension contributions.
- Another approach is allowing members to commit to increasing their contributions now for some point in the future, regardless of changes to their salary.
- Both of these methods often appeal to employees who want to save more but don't want to commit to doing it right now, but would rather commit to doing it at some point in the future.



COMMIT TO INCREASING CONTRIBUTIONS NOW FOR SOME POINT IN THE FUTURE

A recent trial of this initiative saw

54%

increase

in the amount employees were saving for retirement

Source: Irish Life data, 2018

62%

of people

would commit to putting future salary increases into a pension, if their employer made it easy for them.

Source: Coyne Research December 2017

FOCUS ON

SERVICE/AGE RELATED CONTRIBUTION STRUCTURES

Another common feature of DC plans, especially amongst larger employers, is the presence of age or service related criteria when it comes to the level of employer contribution an employee is entitled to. This generally takes the form of a structure that starts at a certain level, say straight matching up to 5% of an employee's salary, but then once 10 years company service is attained, the employer contribution moves from 5% to, for example, 10%.

Companies may decide to do so to try to ensure people with ten years or more service are more likely to stay in the company, or to reward those employees who remain employed for a long period of time.

Looking at retaining staff as a potential reason for putting these structures in place, we have researched schemes where there is a higher employer contribution after 10 years of service compared to schemes with no change in contributions throughout membership in the DC plan. Increasing employer contributions after an employee has reached a certain length of service has little or no impact on the likelihood of retaining that employee in the years after the higher employer contribution kicks in.

Another reason that DC plans implement service-related higher employer contributions is to reward longer service staff for their loyalty to the company, whilst saving some costs on employees who aren't employed for as long. Whilst attempting to reward people for long service is a noble intention, the question is whether these types of structures actually deliver on that.

Take a DC plan member who starts in a company (and immediately joins the DC plan) at age 25, on a starting salary of €50,000, and remains in the company for the rest of their career until their normal retirement age of 65. The figures in the table on the next page, illustrate that aiming to reward longer service with service-related structures may not always achieve that aim.

Service/age related contributions

	5% employer + 5% employee contribution with extra 5% employer contribution after 10 years	Contributions not related to service/age 8.5% employer + 5% employee
Final Value	€655,620	€669,970
Employer Cost	€222,595	€212,471
Member's Pension at Retirement Age	€24,780	€25,320

Source: Irish Life data, 2018

Assumptions for calculations:
These figures assume a salary at age 25 of €50,000, salary increases of 2% per year, 40% tax relief and investment growth of 4% per year.

The first examples is service/age related and based on 5% employer + 5% employee contribution with extra 5% employer contribution after 10 years. The second, non-service/age related examples is based on 8.5% employer + 5% employee contributions without increases after 10 years.

In both examples the employee would retire at 65, with a pension escalating 1.5% p.a., an interest rate of 2% p.a., no spouse pension, and a 5-year guaranteed period. The annual income would be payable for life. This annuity rate of 4% is calculated in line with guidance from the Society of Actuaries in Ireland.

As the figures above illustrate:

- The non-service or age related contribution structure of a straight 8.5% employer contribution with a 5% employee contribution delivers a higher fund for the member at retirement age. The cumulative effect of starting to safe a higher amount from an earlier age outperforms the perceived benefit of increased employer contributions as a result of long service with the company.
- It does so with a lower cost to the employer, than the service-related contribution structure.
- If the ultimate aim is to reward long-serving staff, a higher employer contribution from the outset delivers a better outcome for the employee, at a lower cost for the employer.

Warning: These figures are estimates only. They are not a reliable guide to the future performance of your investment.

CONCLUSIONS AND RECOMMENDATIONS

As outlined throughout this report, there is no one contribution structure which represents the ideal structure for all companies in all scenarios. The proliferation of contribution structures on offer across the DC plans administered by Irish Life tell the story of companies creating contribution structures to fit the business environment they operate in.

Companies need to take into account upcoming regulatory changes, prevailing structures within their industry, the labour market challenges facing them, the characteristics of their workforce and the particular business challenges they're looking for their DC plan to help them tackle in order to choose a contribution structure that works for them.

However, apart from the nuances of every individual company's situation, there are some guiding principles that should be taken into account when deciding on a contribution structure for a DC Plan:

What works well:

- The highest possible level of employer contribution will lead to best possible outcomes for employees. Based on our figures on page 15, a contribution structure which delivers a total contribution rate of around 15% is required to deliver a target pension of 33% of salary, assuming members start their savings journey in their twenties.
- Straight-matching contribution structures lead to more engagement in terms of employee savings rates and AVCs. Straight matching works better than fixed-level structures or even matching structures with higher employer contribution rates.
- Defaulting employees into the plan at a high contribution level works because most people's inertia will keep them at this level. This works better than forcing employees to make an active decision to increase their contributions.

What doesn't work so well:

- The traditional 5% Employer/5% Employee contribution structure will not differentiate a company when it comes to pension plan offering because of the prevalence of such a structure.
- The traditional 5% Employer/5% Employee contribution structure will also not deliver an adequate outcome at retirement for members of DC plans.
- Service-related contribution structures have little impact on staff retention rates around the time that higher contribution rates kick in.
- Service-related contribution structures are often constructed in a way to lead to an inferior outcomes at retirement with a higher employer cost when compared to a fixed-level structure.

Irish Life will work with you to design, implement and communicate the best possible solution for you employees and your company.

NOTES

NOTES

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6581cb (NPI 1-19)