

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

COMMITTEE FOR EMPLOYMENT & SOCIAL SECURITY

SECONDARY PENSIONS: DETAILED PROPOSALS FOR THE INTRODUCTION OF
AUTOMATIC ENROLMENT INTO PRIVATE PENSIONS AND THE ESTABLISHMENT OF
"YOUR ISLAND PENSION"

The States are asked to decide:

Whether, after consideration of the policy letter entitled 'Secondary Pensions: detailed proposals for the introduction of automatic enrolment into private pensions and the establishment of "Your Island Pension"', dated 27th December 2019, they are of the opinion:

1. That a duty should be imposed in legislation on employers to ensure that eligible employees are automatically enrolled in a qualifying pension scheme ("the auto-enrolment duty"), as described in section 1, into which employers and employees shall be required to make defined minimum contributions.
2. That the imposition of the auto-enrolment duty on an employer should be phased in by reference to the number of employees that are employed by that employer, as described in Appendix A.
3. That the defined minimum contributions of employers and employees into a qualifying pension scheme should be increased over seven years from introduction, as described in Table 1 in section 4.
4. That exemptions to the auto-enrolment duty and the attendant duty to make defined minimum contributions should be specified in legislation, as described in section 8.
5. That the sharing of relevant data between the Revenue Service and other government and regulatory bodies and agencies should be permitted through legislation for the purpose of monitoring and enforcing employers' compliance with the auto-enrolment duty and the payment of minimum contributions, as described in section 17.
6. That a pension scheme ("the Scheme") should be established as described in section 3, and that further to this:

- a. a statutory corporation should be established to act as the Trustee of the Scheme;
 - b. the rules governing the scheme and the operation of the Trustee should be publically available, and established and amendable by the Committee *for* Employment & Social Security;
 - c. the governing board of the Trustee should be appointed by the States of Guernsey on the recommendation of the Committee *for* Employment & Social Security;
 - d. the Policy & Resources Committee should make available on demand, a loan facility in favour of the Trustee, on such terms as the Policy & Resources Committee may agree, for the purpose of providing financial support to the Trustee until such time that it becomes financially independent;
 - e. any necessary minor legislative changes are made to ensure that the Trustee and the Scheme may be licensed by the Guernsey Financial Services Commission as appropriate, and are subject to the same regulatory requirements (subject to any necessary modifications) as other comparable pension providers.
7. That Smart Pension Ltd, or a subsidiary of Smart Pension Ltd, should be appointed to deliver administrative and custodianship services to the Scheme, as described in section 14, and in furtherance of this:
- a. the Committee *for* Employment & Social Security should have authority to contract with Smart Pension Ltd to develop these services until such time as the Trustee is established and can assume responsibility for the delivery of administration services, and
 - b. to direct the Policy & Resources Committee to make available on demand a loan facility of £800,000 in favour of Smart Pension Ltd, on such terms as the Policy & Resources Committee may agree with Smart Pension Ltd, for the purpose of establishing the scheme.
8. To direct the Committee *for* Employment & Social Security to report back to the States within six months with proposals for enforcing employers' compliance with the auto-enrolment duty and the payment of minimum contributions, as described in section 17.
9. To direct the Committee *for* Employment & Social Security, after consultation with the Revenue Service and the Trustee, to report back to the States by 2025

with an update on the introduction of these proposals, and proposals for the introduction of an auto-enrolment system for self-employed and non-employed people.

10. To direct the Policy & Resources Committee to investigate the best way for the States of Guernsey to fulfil its obligations as an employer under these rules, and make any changes to the public sector pension scheme it deems necessary, following consultation with the members of that scheme, to comply with the proposed legislation.
11. To direct the Policy & Resources Committee to consider the impact of the auto-enrolment duty when preparing the budget for 2021 onwards.
12. To direct the preparation of such legislation as is necessary to give effect to these propositions.

The above propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

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The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

27th December 2019

Dear Sir

1. Introduction

- 1.1. The 2015 debate on the Personal Tax, Pensions and Benefits Review¹ directed that a report should be produced to establish policies that would meet the objective of improving pension provision and encouraging saving for later life. This was delivered in February 2016 through a policy letter entitled 'Proposed development of a secondary pensions system for Guernsey and Alderney'². The 2016 policy letter set out the rationale for an auto-enrolment pension system and sought in-principle agreement from the States of Guernsey ("the States") to establish such a scheme in Guernsey and Alderney. The policy letter also set out, at high level, some of the operational and structural decisions that would need to be considered.
- 1.2. The States approved the principle of introducing the Secondary Pensions Scheme ("the Scheme") in 2016. This policy letter provides the detailed proposals for the introduction of the Scheme. It is expected that these proposals will come into effect in 2022.
- 1.3. As a community, the Bailiwick finds itself faced with the challenge of an ageing population. It is a problem faced by jurisdictions all over the world, particularly in the more developed economies. However, the scale of the

¹ Billet d'État IV of 2015, Article 1

² Billet d'État III of 2016, Volume 3, Article 15

challenge is greater in the Bailiwick than it is in many other jurisdictions. In 2017, there were roughly 3.3 people of working age for every person of pensionable age. By 2060, it is projected that there will only be 2.3 people of working age for every person of pensionable age³. Maintaining this population balance will be difficult, which is why the States must plan for the future and ensure that today's working population are given opportunities and assistance to prepare for a more financially secure retirement.

1.4. The proposals for an auto-enrolment Secondary Pensions Scheme, set out in this policy letter, can be summarised with three intended outcomes:

- 1) Where not already in place, to require that **employers establish suitable pension arrangements for their employees**. Under these arrangements, all employers will be obliged to pay at least a minimum contribution towards a secondary pension for their enrolled employees.
- 2) To require that **employers automatically enrol eligible employees**⁴ in their workplace pension scheme. The proposals also provide that employees can opt-out of their secondary pension scheme following auto-enrolment (and employers will not be obliged to contribute in respect of employees who have opted out), and re-enrol at a later date.
- 3) To facilitate the establishment of a **new, low-cost secondary pensions scheme, open to all Bailiwick employers and workers**, to enable employers who do not currently offer a workplace pension to provide access to a scheme that is compatible with these proposals, and to ensure that everyone can access a high-quality, affordable pension product.

1.5. The first of these outcomes is intended to ensure that all eligible employees have an opportunity to make contributions to their own pension, without duplicating the workload for employers who are already providing pension arrangements for their employees. Many employers already offer workplace pensions, and will be entitled to continue using those schemes for the purpose of these proposals, provided that they meet the qualifying criteria listed in Part One of this policy letter. Some changes to enrolment practices, to ensure that employees are enrolled automatically as set out below, will also be required.

³ Based on data contained in table 3.2.1. of the Annual Guernsey Population Projection Bulletin, issued in June 2018

⁴ The definition of 'eligible employees' is discussed in section 6.

- 1.6. All employers, including those who offer a qualifying pension scheme, will also be required to make an appropriate contribution on behalf of their enrolled employees. In the first year of the policy, the statutory minimum contribution (by employer and employee) will be an amount equivalent to 2% of an employee's earnings, of which not less than 1% must come from the employer. This figure will gradually increase over the following seven years. The final statutory minimum figure will be a contribution equivalent to 10% of an employee's earnings, of which not less than 3.5% must come from the employer. More information is included in section 4.4.
- 1.7. There are important reasons why employers must make a reasonable contribution to their employees' secondary pension scheme. Employees are far more likely to remain enrolled if given an economic incentive to do so. The combination of the income tax relief provided by the States and the prospect of a co-contribution by the employer, provides a powerful incentive for the employee to remain opted into a qualifying pension scheme. The employer's contribution allows the fund to build to a substantial pension over a working life. Evidence from the UK suggests that individuals are far less likely to opt-out of a scheme, if they realise that they will lose their employer's contribution by doing so.
- 1.8. The second outcome is intended to improve participation by establishing an "enrolled by default" position. Employers will have a legal duty to ensure that all eligible employees are automatically enrolled into a workplace pension. The employee's contributions will be deducted directly from their pay and sent to the pension scheme along with their employer's share of contributions. The employee will not need to complete any forms, will not need to register, will not need to select a pension scheme, and will not personally need to transfer any money. If the employee wished, they could have absolutely no engagement with their pension whatsoever, until they wished to retire.
- 1.9. Free choice is not at risk here, because employees will have a right to opt-out at any time. A huge amount of potential pension saving is lost, at present, because people either do not have access to a suitable pension scheme, or do not take the active steps necessary to participate in one. There are also those who would not personally take active steps to save, but, if auto-enrolled, would not have strong enough reasons to take the time to opt-out. The proposals set out in this policy letter are similar to the UK's policy, which has been in operation since 2012. The UK's experience has been that, of those automatically enrolled, only 9% opt-out⁵. The increase in personal pension

⁵ "Automatic Enrolment Review 2017: Maintaining the Momentum", Department for Work and Pensions, 18 December 2017, p 33, <https://www.gov.uk/government/publications/automatic-enrolment-review-2017-maintaining-the-momentum>

saving has been dramatic, and has gone a long way to addressing under-saving for retirement.

- 1.10. The third outcome is intended to ensure that all employers can access at least one affordable pension scheme, so that they can fulfil their duty to enrol their employees in a qualifying workplace pension scheme. This pension scheme will also be obliged to take voluntary contributions from any self-employed and non-employed people who wished to opt-in. This pension scheme will be called “Your Island Pension”, or YIP for short.
- 1.11. Those who have some awareness of the UK pension market will recognise this as similar to the National Employment Savings Trust (NEST) scheme, a pension fund whose establishment was facilitated by the UK government. There will be a degree of States’ oversight during the formative years of YIP, but it is hoped that the scheme will achieve more autonomy as the fund stabilises and becomes self-sustaining. As stated above, this scheme will also accept additional voluntary contributions from self-employment and non-employment sources, as set out in section 16.
- 1.12. Should the propositions accompanying this policy letter be approved, the target date for the scheme coming into effect is 1st January 2022. At this point employers with 25 or more employees will be obliged to comply with their auto-enrolment duties. Employers with a smaller number of employees will see their auto-enrolment responsibilities phased in over the 15 months following. This schedule allows approximately six or seven months for primary legislation to be drafted to govern secondary pensions and auto-enrolment in the Bailiwick, and additional time, particularly for smaller employers, to prepare to meet their new obligations. The Committee considers it vitally important to press ahead with these provisions as quickly as practically possible. It is vitally important that momentum is not lost⁶. A schedule is appended at Appendix A, which sets out the proposed timescale for auto-enrolment duties to come into force. Employers will be able to meet their obligations before the duties come into force if they wish to.
- 1.13. The Committee will prioritise the establishment of the new Secondary Pension Scheme, YIP, with a view to fully launching the scheme up to six months ahead of the introduction of employers’ auto-enrolment obligations. This will allow time for employers who do not currently offer a (qualifying) workplace pension scheme to manage the one-off workload of signing up to the new scheme, and subsequently enrolling employees, at a time most appropriate for them, rather than completing the sign up process during seasonal busy periods.

⁶ Comment from the Law Officers’ Chambers on the proposed timescale is included at section 21.

- 1.14. The terminology of pensions is confusing. The terms often used in general conversation do not necessarily align with the technical uses of those terms. For the benefit of the reader and the avoidance of any doubt, a short glossary is appended to this policy letter at Appendix B.

2. Need for a Secondary Pensions Scheme

- 2.1. Guernsey's current pension arrangements are not sufficient to enable all individuals to have a comfortable retirement. There is an over-reliance on the States old age pension (soon to be formally renamed 'States pension', the term used hereafter), and many individuals in lower-earning brackets are unable to access workplace or private pensions. This means that they are solely reliant on one source of income during their retirement. The States pension is a contributory benefit. The amount that an individual will receive is linked to the number of weekly contributions they have made or been credited⁷. In order to receive the full States pension, an individual must have made or been credited an average of 50 contributions per year over a period of 45 years. Because the total value of the final pension received is dependent on the number of contributions made, not on the value of the funds paid in, the States pension cannot be used to enable people to save more money for their retirement if they wished to.

Role of the States pension

- 2.2. It has been known for some time that while the States pension provides a much-needed safety net, it should be supplemented by other sources of retirement income in order to achieve a comfortable retirement. Policy Letters, at least as far back as 1976⁸ have noted that workplace pension schemes form a vital part of retirement incomes, and that a system reliant solely on the States pension is undesirable. The need for a secondary pension policy is not new, nor is the general concept. There are numerous examples of secondary pensions in other jurisdictions that can be drawn on to guide the development of a solution to this problem.
- 2.3. At present, the Guernsey Insurance Fund ("The Fund") is insufficiently funded to meet the projected demand. In recent years, steps have been taken to slow the decline. This includes the staggered increase of pension age from 65 to 70, between 2020 and 2049, and a revision to the uprating policy. Despite these changes, the Fund is still due to deplete unless action is taken. It seems likely

⁷ In some circumstances, a person can be credited contributions. In other words, they are deemed to have made a contribution even though they have not paid one. Credits are attached to benefits such as sickness benefit. This helps to ensure that ill-health and other such absences from work, do not detrimentally affect an individual's pension entitlement.

⁸ Billet D'État Volume XV of 1976, Article 1, 'Revision of the Social Insurance Scheme and Health Service Contributions', Paragraph 77.

that the necessary solution would be to increase contribution rates in order to maintain benefits at their current level.

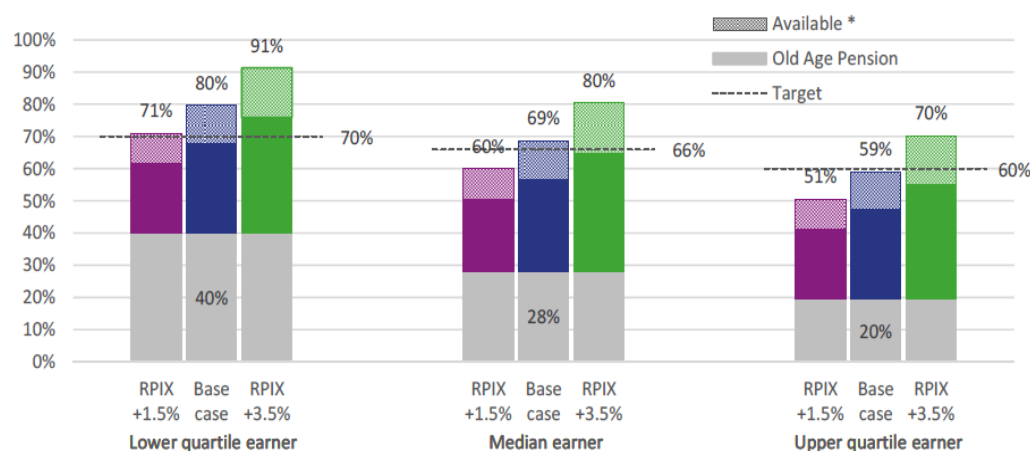
- 2.4. The reason that the Guernsey Insurance Fund is projected to deplete, is because of changing demographics. Like many other jurisdictions, Guernsey operates a 'pay-as-you-go' model for its social insurance funds. This means that today's worker pays for today's pensioner. The worker is not saving for their own future, but rather they are paying for others, in the expectation that when their time comes, the next generation will pay for them. This pay-as-you-go model is effectively an inter-generational contract. In a demographically balanced society, with a constant rate of employment and population growth, this works well. Our community is not demographically balanced.
- 2.5. The baby boomers began to reach retirement age in 2011 and the number of pensioners in our community is increasing, but there are fewer people entering the workforce to replace them. The number of individuals claiming a States pension is growing, and the number of individuals contributing to funding those States pensions is expected to decrease. Put simply, this means that every worker will have to pay more for the States pension to be retained at the same real terms value. Fortunately, a financial reserve has built up over time. This reserve will soften the blow, but the ultimate result is that, in order to maintain the real terms value of the States pension, contributions must increase. The funding of the social insurance funds is a matter commented on annually in the Committee's uprating report. The introduction of the secondary pension policy is not an attempt to reduce or replace the existing States pension. The proposal of a secondary pension policy is intended to supplement existing sources of pension provision, to increase overall retirement income and create a more stable system for the future, not to change existing sources of retirement income.
- 2.6. The States pension is not a trivial amount; in 2020 a full rate States pension will provide about £11,500 per annum (£222.58 per week). In 2020, more than £130m will be paid; it is one of the largest single annual expenses of the States of Guernsey. States pension expenditure is more than 100 times greater than the expenditure on unemployment benefit. Despite this, £11,500 per annum alone is simply not enough for a pensioner who lives in rented accommodation. The vast majority of that income would be swallowed up in rent, leaving the pensioner in need of Income Support in order to bring their income up to a more sustainable level. For comparison, the full rate of the UK's new State Pension is £168.60 per week, although this is earned after only 35 years' of contributions. There are also legacy elements of the UK's state pension schemes which provide significant additional benefits, but these are based on contributions made prior to 2016 and as such will be of little to no benefit to younger generations. In order to be eligible for the full rate

Guernsey States pension, an individual must have paid or had credited an average of at least 50 weekly contributions per year over a 45 year period. It should be noted that many people do not achieve the maximum rate of pension. Fewer than 25% of pensions are paid at the full rate.

Replacement rates

- 2.7. When assessing the quality of retirement income, it is useful to discuss this in terms of 'replacement rates'. A replacement rate is the amount of retirement income an individual has compared to their pre-retirement income. So an individual, who was earning £30,000 per annum prior to retirement, and has a retirement income of £15,000 per annum, could be said to have a replacement rate of 50%.
- 2.8. Replacement rates are important because there is no 'fixed' amount of income that every person would agree could provide a comfortable retirement. An individual is likely to determine whether their retirement is comfortable based on how much their lifestyle changes. If they find themselves with less than 50% of the income they had become accustomed to, they are likely to find their circumstances unsatisfactory, even though they may be significantly above the level of relative poverty, and above the threshold for Income Support. It is therefore important when talking about long term saving and retirement planning, to consider that there may not be a "one size fits all" approach to suitable levels of retirement income.
- 2.9. With that said, people with a lower income prior to reaching pensionable age are clearly less able to afford to make concessions in their lifestyles when they retire. An individual who already has to live frugally has less opportunity to make further cost of living savings. Additionally, an individual with a lower income is more likely to live in rental accommodation and therefore have higher housing costs into retirement. Because of this, it is appropriate to conclude that lower earners need to achieve a higher replacement rate, relative to their pre-retirement income, in order to fund a comfortable retirement.
- 2.10. Graph 1 overleaf, taken from the economic impact report appended to this paper, shows the impact that the introduction of secondary pensions would have on the replacement rate of scheme members in different income brackets. The variant options outside the base case show how weaker or stronger investment returns would affect the value of the fund. It can be clearly seen that membership of a qualifying pension scheme would significantly increase the retirement incomes of those who benefit from it.

Graph 1 – Income replacement rates by earning bracket (base case is RPIX +2.5%)



* depending on lump sum taken from Secondary Pension

- 2.11. Based on core assumptions, the graph above projects that a person investing in a secondary pension between the ages of 25-70, who would otherwise only receive the States pension, could see replacement rates rise from 40% to 80% for a lower quartile earner and from 28% to 69% for a median earner. What can be seen from this graph is that the policy is projected to provide a significant enhancement to retirement income across the spectrum but lower income households in particular are likely to achieve a much more comfortable retirement if saving can be facilitated.
- 2.12. The graph above is an excellent demonstration of why the States pension is important. Even for an active saver under this scheme the States pension can make up 50% of their retirement income and take them over half the way to achieving their target replacement rate. With that said, sole reliance on the States pension is not viable without a very significant increase in the rate it is paid at. Even a significant contribution rate increase, leading to a higher States pension, would still fail to meet the retirement needs of the median earner.

The pillars of pension saving

- 2.13. The idea of a multiple pillar retirement was first proposed by the World Bank in 1994⁹. It suggested that three pillars should be used to support retirement income: the first being State-provided pensions, the second being occupational pensions and the third being personal pensions. Each of these systems of savings has its own benefits and advantages. With these three pillars, or at least more than one in place, a stable retirement income can be achieved whereas a single pillar is likely to be wholly insufficient. Many OECD

⁹ World Bank (1994), Averting the Old Age Crisis, page 15

countries are trying to reinforce their 3 pillar strategy. Countries such as Ireland and Poland are looking to establish their own auto enrolment schemes, and as noted above, the UK's scheme has been operating since 2012.

- 2.14. As noted above the first pillar provides a vital safety net. Unlike the other pillars it tends to provide benefits irrespective of the employment situation of the recipient. Those in employment earn their entitlement through contributions. Those outside of employment for a period, for instance a career break to raise children, are often able to earn contribution credits. However the first pillar has a number of drawbacks. In the case of Guernsey and many other jurisdictions, it is a pay-as-you-go system, which means it becomes less affordable if there is a generational imbalance. People pay into the scheme on the expectation of receiving a pay out, but there is no money allocated in their name. The States pension is not related to an individual's earnings, it does not scale according to the value of the contributions paid by the individual. The States pension is also more rigid than other schemes. It only becomes payable once an individual reaches a certain age and there is no option to claim early, or defer claiming in order to generate a better retirement income.
- 2.15. The second pillar (occupational) provides earnings-based pensions. The combination of contributions by employees and employers ensures a degree of personal responsibility while also supplementing and improving the savings that an individual could make on their own. The nature of this policy is that individuals save for their own pension, rather than contributing on a pay-as-you-go basis for the generation ahead of them. Second pillar pensions are also generally more flexible than the first pillar; it is quite common to have a range of ages at which benefits can be drawn. As second pillar schemes are earnings-based, however, it is difficult for a lower earner to build up sufficient retirement earnings without the re-distributive effect of the first pillar.
- 2.16. The third pillar provides for more flexible arrangements than the other two pillars. For instance the chance to transfer larger amounts at a time to suit the saver, for instance inheritance or a bonus, as well as non-cash assets such as rental properties. It is also suited to those who are self-employed or non-employed who may not be able to access a second pillar. Typically, it is the wealthiest in society who are most able to access these third pillar schemes.
- 2.17. Each of these pillars has its own inherent strengths and weaknesses. Used together these weaknesses can be offset and a better, more consistent retirement income can be achieved. At present Guernsey, particularly in the case of lower income individuals, has an over-reliance on the first pillar. The policy of introducing a secondary pension scheme in Guernsey would significantly expand the availability of second pillar scheme membership as well as making an affordable third pillar pension scheme available to all island

residents. The net effect would be a far more financially stable environment for retired people in the Bailiwick and a more sustainable method of funding retirement incomes through demographic instabilities.

How the policy would support a better retirement

- 2.18. The secondary pension project aims to reinforce the availability and quality of second pillar pensions. This policy would require all employers to make a workplace pension available to all their employees, subject to very few exceptions. The employer would be required to enrol all eligible employees by default. Personal freedom is maintained, as employees can opt-out at any time, but an enrolled-by-default position is expected to maximise savings without removing personal choice. Qualifying pension schemes would be subject to certain quality conditions, together with a requirement for minimum statutory contributions from both employer and employee.
- 2.19. At present it is estimated that around one third of island households containing employed or self-employed people are contributing to a second or third pillar pension¹⁰. As it presently stands, the Island's private pension market is populated by a large number of Retirement Annuity Trusts (RATS). These schemes offer considerable freedom. Investments can be tailored at the request of the member, loans can be made from the scheme, and significant lump sums can be drawn from them upon retirement. Some providers offer standardised RATS at cheaper costs tailored towards smaller fund sizes, but ultimately the nature of these schemes and the volumes required to make them profitable under a viable charging structure, means that there are few private pension arrangements which are affordable for lower earners. The same can be said for workplace, second pillar, pension schemes: smaller employers, with relatively lower-earning employees, may well struggle at present to find a pension scheme with an appropriate charging structure.
- 2.20. Auto-enrolment for all eligible employees should generate significant retirement savings, while "Your Island Pension" will ensure there is an appropriate savings vehicle available for everyone to use. It should be noted that there is a significant chance that the existing pension provider market will expand in response to these proposals. In the UK, after the implementation of auto-enrolment, a number of new and existing providers launched products specifically targeting auto-enrolment. The Committee expects that a number of local providers will develop products for this new market.

¹⁰ Estimate based on 2017 e-census data. Due to the method of extracting this data, there is a small margin of error, estimated to be 1%-2%.

Impact on income support

- 2.21. The introduction of the secondary pension scheme would bring about substantially increased retirement incomes for many islanders, particularly for lower earners many of whom would struggle to access a suitable pension product without it. With these increased retirement incomes comes a reduced need for States support. As indicated in section 20, over the long term this scheme will reduce income support expenditure, some pensioners will have a reduced financial need, but those younger individuals who take advantage of this policy over their entire working life, in many cases will not need income support at all. The policy allows people to take control of their retirement planning. By implementing this policy the States would be taking a financially responsible step, and empowering islanders to take a personally financially responsible step as well.
- 2.22. The remainder of this policy letter is in four parts. The first part (Sections 3 – 5) sets out how existing workplace pensions can become qualifying secondary pension schemes for the purpose of these proposals, as well as the minimum contributions that will be required from employers and employees. The second part (Sections 6 – 11) deals with auto-enrolment, opting-in and opting-out of secondary pensions. The third part (Sections 12 – 16) explains the establishment, governance and funding arrangements for the proposed new, affordable and universally-available secondary pension scheme, "Your Island Pension". Other matters, such as enforcement, the territorial scope of the proposals, and their cost and economic impact, are set out in the fourth and final part (Section 17 onwards).

PART ONE: QUALIFYING PENSION SCHEMES

3. Scheme requirements – structural

- 3.1. Under these proposals, every employee will be automatically enrolled in a secondary pension scheme: either one which is already provided by their employer, or the new "Your Island Pension" scheme. This section explains the requirements that existing workplace pension schemes will need to meet, in order to fulfil the qualifying criteria for this purpose.
- 3.2. It is vital that the schemes which eligible employees are enrolled into are of a good quality and enrolment is facilitated by the employer. Certain kinds of workplace pension approaches run counter to the objective of this policy: for instance requiring an employee to find or establish their own scheme, which removes the automatic part of auto-enrolment. There will need to be rules about which schemes will qualify from a structural standpoint as well as a quality standpoint.
- 3.3. Qualifying schemes will have to be an 'approved scheme' for the purposes of section 150(1) of The Income Tax (Guernsey) Law, 1975. A scheme which is approved under Section 150(2) of that Law will always be a qualifying scheme provided appropriate contributions are made into it. These schemes are traditional occupational pension schemes, established by one employer to benefit their employees. The employer must be a contributor to the scheme, and the employee may also contribute, depending on the arrangements.
- 3.4. Retirement annuity trust schemes (RATS) which are approved schemes under section 157A of The Income Tax (Guernsey) Law, 1975 could be qualifying schemes subject to certain conditions. In order to qualify, the RAT would have to be employer-facilitated, i.e. a RATS selected or established by the employer into which all employees, or all employees of a given category, are auto-enrolled. There would be no requirement for the RATS to be exclusive to one employer, so a multi-employer group RATS would be permissible.
- 3.5. As well as meeting the criteria above, the qualifying scheme rules must facilitate the auto-enrolment process by allowing for eligible employees to be enrolled with minimal requirements personally to provide any information to the pension scheme administrator or trustee, or make any decisions. This means that there should be default investment strategies, and that employers must be able to provide relevant personal details to the pension scheme administrator or trustee, on behalf of their employees. Amending legislation will need to be drafted so that the sharing of data for this purpose will be permissible under GDPR rules.

- 3.6. There will of course be exceptions where the scheme administrator or trustee may need to request further information from the employee prior to enrolment; however these will be limited to circumstances where the administrator has a legal obligation to do so. For instance, they may require further information or documentation to meet their anti-money laundering obligations. It should also be noted that there is no reason why employees could not be presented with choices, such as their preferred investment strategy, or an option to transfer funds from other pensions upon enrolment, provided that a lack of action in relation to these choices does not prevent the eligible employee from being enrolled.
- 3.7. For clarity, where an employer already has a pension scheme which meets the qualifying scheme test there will be no requirement for the employer to set up an alternative, provided that the scheme can be adapted to comply with general auto-enrolment duties.
- 3.8. The Committee is aware that there are a significant number of less formal pension arrangements already in place. Employers may pay their contribution directly into a RATS which the employee has either established or joined in a personal capacity. This policy does not intend to undermine existing good practice by employers seeking to provide workplace pensions for their employees, provided that such good practice can be demonstrated and compliance enforced. The Committee intends to make arrangements, whereby an employer would be able to contribute to an employee's existing 'personal' RATS in lieu of enrolling them in a qualifying scheme. In order to take advantage of this provision the employers' and employees' contributions would need to be made directly to the RATS and the contributions would need to be at least in line with the minimum statutory contribution rate. There would also be a requirement for both parties to consent to the arrangement; if either party did not consent then the employer would be obliged to enrol the employee into a qualifying scheme.
- 3.9. A further requirement would be that all qualifying schemes must be regulated by the appropriate financial services regulator. In many cases this would mean the Guernsey Financial Services Commission (GFSC). Recognising the nature of Guernsey's international finance industry and the fact that many businesses offer the same pension arrangements as they do for UK or the other Crown Dependencies, it would also be acceptable for an employer to use an appropriate pension scheme located in any of those jurisdictions, provided they are approved for Guernsey income tax purposes. Regrettably international schemes located elsewhere would not be acceptable. This is largely because it is simply not possible to monitor the pension rules in all jurisdictions and ensure that there are sufficient protections to ensure compliance with the regime.

- 3.10. At present some individuals receive a discretionary allowance as part of their salary, the intention being that the employee should take this sum and invest it in their pension scheme (rather than having a designated workplace pension). It is difficult to monitor this practice in the context of auto-enrolment and there is no significant advantage to the individual arising from this approach. Under these proposals, employers will be required to contribute directly to a qualifying pension scheme in respect of their employees.
- 3.11. There are a number of ways to fund the administration and governance of a pension scheme. Charging structures can include: fixed annual charges, a percentage of the funds held, a percentage of contributions made, as well as a range of other one-off charges. In other jurisdictions, charge caps have been introduced for qualifying pension schemes to ensure that appropriate value for money is delivered for scheme members. The issue with these caps is that there is always a risk that providers who currently charge less than the cap, will increase their fees to match the cap. Charge caps can also be quite difficult to understand when multiple charging structures are used in one scheme. Therefore, the Committee is not minded to introduce any extensive criteria related to charging at present. However, the Committee is proposing drafting legislation in such a way that the addition of charging restrictions could be made easily at a later date. It is hoped that the local market will be sufficiently competitive to keep charges at a reasonable level. However there is always the potential for abuse, and experience may prove it necessary to introduce restrictions on certain charging practices if they prove to be to the detriment of scheme members. The Committee must be sure that it can respond promptly and effectively if required.
- 3.12. All employers will be required to find and contribute to a qualifying pension scheme for their employees. However, they are not obliged to use a "one size fits all" solution. Employers will be free to use multiple qualifying schemes if they wish, or offer different qualifying pension schemes to different eligible employees so long as all arrangements meet the minimum requirements set out in these proposals. Examples of acceptable differing practices might include higher employer contributions or contribution matching for certain employees, as part of the employer's overall approach to remuneration. Or, in the case of employers currently offering a defined benefit scheme, they may wish to offer a defined contribution scheme for those on shorter contracts, because, for example, it can be complex to calculate the value of that defined benefit pension on transfer and to provide benefits to someone who has only accrued a very small entitlement.

4. Scheme requirements – quality

- 4.1. These proposals aim to ensure that people who have saved into a secondary pension throughout their working life are able to receive an adequate pension once they retire. In order to achieve this, it is necessary to set a minimum amount (the "minimum statutory contribution") that employers and employees will be required to save into their pension on a regular basis.
- 4.2. It is proposed that minimum statutory contribution levels have a phased introduction over an 8 year period. Although this will slow the accumulation of individual pension pots, it will reduce the immediate effect on an individual's take home salary and on employer's costs. Phasing in the minimum contribution requirements will allow time for employers and employees to adjust and is intended to reduce the risk of opting-out and prevent a serious economic shock to the local economy.
- 4.3. Once the phasing-in has been completed, the final combined contribution from employer and employee will be an amount equivalent to 10% of the employee's salary, of which not less than 3.5% must be contributed by the employer. This final combined contribution rate, together with the staging points for its introduction on a phased basis, have not changed since the 2016 policy letter. In the long-term, once the scheme is mature, approximately one-third of the total 10% contribution will normally be made by the employer and two thirds by the employee (see table 1 overleaf).
- 4.4. Contributions will function identically to social insurance contributions in respect of definition and applicable limits. Employers will not be obliged to auto-enrol an employee or make contributions on their behalf if the employee's gross earnings in a relevant pay period are less than the pro-rata social insurance lower earnings limit, which in 2020 is £144 per week (£7448 per annum). Once gross earnings exceed that threshold, contributions become payable on all earnings up to the upper earnings limit, beyond which contributions are not applicable. The upper earnings limit in 2020 is £2,880.00 per week (£149,760 per annum). This is explained in more detail in section 6.

Table 1 – Proposed phasing of statutory minimum contribution rates as a percentage of employee gross earnings

| Category | Contributions for the Applicable Year | | | | | | | |
|-----------------|---------------------------------------|-------------|-----------|-----------|-----------|-----------|-----------|------------|
| | Launch Year | +1 | +2 | +3 | +4 | +5 | +6 | +7 |
| Employee | 1% | 1.5% | 2% | 3% | 4% | 5% | 6% | 6.5% |
| Employer | 1% | 1% | 2% | 2% | 3% | 3% | 3% | 3.5% |
| Total | 2% | 2.5% | 4% | 5% | 7% | 8% | 9% | 10% |

- 4.5. Employers may contribute more than their statutory minimum contribution levels if they wish. Indeed, many employers with existing schemes that could qualify as a qualifying pension scheme already contribute at a rate above the minimum. Contributions in excess of the applicable minimum made by the employer can be used to offset the minimum contribution made by the employee, but not vice-versa. For instance, if an employer chose to contribute an amount equal to 10% of earnings, the employee could pay nothing. But if an employee contributed an amount equivalent to 9% of their earnings, the employer would still be required to make their 3.5% contribution.
- 4.6. An employer, through a contract of employment, can also arrange for an employee's contribution to be higher than the minimum. For instance, where an employer contributes 6% they could deduct 6% from their employee, generating a total combined contribution of 12%.
- 4.7. These proposals require employees to be auto-enrolled into a pension scheme by their employer. This means the employer is responsible for setting the level of their own contribution, but also the level of contribution to be deducted from their employee's salary, in order to ensure that the minimum combined contribution rate is met or exceeded.
- 4.8. There will therefore need to be safeguards to ensure that unreasonably large sums cannot be deducted from an employee's salary without their express consent. Although it is anticipated that there will be little need for these limits, it is possible that an employer might initiate very large deductions from an employee's salary in order to encourage opt-outs (which in turn would remove the employer's liability to pay their contributions).
- 4.9. It is proposed that the Committee *for* Employment & Social Security is given a power to impose a limit on the contributions that can be deducted from the employee's salary, save for where the employee requests that contribution

rate. This limit may be expressed as a fixed overall percentage, or as a ratio of employer-to-employee contributions. These limits may need to change over time, reflecting the gradual increase in the minimum contribution rate. There will also need to be exceptions for pre-existing arrangements.

5. Defined benefit schemes – quality

- 5.1. In recent times, there has been a general move toward defined contribution schemes for workplace pensions. These are pension schemes where the amount of money available to the scheme member is dependent on the contributions paid in, the level of charges and the performance of the investments. Defined benefit schemes are pension schemes which offer certain benefits which are not limited by a fund size. Instead the benefit is calculated based on the number of years worked and the salary of an employee over a given reference period. As a result, benefits are paid at pre-defined levels (subject to inflationary adjustments) for as long as the pensioner is still alive. The funding mechanisms for these schemes are complex as it requires careful planning: longer-than-expected lifetimes or poor investment returns can result in an underfunding which must be made good over time, and the reverse is also true.
- 5.2. The nature of defined benefit schemes is such that it does not make sense to apply a minimum contribution rate for employers and/or employees to these schemes. An alternative approach must be used to ensure they will provide an acceptable quality of pension to savers on retirement.
- 5.3. The approach used in other jurisdictions is to set out reference tests, to demonstrate that the benefit received by the vast majority of scheme members is greater than the minimum qualifying criteria. Because there are a great variety of benefits offered under these bespoke arrangements, one test will not suffice. There must be variant tests for the less common arrangements.
- 5.4. The Committee does not believe it would be proportionate for Guernsey to set reference tests for all eventualities, as there is only a small number of defined benefit schemes in operation in Guernsey. The nature of a defined benefit scheme is that it tends to be more expensive and more complex than other offerings. Consequently, employers who still offer them are generally very committed to offering a high quality pension for their employees.
- 5.5. In place of setting out formal tests for defined benefit schemes, the Committee proposes that independent certification that benefits for the majority of scheme members are likely to be at least as good as those they would obtain by paying the minimum statutory contribution rate into a defined contribution scheme, must be provided by the employer. It is

proposed that this certificate is provided by an actuary and can be incorporated into actuarial reviews which should occur periodically to ensure funding is stable. The actuary should also note any concerns about scheme funding. Schemes are often underfunded, but concerns should be raised if there is a notable risk of the employer not being able to make sufficient contributions as to enable the scheme to meet its pension liabilities on an on-going basis.

- 5.6. It is also proposed that defined benefit schemes will be exempt from certain requirements of the qualifying scheme criteria that will apply to other schemes, such as applying a specific definition of pensionable earnings. This is because these schemes tend to have their own definition of earnings. But irrespective of the definition, they will in almost all cases provide a benefit equal to or greater than a minimum qualifying defined contribution scheme. To make these schemes change their definition of earnings would be a significant undertaking for the schemes and would be likely to accelerate their closure. Given the high quality of pension provision that they provide, this would be counter to the objectives of the policy.

PART TWO: AUTO-ENROLMENT

6. Auto-enrolment requirement – eligible employees

- 6.1. One of the most important elements of this proposal is the requirement on employers to automatically enrol their eligible employees (subject to certain criteria, and the ability to opt-out, as discussed further below) into a qualifying secondary pension scheme. Auto-enrolment is considered to be key in encouraging a sufficient number of people to save, at a sufficient level, to result in decent replacement rates (which the States pension alone cannot secure) for many people in retirement.
- 6.2. The two most significant criteria for determining who an employer must auto-enrol are age and earnings. If an employee is 16 or older (but below pensionable age¹¹) and earning in excess of the social security lower earnings limit in a given pay period (£144 per week or £7,488 per annum), the employer will generally be required to auto-enrol its eligible employees.
- 6.3. For the sake of clarity, an ‘eligible employee’ is generally an employee who is resident in Guernsey,¹² earns in excess of the social security lower earnings limit and is not a member of an excluded category of employee. Employers will not be obliged to conform to these requirements for employees located outside of Guernsey. The location of the employer will be immaterial. In certain circumstances an individual who is off island for a short period due to a secondment might still be deemed Guernsey resident. This will be in line with the existing practice for social security contribution liability.
- 6.4. For the purposes of auto-enrolment, ‘earnings’ would have substantively the same meaning ascribed to it by the Social Insurance (Guernsey) Law, 1978. This is a broad definition which includes commission, bonuses, overtime payments and other such remuneration. It is a definition which employers will already be familiar with and therefore should be no more difficult to calculate than is currently the case.
- 6.5. An employer will have to enrol an employee into a qualifying pension scheme once the employee’s earnings have exceeded the lower earnings limit. Like social security contributions, this is a cliff edge: should an employee’s salary exceed the lower limit, all their salary is subject to the contribution requirement, not just the earnings in excess of the limit.
- 6.6. If an enrolled employee earns less than the lower earnings limit in a given pay period, there will be no requirement for either the employer or the employee

¹¹ ‘Pensionable Age’ is the defined age at which a person can claim a States pension. It is presently 65, but from 2020 will increase by two months every ten months between 2020 until reaching 70 in 2049.

¹² Or Alderney, should the States of Alderney wish to extend this policy.

to make a contribution for that pay period. Of course, if an employer chooses to, it will be permitted to make a contribution on behalf of the employee.

- 6.7. The definition of earnings will also be subject to the social security upper earnings limit, which in 2020 is £2,880.00 per week (£149,760 per annum). There will be no requirement for employees or employers to make contributions in respect of earnings above this limit. This serves two purposes. Firstly the alignment with social security should make payroll processing easier and immediately understandable to anyone familiar with local social security deductions. Secondly, individuals earning above the Upper Earnings Limit are likely to be able to provide for a very comfortable retirement without the need for further assistance from their employer. Once again, there is nothing to prevent contributions being made above this threshold, on a voluntary basis, should the two parties make those arrangements.
- 6.8. Employers will be permitted to defer enrolling a qualifying employee for a maximum period of 3 months. But to do so they will be required to provide notice to the employee of their intention to do so. There will also be provisions to ensure that employers cannot abuse this provision by employing people on consecutive short term contracts. This is explained further in section 11.
- 6.9. Finally, employers will not be obliged to automatically-enrol an employee into a pension scheme if the employee is in full-time education, including higher education. This exclusion is proposed for a number of reasons. Firstly, a student employee may well earn significantly below the annual lower earnings limit, but much of their income is often clustered during academic holidays, during which time they may exceed the earnings threshold, even if just for a few weeks once or twice a year. There seems very little benefit in enrolling an employee for the sake of a few weeks, particularly when they may be using their limited income to pay tuition fees or term time living expenses.
- 6.10. As well as earning comparatively little per annum in their jobs, student employees are also unlikely to stay with any one employer for very long, resulting in either multiple, very small and soon-to-be-depleted funds, or repeated opt-outs on the part of the employee. Both circumstances are unlikely to generate a positive attitude to pension saving in the future, which may result in an increase in opt-outs. The reason for specifying full-time education rather than a higher age limit is simply because education is not solely the pursuit of younger people. Some people spend longer in education, or take a break between various stages of their education and the Committee believes the grounds remain equally valid in most cases.

- 6.11. Employers will have to give notice to employees of their enrolment. This notice will explain the details of the enrolment, including who the administrator will be and how employees can find information about the qualifying pension scheme. It must also contain information about the eligible employee's right to opt-out, and their right to a refund, as will be explained in section 8. The employer should keep some record of receipt of the opt-out from their employee and will be required to retain that for a period of up to 7 years in line with retention policies for other employer obligations.
- 6.12. In the interest of full disclosure it should be noted that there may be a small number of special exceptions not specified above. For instance, it may be the case that serving members of HM armed forces would be exempt from the definition of employees. In this case a comparatively good pension provision is already available and the extension of this provision would likely just create unnecessary complications.

7. Application to self-employed and non-employed individuals

- 7.1. In the 2016 policy letter, it was proposed that the automatic enrolment process would be carried out through the social security contribution collection system. Secondary pension contributions would have been charged and received alongside social security contributions. This would have applied to all active contributors below pensionable age, irrespective of whether they were employed, self-employed or non-employed.
- 7.2. When originally proposed, the Secondary Pensions Scheme would have required auto-enrolment for any individual below pensionable age, with earnings in excess of the social security lower earnings limit. This would have included self-employed and non-employed¹³ individuals. It is now proposed that the Scheme only apply to employed persons. Collection through the social security contribution system was found to be more complex than first thought. The legacy contributions software system is difficult to amend in the required way. A new Revenue Service platform is being developed, but waiting for this to be implemented would be likely to lead to an unacceptable delay in implementing the project. It would also further complicate what is already a complex project.
- 7.3. As well as these implementation difficulties, it also became apparent that the quarterly collection cycle for social insurance contributions would have left significant sums collected but not yet paid into the relevant pension fund and as a result not invested. Scheme members would have seen 3 months' worth of contributions deducted from their wages but would not have seen any

¹³ For clarification a non-employed person in this context would be an individual who has income from a non-employment source. For instance those with income from a rental property.

contributions in their accounts. It was feared that this would lead to a higher opt-out rate and a lack of faith in the system. It also would have left those funds not invested and unable to earn returns. The cumulative effect of having so much sitting dormant and not invested at any one time would have led to diminished returns, particularly over a lifetime of saving. Lastly, collecting the secondary pension contributions together with the social insurance contributions would not lend itself to the situation where employers may choose to pay higher rates of secondary pension contributions as an employee benefit.

- 7.4. It is now proposed that employers be obliged to pay into schemes directly, with the scheme providers taking responsibility for collection and ensuring the funds are transferred into the appropriate investments promptly. A benefit of this arrangement is a clear separation between the States pension and individuals' secondary pensions. Money paid by an individual under the Secondary Pensions Scheme is their own money, which will become their retirement income, and it is important that this is recognised.
- 7.5. Without the States collecting contributions, it is difficult to introduce any kind of meaningful enforcement of auto-enrolment for self-employed or non-employed people, as they would be required to select and enrol with a provider themselves. There would be no mechanism by which they could be enrolled in a default scheme in the event they did not actively select a provider. At most, this would simply be self-employed and non-employed people reporting their pension arrangements (or lack thereof) to a government department.
- 7.6. It should be noted that the States-facilitated scheme ("Your Island Pension", discussed below) will be open to all self-employed and non-employed people to make both periodic and/or lump sum contributions to. This will ensure that no self-employed or non-employed person feels they cannot save for retirement simply because there is no financially viable product available to them.
- 7.7. The Committee is still firmly of the belief that the Secondary Pensions Scheme can deliver significant benefits to self-employed and non-employed people. However, given the additional difficulty of introducing these provisions for a comparatively small part of the population, the Committee believes it is advisable to return to those provisions at a later date and not delay the benefits that can be achieved for employed people now. This will also allow time to review the implementation of the auto-enrolment policy and determine whether that is the most effective means of incentivising retirement saving among these groups.

- 7.8. The economic impact assessment conducted by BWCI and appended to this policy letter is based on the assumption that self-employed and non-employed people would be auto-enrolled. Although this has changed, the Committee still consider it appropriate to append it without amendment, given that the great majority of savers would always have been employed people. The impact assessment still provides an indication of the direction of travel and overall impact the Committee expects this Policy would have, should the proposals be agreed. As the "Your Island Pension" scheme will be available for voluntary contributions, it remains possible that pension saving among the self-employed and non-employed will increase significantly once these proposals are introduced.
- 7.9. As a consequence of narrowing the application of this scheme, it is necessary to define 'employed people'. For this purpose, substantially the same definitions used in the Social Insurance (Guernsey) Law, 1971 and its subordinate legislation will be used. In other words, the scheme will apply to any individual obliged to pay social insurance contributions at the employed person's rate, otherwise known as Class 1 contributions. This links to a long-established definition which would already need to be considered in all cases where there is uncertainty about a person's employment status.

8. The right to opt-out

- 8.1. It is proposed that, subject to any contractual arrangement between the employer and employee, every qualifying employee will have the right to opt-out of the qualifying pension scheme which they are auto-enrolled into. They do not have to give a reason why, and provided that they opt-out within 6 weeks of being enrolled, they will be entitled to a full refund of their contributions, as will their employer in relation to its contributions for that employee.
- 8.2. In practice, refunds could be made in one of two ways. The first option is that contributions would be transferred into the fund by the employer during the opt-out window. It would then be the responsibility of the administrator of the pension scheme to transfer the funds back, either directly to both parties or through the employer. The second option is that contributions would not be collected by the scheme administrator during the opt-out window. Once the right to opt-out and claim a refund has expired, all outstanding contributions (which may have been held by the employer up to that point) must then be paid by the employer to the administrator. The Committee believes it is best for administrators and employers to agree their preferred approach between themselves and either option will be permissible.
- 8.3. Irrespective of which option is chosen, a refund of contributions must equal the contributions initially made. In other words, if the scheme collected the

funds and invested them, any money gained would be the scheme's to retain and any money lost would need to be made up by the scheme. The Committee expects that, because of this complication, schemes that collect contributions will retain them as cash for the first 6 weeks.

- 8.4. The reason for permitting opt-outs is to allow eligible employees to make decisions based on their own personal circumstances. Ultimately there are many situations where it is a financially prudent decision not to pay into a pension scheme, even if that means waiving an employer contribution. An example could be where someone chooses to prioritise paying off credit card debt because of the much higher interest rate they are paying on it.
- 8.5. If an employee opts-out, their employer will no longer be obliged to contribute to the scheme on that person's behalf. There will not be any obligation on the employer to pay an equivalent sum directly to their employee in lieu of making a contribution.
- 8.6. In order to opt-out, individuals will be required to contact the administrator of the pension scheme or their employer, in line with whatever procedures their scheme applies. The employer would be required to keep records of opt-outs for inspection, though in practice the employer may choose for the administrator to keep these records on their behalf. Opt-out records could not be a note of a verbal conversation, there would need to be a record of an active decision by the employee, whether that is written or digital.
- 8.7. The Committee is acutely aware of the impact these proposals may have on those whose finances are already stretched. Fortunately those who are in receipt of Income Support already have pension contributions disregarded from their resource calculation. This means that, up to a certain limit, their benefit entitlement will increase proportionately with their pension contribution. Although this creates a greater dependence on the benefit system in the short term, in the longer term it will mean that they will require less support in their retirement. It also means that many of those who have a short term need for additional financial support will not feel obliged to opt-out of contributing towards their pension.
- 8.8. Finally, it is proposed that employers will be permitted to make it a contractual condition that contributions must be made to a pension scheme, with no right to opt-out. This is the case for the great majority of public sector employees, who pay into the Public Servants' Pension Scheme, and that is expected to continue under these proposals.

9. Automatic re-enrolment

- 9.1. Where an individual has opted out, their employer will be obliged to re-enrol them after a period of 3 years¹⁴. If the employee continues to wish to opt-out they will have to complete the opt-out process again. Over the course of three years many people see a significant change in circumstances. Those who may have opted out for perfectly sensible reasons may find they are now able to contribute to their fund.
- 9.2. The Committee considered that in some cases people may be making their own pension arrangements outside of the auto-enrolment scheme, and that they may have valid reasons to opt-out continuously. However the Committee is not minded to propose a more permanent opt-out at this time. This is because there is no resource-efficient way to determine and verify these alternative arrangements. In comparison, a fairly simple opt-out process conducted every three years is not particularly onerous.
- 9.3. In order to minimise the burden on the employer, there will be some leeway with regard to the re-enrolment date. The employer will have to re-enrol the employee within 3 months, commencing on the third anniversary of their original enrolment. This means that larger employers can re-enrol employees in batches on a quarterly basis.

10. The right to opt-in

- 10.1. In addition to those who are obliged to be auto-enrolled, it is proposed to include a right to opt-in for certain individuals. Employers would be legally obliged to enrol these individuals if the individual requested. This would include the following four categories:
- Individuals of pensionable age, who would be eligible but for their age,
 - Individuals who would be eligible, except for the fact that they earn less than the lower earnings limit,
 - Individuals who are in full time education, who would be eligible but for their full time education status, and
 - Individuals who are entitled to be auto-enrolled but who have previously opted out.

¹⁴ The 2016 policy letter proposed re-enrolment every 2 years. After due consideration, the Committee determined that this was too onerous and that the UK's policy of re-enrolment every three years appeared to be a more appropriate rule. This is in line with the current UK obligations.

- 10.2. The Committee believes that individuals who work beyond their pensionable age should be entitled to improve their retirement income whenever they choose to take it. With that said, most people no longer wish to contribute to a pension once they are eligible to draw their States pension, so ongoing auto-enrolment may be a frustration to many. A restriction is placed at 75 years old because the limit for income tax relief is 75. The reason for this limit is to avoid pension schemes becoming tax-free inheritance vehicles. Without the benefit of tax relief on contributions, and given that payments from a pension are themselves taxable as income, it would be a rare set of circumstances for this to be a prudent financial decision for any individual.
- 10.3. In many cases it may not be financially viable for an individual to save if they are earning less than the lower earnings limit. However there may be cases where the individual wishes to. In these circumstances they would have a right to opt-in, though there would be no duty for the employer to make employer contributions on their behalf.
- 10.4. It is also proposed that the right to opt-in is extended to those who are excluded from auto-enrolment due to being in full time education. Though it is expected that relatively few would choose to opt-in under these circumstances, there may be circumstances in which the employee is keen to save and it makes good financial sense. The Committee considers it would be unreasonable to put barriers in the way of a prudent saver.
- 10.5. In the case of the three categories mentioned in 10.2 10.3 & 10.4 above, the right to opt-in would carry no obligation for the employer to make an employer's contribution on behalf of the employee. The employer would only be obliged to deduct the applicable contribution from the individual's salary and pay it into a qualifying scheme.
- 10.6. Individuals who have opted out will also have a right to opt back in. However their employer will not be obliged to enrol them until 6 months have elapsed since the employee opted out. This is to ensure that an individual does not put an undue burden on their employer and the scheme administrator by fluctuating between enrolled and unenrolled at whim.
- 10.7. If an employer were to receive a valid request to opt-in, they would be obliged to enrol the eligible employee in time for the end of the next full pay period unless they defer enrolment. An employer would be able to defer an opt-in request as if that employee had just become eligible for auto-enrolment (i.e. they could delay enrolment for a period of up to 3 months). The process of deferral and why deferral is permitted is explained in section 11.

11. Deferring enrolment

- 11.1. An employer will have a right to defer the enrolment of an employee or any group of their employees for a period of up to 3 months. This period will commence either from the date that the employer is obliged to auto-enrol the employee, or in the case of a new employee, from the date on which the employee is hired.
- 11.2. In order to defer enrolment, the employer will have to provide notice to their eligible employees that they are deferring the employee's enrolment and inform them of the date that they will be enrolled. This ensures that employees are aware of what is happening and confirms that the employer has understood their duties.
- 11.3. The purpose of the deferment is twofold. Firstly it allows the employer to process enrolments in batches if needed. Secondly it means that the employer does not need to enrol those who are unlikely to gain any significant benefit from enrolment (for instance, those on very short contracts of less than 3 months).
- 11.4. If an employer defers enrolment, they must enrol the employee at the expiration of that deferment period, unless that employee no longer meets the auto-enrolment requirements. After the deferment period has expired, employers would be required to enrol employees who have opted in, even if employees do not meet the auto-enrolment criteria.
- 11.5. Provisions would be put in place to ensure that this could not be exploited. For instance if an employer were to rotate an employee's contract between two different companies and attempt to take advantage of a deferral every 3 months. Checks for this would form part of the compliance process. There will also be a route for employees who are concerned that their rights are not being observed to make a complaint which would be investigated.

PART THREE: "YOUR ISLAND PENSION"

12. Your Island Pension – establishment

- 12.1. There are many employers who do not currently offer workplace pension schemes for their employees, and who would not necessarily find it straightforward to set one up without assistance. In order to achieve its aim, this policy requires there to be an appropriate secondary pension scheme available to every worker in Guernsey. An important part of the work leading to this policy letter has, therefore, been the development of plans for a States-facilitated secondary pension scheme that will be open to all savers, especially those who do not have other alternatives.
- 12.2. This new scheme, known as "Your Island Pension" or YIP, will be established with a requirement to provide a service to all islanders and their employers. This extends both to auto-enrolment and voluntary contributions. In other words, the scheme will be obliged to accept any employer wishing to use it for auto-enrolment provisions, as well as any individual wishing to make voluntary contributions into a scheme with the characteristics of a personal pension scheme, irrespective of whether or not they are actively enrolled through an employer.
- 12.3. Transfers into and out of the fund from/to appropriate funds would also be permissible. YIP would not allow any facility for loans, as many retirement annuity trusts (RATs) do. It is anticipated that there will be an option to take a lump sum on retirement. This would be supplemented by the option either to purchase an annuity¹⁵ from a 3rd party provider, or to draw down from the fund at an appropriate rate. This is in line with current practices. Funds invested by a scheme member would be their own, and any remaining sums after their death could provide benefits to their dependants in line with Income Tax rules relating to benefits after death for occupational pension schemes.
- 12.4. The intention of the scheme is not to replace existing providers in the Bailiwick, but rather to offer an affordable pension product with low charges which is available to anyone for both second pillar and third pillar pension provision. It would allow low-income households to save at least a modest amount for their retirement.
- 12.5. In the initial years after establishment it is expected that the scheme's total assets under management will be relatively small. This is largely due to the very low statutory contribution rates in early years. By the end of the first year the scheme is projected to have less than £5 million of total assets. By the end

¹⁵ See Appendix B for a definition of 'annuity'

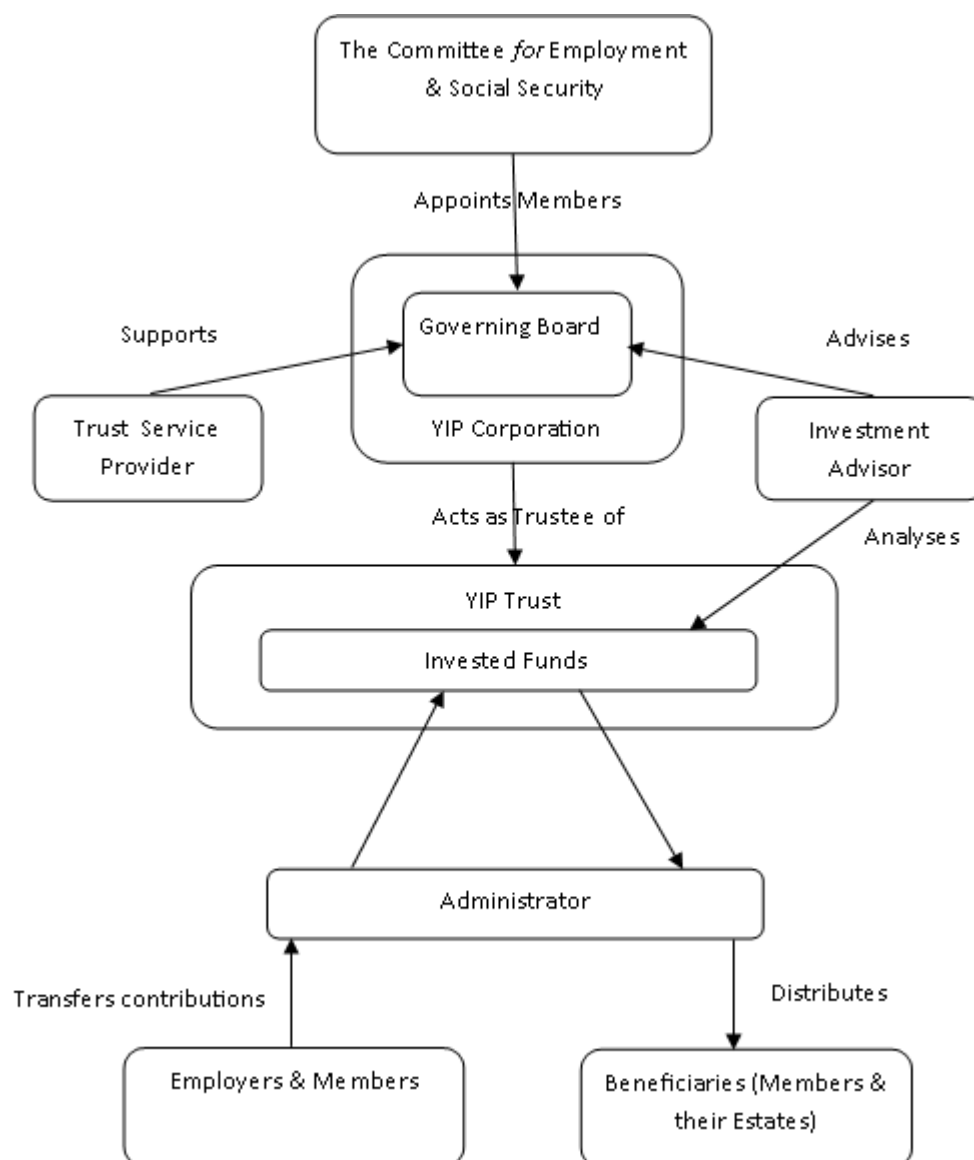
of the 15th year it is expected that the fund assets would be in the £400 million to £500 million range.

- 12.6. In addition to high running costs relative to the size of the fund in its early years, there are also significant establishment costs associated with the scheme. It is clear that, during the early years, the fund will not be able to cover its costs without placing excessive strain on members' contributions. If it was required to be self-funding from the outset, administration costs would far outweigh any investment returns and members would see less money in their accounts than they had paid in. The Committee considers, therefore, that the States need to provide financial support to the scheme in order to offer a good value-for-money package to savers in its early years. This is explained further in section 20.

13. Your Island Pension ("YIP") – governance

- 13.1. A Statutory corporation will be established to act as Trustee of YIP. The Trustee will be managed by a Governing Board. YIP and its Trustee will be legally separate from the States of Guernsey and the States will not be able to access the assets of YIP members. The assets would be held in trust for the benefit of the scheme members and their dependants. The Committee would have a responsibility to appoint the members of the Governing Board of the Trustee. In addition to the governing board there will be several providers contracted by the Trustee to deliver services essential to the operation of YIP. This includes the day to day administration. The diagram overleaf shows this structure in a very simple form.

Figure 1 – Structure of "Your Island Pension Scheme"



- 13.2. The rules governing YIP would be formally set out and available publically. It is intended that any substantial changes to the rules would require the approval of the States, either directly or through power delegated to a Committee. The Trustee would have to obtain a licence from the GFSC to operate, and to operate within the same regulatory environment as its commercial competitors.
- 13.3. The Trustee, through the Governing Board, would have responsibility for the good governance of YIP and would have a fiduciary duty to act in the best interest of YIP members. This would include appointing service providers such as an administrator, a custodian, an investment advisor and an auditor. The Governing Board would be obliged to keep any contracts of service under review and assess performance against any agreed KPIs. The Governing Board

would also be responsible, with the support of the investment advisor, for reviewing the performance of the investment funds and determining which funds should be offered to YIP members, including the default fund. In general it can be said that the Governing Board will hold responsibility for the smooth operation of YIP in its entirety. They will be responsible for oversight and good governance. They are bound to exercise their powers in the interest of the member, not in the furtherance of any corporate or personal interest, or in the interests of any employer.

- 13.4. It is proposed that the Governing Board of the Trustee would comprise a minimum of five members including a chair. The members would be able to form and delegate power to sub-committees which, subject to the requirement that the chairperson of any sub-committee must be a member of the Governing Board, could be comprised of any individuals the Governing Board wished. This would allow the Governing Board to co-opt other individuals to support them in specific areas of business.
- 13.5. The members, including the chair, would be selected in the same manner that appointments are made to other arms-length commercial bodies, such as appointments to the board of Guernsey Water. Given the significant public interest and financial support from the States, the Committee believes it appropriate to retain this level of control during at least the early years of the fund.
- 13.6. The Committee proposes that sitting Deputies and currently-employed public servants are excluded from sitting as members of the Governing Board. As these would be salaried positions, there could be a perception of impropriety if the States were to appoint one of its own. There is also an inherent conflict of interest as the States will be financing YIP in the early years and Trustees should be advocating for sufficient funds to do their work effectively, rather than an amount that suits the States' budget. The exclusion of Deputies and public servants will also help to make the division of responsibilities clear. Though States-facilitated, YIP will be an enterprise which will operate in the commercial world alongside the existing market.
- 13.7. There will be term limits for the members of the Governing Board. A standard term will be not more than three years. Ordinarily a member could serve for not more than six years continuously. In exceptional cases the Committee would have the right to extend an appointment for an additional year. This might be necessary in cases where there had recently been a high turnover of members, and there was a risk of losing institutional knowledge. Initial appointments would be made on a staggered term basis to facilitate a balanced rotation of members of the Governing Board.

- 13.8. In order to ensure that the voices of stakeholders are properly considered, the Governing Board would have a duty to consult with employer and employee representatives in relation to key decisions. These representatives would include unions and business groups and would be further defined in the legislation establishing the scheme. Engagement would include, but not be limited to, consulting on any significant change to the scheme rules.
- 13.9. The Trustee and Governing Board members would be indemnified against losses incurred as a result of their actions made in a professional capacity, with the exception of those actions which would amount to wilful default or fraud. This is common practice and is likely to be a necessity in order to attract high quality candidates for the Governing Board. This is not to say that the positions do not carry the weight of personal responsibility and accountability, and the usual fiduciary and statutory duties and prohibitions would apply to them.
- 13.10. The Trustee will need a budget and staff to facilitate its day-to-day governance operations. This will include roles such as executive support, a designated data protection officer, accountancy, payroll and IT. Having considered the staffing requirements of the Trustee, it appears that it would be inefficient for it to have a full complement of all the required staff to support it. The Trustee would be likely to be able to access a better range of experience on an as-needs basis by employing the services of an existing service provider. It is anticipated that this will also represent better value for YIP members. This would be a contract of service; however, in order to satisfy some conditions of obtaining a GFSC licence, it is possible that the service provider will need to hold some sort of position within the Governing Board. It will ultimately be a matter for the Governing Board to determine the precise nature of how its support is structured. The intention is that the Committee will support the Governing Board through a tender exercise soon after they have been selected.
- 13.11. Additional support will also be provided by way of an independent investment advisor. It is near-ubiquitous to recruit this kind of service for a pension scheme of this size. To do otherwise would be considered poor practice. It will be the Governing Board's responsibility to determine which investment funds are available for YIP members to select, and what the default investment fund will be for those who make no active decision. The investment advisor will support the Governing Board by conducting analysis and due diligence on funds, according to the statement of investment principles set out by the Governing Board. This will mean providing independent advice on the relative risk of the fund and the achievability of the target returns, scrutinising the very technical proposals of investment managers. Ultimately, the independent advisor should give peace of mind to both the Governing Board and to YIP scheme members.

- 13.12. The final service provider reporting to the Trustee will be the Administrator. The Administrator's role is the day to day operation of YIP. They will be the face of "Your Island Pension", operating the vast majority of services that YIP members and employers will utilise. Unlike the other service providers, the proposed Administrator has already been selected for States approval. The details of the administration services are set out in more detail in section 14. The Governing Board will be responsible for ensuring this service is delivered effectively and in compliance with legislation and regulatory requirements.
- 13.13. The usual position for similar funds is that the Trustee's expenses and the cost associated with managing the fund are taken from the assets held in trust. The Committee intend that this should be the case in the long term. However, the nature of the phased introduction of this policy means that in the early years of the fund, the total assets will be relatively small. Paying for Trustee services would put a heavy draw on individual members' assets and deplete a significant proportion of savings in the early years.
- 13.14. The Committee is therefore proposing that the States make a loan to the Trustee in order to fund its establishment and early operation costs. These costs are explained further in Section 20. The Trustee will draw an asset management charge (AMC), which will fall within the headline AMC described in Section 15. On this basis the overall charges will be able to remain comparatively low. In due course, once the fund grows, it may be possible to reduce this charge further.
- 13.15. It will take some time for the Trustee to be established. However, it is proposed that a shadow board should be established in advance. The shadow board would be authorised by the Committee to act as the regular board of the Trustee in respect of the decisions necessary to establish YIP. This would mean that much of the preparatory work to set up YIP could be done while detailed scheme rules are drafted. This could include the selection of an investment advisor and an auditor, securing suitable support by way of employees or a corporate service provider, selecting the investment options available to members, preparing a plan for the scheme launch and preparing a licence application for the GFSC. Once the Trustee was established the shadow board (subject to States approval) would be formally appointed as members of the Governing Board of the Trustee. This will mean that YIP can be launched relatively quickly once drafting is complete.
- 13.16. Because of the unique structure of YIP, it may not fall under some existing legislative definitions, for instance relating to GFSC licencing or Income Tax 'approved schemes'. It is proposed that any necessary minor amendments (or other provision) are made to ensure that YIP can operate in the same fashion, and subject to the same regulatory restrictions as if it were a privately established pension scheme with a regulated licensee as trustee.

14. Your Island Pension – administration

- 14.1. While the Trustee will be responsible for the governance of YIP and will have a duty to act in the interests of members, the Trustee will not be conducting the day-to-day administration of the fund. That work will instead be done by a service provider who will deliver administration and custodian services. Rather than establishing a bespoke organisation to do this, the administration of YIP was a service that was tendered for.
- 14.2. The administration services required include: the operation of a digital portal accessible by members and by employers, the collection of contributions and the allocation of these contributions to the relevant investment funds, the operation of digital and telephone contact points for service users, undertaking due diligence on customers, establishing anti-money laundering processes, and the processing of drawdown and the transfer of funds into and out of YIP.
- 14.3. Having tendered for services during 2018 and conducted an extensive and thorough review of these bids, the Committee proposes the appointment of Smart Pension Ltd to offer administration and custodian services on a 15-year contract. The tender process included an evaluation of all providers on a similar basis, as well as an evaluation of a number of different component services. It was noted that a bundled solution provided by one or more organisations was preferred. In accordance with States of Guernsey procurement rules, the scoring included an allocation for community benefits which gave an advantage to locally-based bidders.
- 14.4. It has been agreed that Smart Pension Ltd's charging structure will work on an asset management charge (AMC) basis. This means that Smart will take a percentage of the assets in the fund, rather than a fixed charge or a percentage of every contribution as it is collected. The charging structure includes no sign-up fees for the employer or employee and the percentage-based charge is a model particularly favourable to lower earners. If target investment returns are achieved, even the smallest pots should not be depleted over time. More information about the overall scheme charges is available in section 15.
- 14.5. Due to the high start-up and development costs, Smart Pension Ltd has requested £800,000 from the States, in order to meet development costs and to share the financial risk in the pre-launch period. It has been agreed that this should be structured as an interest-bearing loan which would be repayable to the States within two years of the launch of YIP.
- 14.6. While a percentage-based charging structure at this threshold offers good value for lower earners, it means that the provider is likely to incur losses in the early years of the fund. In order to make this a viable proposal for service

providers, the Committee therefore determined that it was appropriate to offer a long-term 15 year contract. In order to protect the interests of YIP members, terms have been agreed which allow the charges to adapt if there are significant market changes and the offering no longer represents good value compared to the price of similar services at the time. The nature of the AMC-based charging structure is such that the revenue from the contract will increase year on year. In order to partially offset the tail-end gains, reductions in charges have been agreed should the fund reach certain values. The Committee believes that this proposal represents excellent value for all concerned. Financial matters are discussed further in section 20.

- 14.7. The agreement with Smart Pension Ltd will be structured under two contracts. The first will be a contract for development entered into with the States. This will be an agreement for Smart Pension Ltd to adapt their existing digital platform for Guernsey's needs and to establish suitable procedures for Guernsey business. The second contract will be a contract for services entered into with the Trustee. It is the latter of these that will last 15 years. The development contract is expected to last approximately 18 months. Once the development contract is completed, the contract for services will be entered into and then two years after launch the loan from the States will become repayable with interest.
- 14.8. Employers wishing to use YIP will need to register. This process will require Smart Pension Ltd to complete anti-money laundering checks on the employer; this is in line with GFSC requirements. Employers will have access to a digital platform. This platform will guide them through the steps needed to meet their legal duties. The employer will need to register their employees through the site. This creates a unique user ID and profile for the employee, which can be registered to a work and/or personal e-mail. Employers are able to set up different groups of employees and offer different contribution arrangements for the groups. For instance, if the employer wanted to contribute an amount greater than the statutory minimum contribution, but only for senior employees, that could be done quickly and easily.
- 14.9. The employer can upload their business branding to the platform which would appear to the employee when they log-in to the portal. This will help to ensure the employer's contribution is recognised. It can also be used to generate automated documentation with the appropriate branding, for instance letters and e-mails for employees. Smart Pension Ltd are also able to automate reminders for things such as the re-enrolment of opted out employees. The platform will automatically generate any letters or information that the employer is legally obliged to serve their staff. This further reduces workload and pressure for employers.

- 14.10. Employers will need to upload payroll data every pay period. This data is required to calculate the correct contribution rate. This process can be done in a variety of ways. At the most basic end of the spectrum, a template provided by Smart Pension Ltd can be completed with the required information; this is then uploaded through the portal for the assessment, automatic enrolment and calculation of contributions for employees. If the employer's payroll software assesses pension contribution liability as part of its features and generates a file in the correct format, it may be possible to send this directly to Smart Pension Ltd. Alternatively a file containing this information can be prepared by the employer in the correct format. Finally, Smart Pension Ltd has established relationships with a large number of payroll software providers. Through these relationships they have developed tools which can automate the process with direct integration. These providers include Sage, MyPaye and Quickbooks. Approximately 15 payroll programs already offer some degree of simplified upload process. This degree of simplicity and choice ideally places Smart Pension Ltd to be able to support smaller employers with minimal effort.
- 14.11. Once the correct contributions have been determined, the employer can make a payment through Smart Pension Ltd into YIP. Contributions are made by direct debit. Once the funds are received, Smart Pension Ltd will process the payments ensuring that the amount is correctly allocated to the employee's account and invested either into the default fund or into another investment option that has been selected by the employee.
- 14.12. Employees will be able to access information about their pension through an online portal. The first time they log in they will be asked to submit their personal contact details; this makes it much easier for the pension provider to remain in touch with the employee even if they cease to work for their current employer. The home page of the employee's portal will display basic information, such as how much the employee has currently saved and the contribution rates paid by both the employee and employer. Employees will then be able to access more detailed information, such as how much of their total savings is from their contribution, how much is from their employer's contributions and how much is from investment returns. Annual statements are also provided and Smart Pension Ltd are currently investigating better ways to deliver this information beyond a simple piece of paper with a financial statement. In the future, statements are expected to include infographics and comparisons with peers to provide information in a way which is difficult to contextualise on its own.
- 14.13. Employees will also be able to take various actions through the portal. These actions may include opting out of enrolment or changing investment allocations between a selection of investment options that have been pre-approved by the Trustee. The investment options may include alternatives such as a specific ethical investment fund and more or less aggressive

investment strategies. The precise funds which are to be offered will be determined by the Trustee closer to the launch of YIP, but it is expected that as a minimum they will include lower and higher risk options.

- 14.14. In order to operate in Guernsey, Smart Pension Ltd will be opening a local office staffed with a minimum of two full-time employees as well as locally based directors. Their operations would be subject to GFSC licencing rules. Smart Pension Ltd do not yet have a licence, but will apply for one in due course as part of the development stage. Customer services would primarily be delivered to employers and employees via e-mail, messaging through the online portals, and telephone. At present Smart Pension Ltd's customer services are based in Poole, with most other services being delivered in London. On the rare occasion that face-to-face customer services are required, the locally-based staff could make the necessary arrangements. This would also be true for Alderney-based employers.
- 14.15. The data collected by Smart Pension Ltd would ultimately belong to the Trust, and should Smart Pension Ltd ever be replaced as administrator, there would be procedures in place to transfer all data to the newly-appointed administrator. The data held by Smart Pension Ltd is held securely off island in a state-of-the-art European data storage facility. On-island data storage is not an option at this time due to the integration of the database and Smart Pension Ltd's platform. With that said, the Committee is satisfied that all data held by Smart Pension Ltd would be secure and compliant with all applicable data protection legislation.
- 14.16. More information about Smart Pension Ltd and its general business is provided at Appendix C of this policy letter.

15. Your Island Pension – charging

- 15.1. As previously noted, it is intended to pursue an annual management charge (AMC) only based charging model. This means that the charges will come in the form of a percentage-based deduction applied equally across all funds. There will not be any fixed fees for accessing any aspect of the service. The expected charge will be between 0.85 percent and 0.95 percent. This means that a person with a fund of £1,000 would pay less than £10 in fees for the year. These charges cover administration services, investment management and governance costs.
- 15.2. The Committee is acutely aware that YIP needs to meet the needs of lower-earning employees and smaller employers. Therefore there would be no fixed costs and no sign up fees. From the perspective of the employer, it is free to use. From the perspective of the employee, this model ensures affordable fees even for those with relatively small funds.

15.3. The reason why a specific charge cannot be confirmed at this point is because it will be dependent on the default investment options selected. It should also be noted that if YIP members choose to use a non-default investment option which the Trustee has chosen to offer, that may come with an increased charge. Some investment products, for instance Sharia or Environmental, Social and Governance funds, tend to come with a higher management charge than their more conventional alternatives.

15.4. The nature of this charging model is such that it will produce early losses for both the Trustee and the Administrator. The growth of the fund as contribution rates increase and existing pots build, means that in the medium term the charging model will mirror the 'hockey stick' growth curve of the fund and losses should be recouped. It should be noted that in the long term (approximately 20 years), the fund should have built to a point where early losses will have been recovered and the charging model can be revised downward.

16. Additional voluntary contributions

16.1. In addition to the default enrolment contribution made by the employee, there will also be two ways to make additional contributions. Through YIP's digital platform, employees will have the ability to adjust contribution rates from the default established by their employer. For instance, if an employer had set a default rate of 6.5% contributions by the employee, the employee could adjust this to, say, 10%. To be clear, this feature would be structured so that an employee could not adjust their contribution so that the combined contribution would fall below the statutory minimum. These kinds of adjustments could also apply in contribution matching arrangements, where employers incentivise saving by agreeing to match the employee's contribution up to a certain threshold.

16.2. YIP would also have an obligation to accept contributions directly from an individual, provided they meet certain criteria. The individual would have to be a Bailiwick resident and the sum would have to be over a minimum threshold to ensure it is still commercially viable to process. Individuals making these contributions may have to go through an anti-money laundering check in line with GFSC rules and good practice. These kinds of contributions would be suited to non-employed and self-employed individuals who do not benefit from the auto enrolment provisions. It could also be used in situations where someone comes into a large sum of money, perhaps through inheritance or from downsizing their home. These are options that are currently open for existing pension providers if they wish to offer them. However there would be no obligation for a pension scheme to accept additional voluntary contributions as a condition of being a qualifying scheme for the purpose of auto-enrolment.

PART FOUR: OTHER MATTERS

17. Enforcement

- 17.1. Under the legislation that will bring the Secondary Pensions scheme into effect, a number of offences will be created. Such an offence would be where an employer does not enrol an eligible employee when they are newly employed, are due for re-enrolment, or exercise a right to opt-in. Another example would be submitting fraudulent documentation in relation to auto-enrolment compliance.
- 17.2. There will be legislative requirements to ensure that the employer and employee cannot conspire to make alternative arrangements in lieu of pension contributions, except where the alternative arrangement is a payment made directly by the employer into another pension scheme which the employee had enrolled into privately. This would include circumstances where an employer offers an incentive, financial or otherwise, to opt-out.
- 17.3. It is noted that it may also be appropriate to include further provisions to protect employees' rights, for instance: granting an appropriate body the power to issue civil penalties; providing for employees to be able to pursue an underpayment of their employer's contribution through the courts; and confirming the status of employer's contributions in relation to insolvency proceedings. These enforcement options are not considered further in this policy letter but may be revisited by the Committee in future.
- 17.4. It is proposed that compliance powers similar to those held by the Revenue Service compliance team and the Employment Relations Service should be granted to those responsible for monitoring compliance with the policy. These powers would include the power to compel sight of corporate records and to make on-site visits to employers. Providing false statements or otherwise obstructing an investigation would be an offence.
- 17.5. The Channel Islands Financial Ombudsman (the 'Ombudsman') provides a route of redress for those with a grievance who have been unable to settle it with a financial services provider. Examples could be if a payment was substantially and unjustifiably delayed, or the customer has lost money to fraudsters which they believe the financial services provider should have protected against. The Ombudsman has the authority to investigate a matter and, if it deems appropriate, order the business to pay compensation to the complainant. The present remit of the Ombudsman in Guernsey excludes many workplace pension schemes.
- 17.6. The Committee would be amenable to a proposed expansion of the Ombudsman's role, including the inclusion of YIP. The Committee has raised

the matter with the Committee *for* Economic Development and will continue to work together to assist that Committee in exploring the matter further. The Committee notes that this matter also affects Jersey and so consultation would be required before any changes could be considered.

- 17.7. In addition to the potential expansion of the Ombudsman's role there are, at present, a variety of organisations who take responsibilities for various aspects of occupational pensions. The Revenue Service determines which pension schemes meet the standards for contributions to be tax-exempt, as well as collecting information about earnings and pension contributions. The GFSC regulates certain pension schemes where a regulated licensee acts as trustee or administrator of the scheme and ensures compliance with governance standards. The Employment Relations Service provides advice on good employment practices and investigates possible breaches of employment law. While the proposed legislation would ensure that there is a clear distinction in the responsibilities of these parties, it is inevitable that through the course of their ordinary day-to-day business, they all have the potential to uncover information which would benefit one another.
- 17.8. Evidence of this is already seen in the statutory data sharing arrangements between the Revenue Service and the Employment Relations Service. Through assessments of contribution records, the Revenue Service occasionally finds evidence of sub-minimum wage pay. This information may be conveyed to Employment Relations for subsequent investigation. The Committee consider it to be in the interest of all parties, and firmly within the public expectation, that information-sharing be permitted for the purpose of detecting breaches of Secondary Pension legislation. Therefore, the Committee is proposing that the legislation is drafted in such a way (which may also require amendments to existing legislation) to allow the aforementioned parties to share information with the enforcement organisation responsible for Secondary Pensions.
- 17.9. The nature of the enforcement function is such that it will need access to a database of all employers and employees on the island as well as earnings information and access to a list of pension schemes approved for income tax purposes. Because of this, the enforcement function will be added to the remit of the Revenue Service, which in some cases is the only organisation on the island to have a database of this information. This is not to say that compliance can be achieved using nothing more than its existing databases. Nor is it to say that the Revenue Service could conduct this work without additional resources. Early bids have already been noted for an additional staff resource. It is expected that multiple additional staff will be required, with a total cost of £100,000 per annum once the scheme is launched.

- 17.10. The intention is to ensure that compliance will be proportionate and that duplication of data collection should be limited where possible. It is anticipated that compliance reporting would be a duty of the employer not of the scheme administrator/trustees.
- 17.11. It is expected that the Revenue Service would have the power to compel the production of relevant information on demand. This is likely to include periodic reporting, and may be incorporated wholly or partly into existing reporting mechanisms. The Committee is confident that the Revenue Service can establish a proportionate and effective system of compliance monitoring.

18. Alderney and Sark

- 18.1. The 2016 policy letter suggested that Secondary Pensions proposals would cover Guernsey (including Herm and Jethou) and Alderney. These proposals have been designed with that aim in mind. However, it is a matter for the States of Alderney to determine whether or not these provisions will apply in that Island. The Your Island Pension Administrator has indicated that they would welcome Alderney's inclusion and, while they will have no permanent offices there, their Guernsey staff would make regular visits, as required.
- 18.2. During the drafting of this policy letter, States of Alderney representatives were consulted on the proposals. Should the propositions in this policy letter be approved, a proposal to extend the scheme to Alderney may be debated in the States of Alderney in the near future.
- 18.3. While auto-enrolment provisions will not apply to Sark, the extension of any form of Secondary Pensions Scheme would be a matter for their government to determine.
- 18.4. Although auto-enrolment may not apply, Your Island Pension will be open to Alderney and Sark residents wishing to make voluntary contributions unrelated to employment. Opening the scheme to the other Islands of the Bailiwick comes at no cost to Guernsey, but is likely to be of significant benefit to both Alderney and Sark residents.

19. Possible exemptions

- 19.1. Following a successful amendment to the 2016 policy letter, the Committee was directed to consider "the possibility of temporary exemptions for business start-ups". Having carefully considered the matter, the Committee is not proposing the introduction of such an exemption.
- 19.2. In the course of coming to that conclusion, the Committee had regard to three significant factors:

- The financial impact on start-ups
 - The operational impact on start-ups
 - The impact on the policy outcomes
- 19.3. The financial impact on start-ups may indeed be of significance. However, as a start-up, the employer will be in a good position to factor this cost in when determining the overall remuneration package and to introduce appropriate processes when setting out payroll processes. The Committee has been mindful of limiting the cost to employers, which is why YIP has been designed to offer a service which is administratively simple and will be free to employers (apart from their statutory contributions).
- 19.4. In practice, the Committee considers that the operational impact on start-ups will not be excessive. Again, the Committee, mindful of the need to keep processes simple for all employers, has selected an administrator for YIP whose business model was founded on the idea that auto-enrolment should be made as simple as possible for small businesses. Enrolling to the scheme will be a relatively simple and user-friendly process. Anti-money laundering procedures will be robust, but automated checking and digital submission of documents should keep things efficient. Once enrolled, payroll information can be uploaded very easily, and using a payroll software compatible with the administrator's platform can reduce this to just a few clicks. Start-ups are likely to be in the best position to take advantage of this if they so wish. The Committee also expects it to be likely that the existing pensions market will make simple auto-enrolment products available which suit the needs of small and growing businesses. It is also worth noting that, as with all other employers, start-ups can take advantage of the three month deferral to take some time to sort out arrangements after first hiring someone.
- 19.5. The Committee considers that allowing an exception for start-ups would be damaging to the overall policy objective. The number affected may be comparatively small and the individuals may only be affected for a short time, but the impact of the loss of one year's contributions could be quite significant, particularly in the early part of a person's working life when there is the potential for years and years of cumulative investment returns. While the introduction of this policy is projected to improve retirement income significantly, in many cases it will still not be enough to deliver a target replacement rate. Any exception to the policy needs to be carefully considered, and in this case the Committee is not convinced that the benefits outweigh the negative impact on pension saving.
- 19.6. The Committee also had concerns that it would be difficult to apply a fair and consistent policy to start-ups. The stereotype of a start-up is a sole entrepreneur, putting everything they have on the line to set up a business.

However many start-ups are new businesses but owned by individuals with considerable wealth and expertise running a business, and capable of injecting the necessary capital to start the business. In some cases a start-up may be more able to afford these pension contributions than many well established businesses. The Committee does not believe that there is an easy and proportionate way to differentiate between these two.

19.7. The Committee has concluded that rather than excluding start-ups, it is better to mitigate the impact on them as much as possible, by limiting fees and ensuring that the administrative burden is minimised.

19.8. The Committee also considered whether there should be an exception for 'smaller' employers. Ultimately it was determined that this would not be appropriate either. Guernsey's labour market, more so than other jurisdictions, is reliant on so called 'micro employers'¹⁶ with fewer than ten employees. Exempting micro employers would exempt about three quarters of all employers in Guernsey. Even exempting employers with just one employee would exclude about one quarter of employers. Although these single person employers may only employ about 2% of the employed population, an exception for 2% of the employed population at any one time would be unacceptable and have a serious effect on saving. The implication of such a blunt exception would also be unfair: an employer who employed two people part-time in lieu of one person full-time would be unfairly impacted. This is not something the Committee would wish to happen at a time when the community should be encouraging a diversity of working arrangements to maximise workforce participation.

19.9. If an exemption were to be given to 'smaller' employers, it would have to be a complex one, taking into account hours worked, and probably financial considerations as well. In order to apply an exemption fairly, a series of complex rules would need to apply. The implications of these proposals are already challenging enough to understand, implement, and enforce. A further complication, which has the effect of reducing saving cannot be justified.

20. Cost

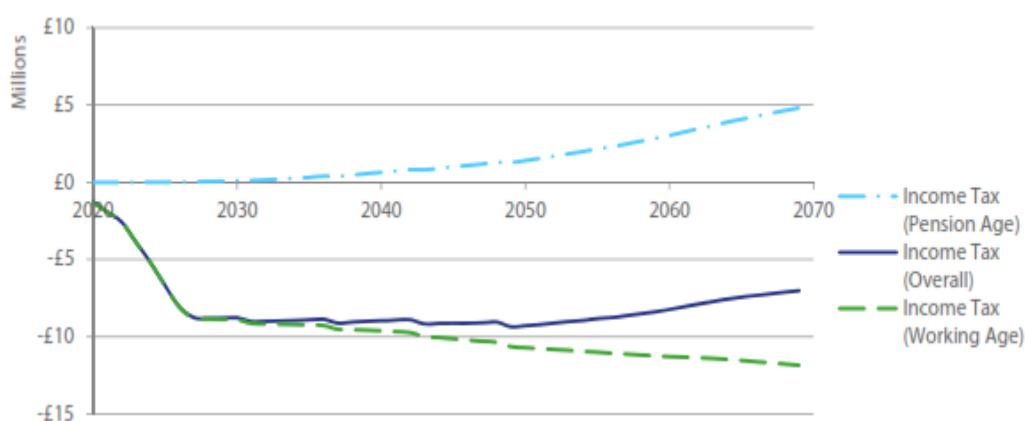
20.1. The costs to the States associated with the introduction of this scheme can be divided into three categories; income foregone, additional expenditure, and loans. In the case of the first two categories, costs are likely to increase as the statutory minimum contribution rate increases.

¹⁶ Different definitions of 'micro employers' are used in different contexts, in this case we are referring to employers with fewer than ten employees. In some cases a lower number is used and/or financial criteria are applied.

Income foregone

- 20.2. Projections regarding income foregone are based on a BWCI economic impact assessment which is appended to this policy letter. There are two notable impacts on these figures. The first is that they are based on 2017 figures. The second is that they are based on the policy as originally envisioned, which means the numbers assume the self-employed and non-employed being automatically enrolled (this affects some but not all of the figures).
- 20.3. Income Tax relief is generally available on contributions to approved pension schemes, subject to certain limits and restrictions. As more people become enrolled in pension schemes the number of people benefiting from this tax allowance will increase, and there will be a consequential reduction in income tax receipts. As the projections factored in self-employed and non-employed people, there is likely to be an overestimation included in these figures, but the overall cost is likely to remain similar, just spread over a longer period, assuming that provisions for the self-employed and non-employed will follow in due course.
- 20.4. During the first year that the Secondary Pensions scheme is active it is expected that there will be a £1.3m reduction in Income Tax receipts when compared to the revenue that would have been generated had the policy not been introduced. Once the scheme is fully operational the reduction is expected to be £8.8m. It should be noted that over a long term horizon the effects of this reduction will start to reduce, as pensions are taxable once drawn down. The graph overleaf is extracted from the economic impact assessment and shows the long term projected effect on income tax receipts.

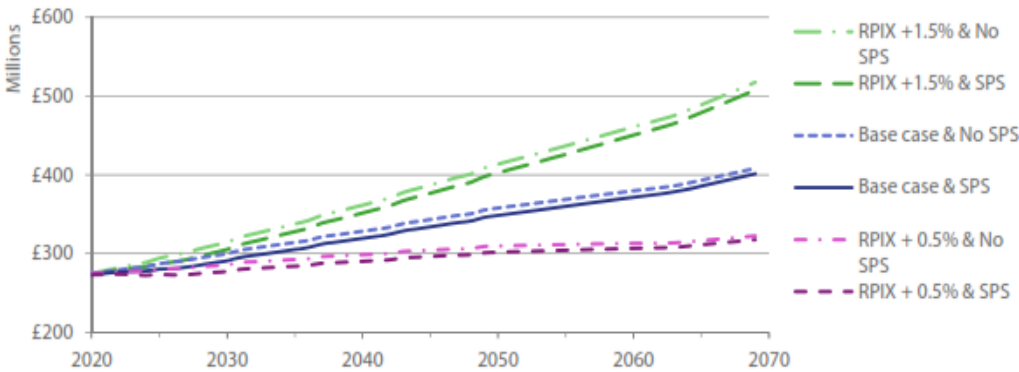
Graph 2 – Projected marginal impact on income tax receipts



Graph 3 below shows the impact of the introduction of secondary pensions in the context of expected income tax revenue. It demonstrates that while there will be a negative impact on revenue, the effect is relatively stable and while

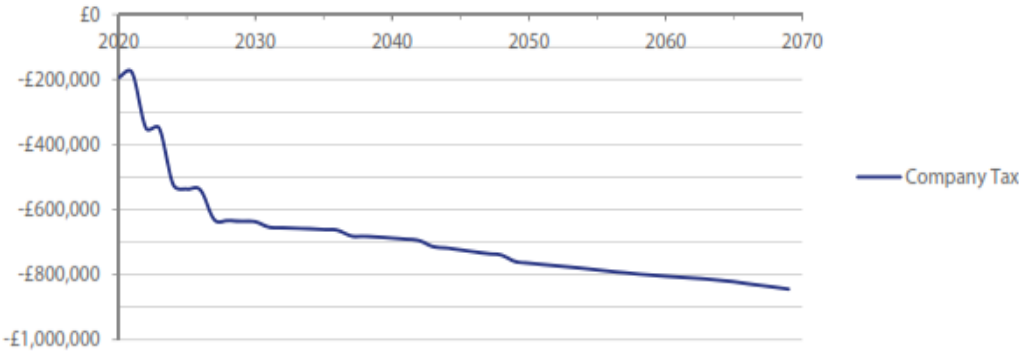
this impact should not be dismissed as insignificant, in context the difference is much less than the impact of other factors over a long term.

Graph 3 – Projected impact on total income tax receipts, including variants for differing economic forecasts



20.5. Company tax receipts will also be affected but to a lesser extent. This is because profits are expected to decrease slightly as a result of the additional expense incurred by the introduction of auto-enrolment. The impact in the first year of operation is expected to be approximately £200k. The impact once the 10% minimum contribution rate is in place is projected to be £630k. Graph 4 below shows the long-term effect.

Graph 4 – Projected marginal impact on corporate tax receipts

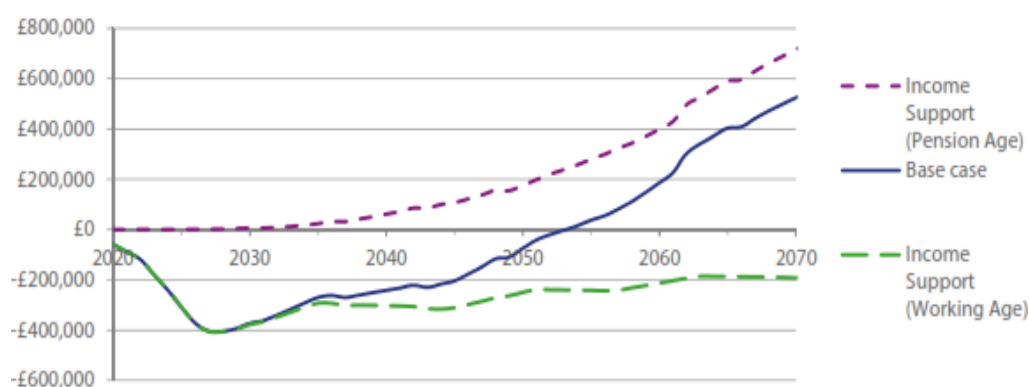


20.6. The cumulative effect of these two figures suggest that once the Secondary Pensions scheme is implemented and achieves the combined 10% statutory minimum contribution, the overall expected decline in States revenue would be £9.4m for that year, compared to what it would have been had the policy not been adopted. This figure will reduce over time as pensions are drawn down and become subject to income tax.

Additional costs

- 20.7. As noted in section 8.7, initially there will be an increased cost to Income Support, because pension contributions are wholly or partly disregarded from the resources of a claimant. This means that in most cases an increase in benefit will offset the pension payments. In the first year of operation it is expected that the additional expenditure will be in the region of £100k, rising to £400k once the scheme reaches the combined 10% statutory minimum contribution. This increased cost will continue for some time but will ultimately reduce year on year. This is because the increase in retirement income for so many people will reduce later life dependency on income support. Ultimately the expense to income support should become net neutral around 2055 and by the end of the projected period (2072) income support expenditure is projected to be £500k lower than it would otherwise have been. Graph 5 overleaf illustrates this.

Graph 5 – Projected marginal impact on income support expenditure



- 20.8. The States as an employer is not fully compliant with these proposals as they currently stand. There are a number of staff who are not eligible to become a member of the public servants' pension scheme. This includes staff on temporary contracts of less than one year in duration and bank staff.
- 20.9. Given that pension matters for the States as an employer are not within the mandate of the Committee *for* Employment & Social Security, the Committee suggests that the best way to address this matter is for the Policy & Resources Committee to make appropriate arrangements and to report back to the States in due course, if necessary.
- 20.10. Although it will be a matter for the Policy & Resources Committee to determine in due course, it appears likely that the most appropriate solution will be to identify or establish an alternative pension scheme for those not currently eligible to be enrolled in the Public Servants' Pension Scheme. Should there be any proposed change that might impact on current members

of the Public Servant's Pension Scheme, appropriate consultation would need to take place.

States of Guernsey loan to the Administrator

- 20.11. The cost of establishing a pension can be significant, particularly if an assets-under-management, annual management charge (AMC) is used. The problem is exacerbated in this case due to the phased introduction of the statutory minimum contributions. In order to generate revenue and cover early costs, many providers choose to issue a contribution charge, fixed annual fee, or sign up cost. The Committee wishes to avoid these charges in respect of the universally-available "Your Island Pension" (YIP) scheme, as they can have a significant and disproportionate effect on savers with low incomes. However, avoiding such charges means that YIP is unlikely to be self-funding for some time, although the fund size is projected to grow quite quickly once the full statutory minimum contribution rate is reached.
- 20.12. The proposal from Smart Pension Ltd is predicated on an assets-under-management charge and a loan of £800k. The loan is required because costs will be incurred during the development phase, with no active revenue stream to replace them. The loan would be interest-bearing and paid in tranches upon completion of agreed milestones in the development phase. The loan would be repaid within two years of the launch of YIP. This is before Smart expects to make any profit from the scheme and as a result represents a sharing of the commercial risk.
- 20.13. Having considered a number of other possible funding models the Committee believes that this proposal represents the best value for the States and for the eventual scheme users. The Committee proposes that authority be given for the Policy & Resources Committee, acting on behalf of the States, to make a loan facility of not more than £800k available to Smart Pension Ltd. It should be noted that this loan would be unsecured, and that therefore the States would be taking more risk than it otherwise might. Having regard to the risk it was considered that this still represented the best and most prudent use of public funds in this matter, particularly because the unsecured loan was a direct alternative to a non-refundable grant.
- 20.14. Given that the proposed loan to Smart would be unsecured, there is an inherent risk of non-repayment. The Committee has undergone significant financial due diligence and while the risk of default can never be totally eliminated, the Committee considers it to be acceptable in this instance, particularly because of Smart Pension Ltd's very robust business planning and the company's financial backing from household name companies.

Funding the trustee and support services

- 20.15. The funding of governance arrangements for the "Your Island Pension" (YIP) scheme is a complex matter. The Trustee will incur significant expense, of which the Governing Board's remuneration will only comprise a small percentage. There will be additional costs relating to procuring investment advice, auditors, trustee support services, paying licence fees and so forth. It is projected that the total average annual operating cost of the Trustee will be approximately £400,000.
- 20.16. It is proposed that members of the Governing Board are paid in line with the UK average remuneration for Trustees of similarly sized funds. The most significant costs are expected from the retention of an independent investment advisor and the procurement of Trustee support services. The independent investment advisor is a variable cost as detailed review of the investment funds does not need to take place every year, although investment performance of the funds does of course require continuous monitoring and reporting. Once the groundwork is laid in Year 1, the investment advisor costs are generally lower until the year of contract expiry. The cost of Trustee administration services is more of an unknown as this specific service has not been tendered for previously by the Committee. However, the Committee believes that this is a service which should receive significant interest from the market when tendered.
- 20.17. While governance comes at a significant expense, it is necessary to ensure robust and proper governance of what will ultimately be one of the largest pension schemes in the Bailiwick. As a States-facilitated scheme it must also hold itself to the very highest standards of governance and ensure it leads the way in respect of good practice.
- 20.18. A proportion of the AMC charge for YIP will be paid to the Trustee. Bearing in mind that the charge needs to remain at a relatively low level to ensure it is appropriate for low-income savers, the Trustee's share is unlikely to generate more than a few thousand pounds in the first year. However, that same percentage charge should generate a revenue approaching £1m by year 15 of operation. This means that a reasonable charge will not meet expenditure in the early years, but will generate a substantial surplus for the Trustee in later years. The Committee propose that the States make an annual loan to the Trustee to account for the difference in their income and expenditure in the early years of YIP. If this proposal were to be approved, it is likely that the Trustee would require a gradually-reducing annual loan until approximately Year 10 of operation, after which it should become self-sustaining.

Economic impact

- 20.19. The implementation of the Secondary Pensions Scheme will have an impact on the economy. The increased expenditure from businesses and increased public saving will limit growth and effectively remove funds from the economy. Once contribution levels reach their maximum levels, consumption is expected to reduce by £30m, equivalent to less than 1% of GDP. The proposal to phase in contributions over a number of years means that this is likely to manifest itself as a suppression of growth until such time the economy has adjusted to new levels of savings. In the very long term, as pensioner incomes are increased, the effect on GDP may be at least partially reversed by an increase in pensioner income and consequent consumption.
- 20.20. It is also likely that there will be some impact on the labour market. Increased costs may result in some employers needing to take cost-cutting measures such as employment or wage freezes. However, the Committee does not expect the impact on unemployment levels to be material: indeed, since introducing their auto-enrolment scheme, UK unemployment levels have fallen. Guernsey has an enviably low rate of unemployment rate, holding at around 1% over the last decade.
- 20.21. Employers are likely to consider the additional pension benefits offered as part of the employee's remuneration package and take this into consideration when reviewing pay. As a result, employees may see their take home pay increase at a lower rate than it might otherwise. However there is no reason why the combined value of their pay and benefits should not grow at the same rate as it would have were the scheme not to be introduced.
- 20.22. The costs of introducing Secondary Pensions are varied and far from insignificant. However securing an adequate retirement income is vital. If The States do not encourage additional savings now, the price will be paid in future through increased income support expenditure and through deterioration in social wellbeing. The Committee firmly believes that it is vital that the action is taken now.
- 20.23. A detailed breakdown of the economic impact of the proposal is contained in the independently-produced economic impact report appended to this policy letter.

Summary

- 20.24. The table below summarises the expected total revenue impact to the States up to the fifth year of the operation of the scheme. This includes both costs and revenue forgone.

Table 2 – Summary of total projected revenue impact to the States

| | Y-2 (2020) | Y-1 (2021) | Y1 (2022) | Y2 (2023) | Y3 (2024) | Y4 (2025) | Y5 (2026) |
|-----------------------------|---------------|---------------|--------------|--------------|--------------|--------------|--------------|
| Loan to administrator | £600k | £200k | £0 | -£930k | £0 | £0 | £0 |
| Loan to trustee | £200k | £400k | £400k | £400k | £390k | £380k | £360k |
| | | | | | | | |
| Lost income tax revenue | £0 | £0* | £1.3m | £2.0m | £2.6m | £3.9m | £5.2m |
| Lost company tax | £0 | £0* | £200k | £180k | £340k | £340k | £500k |
| Income support | £0 | £0* | £120k | £180k | £240k | £355k | £470k |
| Staffing and other costs | £50k | £100k | £100k | £100k | £100k | £100k | £100k |
| | | | | | | | |
| Total revenue impact | £850k | £700k | £2.1m | £1.9m | £3.7m | £5.1m | £6.6m |

* These figures do not take into account the likelihood that some employers will comply with auto-enrolment requirements before the duties officially commence. The financial impact of such action ahead of the launch is difficult to forecast.

21. Consultation and engagement

- 21.1. Through the development of these proposals, the Committee has consulted with the Policy & Resources Committee and a member of that Committee has also been a members of the project board. The Committee has also consulted with the Committee for Economic Development and has engaged with business representatives.
- 21.2. The Committee has consulted with the Law Officers regarding the legal implications of and legislative drafting requirements resulting from, the propositions set out in this policy letter. The Law Officers have made clear to the Committee that the proposed timetable is very optimistic for a project of this size and complexity, and that there is a risk that it will not be met.

22. Conclusion

- 22.1. In 2016, the States gave overwhelming support in-principle for the development of a secondary pensions system for Guernsey, based on the

auto-enrolment model that had been introduced in the UK with notable success.

- 22.2. Throughout this political term, the Committee has developed the outline of the scheme, approved in 2016, into a detailed specification sufficient for the drafting of legislation. In so doing, the Committee, through a rigorous tender process, has selected Smart Pension Ltd as a suitable administrator scheme.
- 22.3. In developing the detailed proposals, the Committee has remained absolutely convinced of the need for this type of easily accessible, relatively low-cost pension provision in Guernsey, to add to the valuable, but limited, provision of the States' pension.
- 22.4. The development of a Secondary Pensions system appears in the Policy & Resource Plan as a priority policy area for the States. The propositions associated with this policy letter address that priority and fully accord with the Committee's purpose:
- “To foster a compassionate, cohesive and aspirational society in which responsibility is encouraged and individuals and families are supported through schemes of social protection relating to pensions, other contributory and non-contributory benefits, social housing, employment, re-employment and labour market legislation.”
- 22.5. In accordance with Rule 4(4) of the Rules of Procedure of the States of Deliberation and their Committees, it is noted that the propositions are supported by all Committee members.

Yours faithfully

M K Le Clerc
President

S L Langlois
Vice-President

J A B Gollop
E A McSwiggan
P J Roffey

M J Brown
Non-States Member

A R Le Lièvre
Non-States Member

APPENDIX A

23. Proposed timescale at which an employer's auto-enrolment obligations will come into force

- 23.1. Table 3 below shows the Committee's proposed timescale for when an employer will become obligated to enrol their employees into the Secondary Pensions Scheme. The dates vary according to the size of the employer.

Table 3 – Commencement dates for employers' auto-enrolment obligations

| Duty commencement date | Number of employees as of 1 st January 2022 |
|------------------------------|--|
| 1 st January 2022 | 26+ |
| 1 st April 2022 | 11-25 |
| 1 st July 2022 | 6-10 |
| 1 st January 2023 | 2-5 |
| 1 st April 2023 | 1 |

APPENDIX B

24. Glossary

- 24.1. **“Annuity”** – In exchange for all or part of a person’s accumulated retirement savings, an annuity provider, will provide the purchaser or member with a fixed regular income throughout their retirement. A purchased annuity provides a degree of certainty that, come what may, the purchaser will not run out of funds in retirement.
- 24.2. **“Defined benefit scheme”** – This is pension where a member will receive a fixed periodic payment which is guaranteed on retirement (subject to scheme funding levels and/or the employer’s ability to fund a scheme in deficit). The amount of the payment is usually dependant on salary and length of service. In other words, when you retire you know how much you will receive every week or month for the rest of your life, irrespective of how long that may be. There are no individual funds, only one collective fund from which the cost of paying out the benefits must be met. These schemes are becoming less common, remaining primarily in public bodies.
- 24.3. **“Defined contribution scheme”** – This is a pension scheme where money is paid in by, or on behalf of, the scheme member. It accumulates into a personal pot of money which can be drawn from periodically during retirement. The amount available at retirement is dependent on how much is contributed, investment returns, and fees. These represent the vast majority of pension schemes.
- 24.4. **“First pillar pension”** – A pension provided by a government, available to residents or contributors in that jurisdiction. Eligibility can be based on a variety of criteria, which may or may not be means tested.
- 24.5. **“KPIs”** – Key performance indicators.
- 24.6. **“Occupational Pension/Second Pillar Pension/Secondary Pension”** – savings for retirement through a scheme made available by an individual’s employer. Typically both employer and employee contribute to these.
- 24.7. **“Private Pension/Third Pillar Pension”** – savings for retirement made into a personal pension scheme and paid into by the individual.
- 24.8. **“Retirement Annuity Trust Scheme (RATS)”** – A specific type of pension scheme available in Guernsey; these are very common and are offered by a wide variety of providers. The structure of RATS can vary quite significantly, from ‘off-the shelf’ standard packages to bespoke products.

- 24.9. **“Retirement Income”** – The combination of income which a person can obtain from the first, second, and third pillar pensions which they can access.
- 24.10. **“States pension”** – the new name for ‘old age pension’, is the benefit available through Social Security, which is funded by contributions to the Guernsey Insurance Fund. This is an example of a first pillar pension.
- 24.11. **“Workplace pension”** – A workplace pension in the context of this policy letter can be either an occupational pension or a private pension scheme. This is a technical distinction. A RAT is a private pension arrangement but can be used to meet auto-enrolment obligations in some circumstances. So a workplace pension could mean either a private or occupational pension which is capable of meeting auto-enrolment obligations.
- 24.12. **“YIP/Your Island Pension”** – See part 3, sections 12-16.

APPENDIX C

25. Information about Smart Pension Ltd

- 25.1. Smart Pension Ltd is a UK based company, with their principal office based in London and other UK offices based in Poole and Brighton. They also have six other offices worldwide. Its core business is an authorised UK master trust, specialising in meeting the UK's auto-enrolment requirements for smaller employers. Smart Pension Ltd was established in 2014. At the time of writing, their UK master trust has over 61,000 employers, 449,000 members, and £450million in assets under management. The master trust has received Master Trust Assurance Framework (MAF) Accreditation, jointly created by the Pensions Regulator in the UK and the Institute of Chartered Accountants in England and Wales (ICAEW). The framework allows the trustees to obtain independent assurance that the controls that they have established around their key streams and processes are in place and effective.
- 25.2. More importantly, the scheme, in line with the UK's new authorisation regime, has been awarded Master Trust Authorisation by the Pensions Regulator. This new licensing regime has significantly increased the standards required to operate a Master Trust in the UK. All Master Trusts needed to apply for authorisation from 1st October 2018, in order to continue to operate and it is expected that in excess of half of the market operators will exit the market either voluntarily or by failure to obtain authorisation.
- 25.3. Although a relatively new company, Smart Pension Ltd is making significant progress in the UK pension industry, having won multiple industry accolades. This includes:
- DC Master Trust of the Year, DC Innovation of the year, and Retirement Innovation of the year – 2019 UK Pensions Awards
 - Technology Services of the Year – 2019 Financial Times Pensions and Investments Provider Awards
 - European Pension Fund of the Year – 2018 European Pensions Awards
- 25.4. Smart Pension Ltd is also expanding their pension platform services into other markets, largely on a partnership basis with existing businesses in the respective jurisdictions. Recently they have signed agreements to enter into markets within Ireland and the United Arab Emirates to provide defined contribution platform services.
- 25.5. Smart Pension Ltd uses a proprietary platform which offers an extremely user-friendly experience. This allows members to view their account online, through a website and mobile app. Access to the mobile app can be controlled

by fingerprint recognition for an added level of security. It is also possible to access some features using a smart speaker such as Amazon Echo. Smart Pension Ltd would develop a Your Island Pension website and app based on their existing platform. This would be white-labelled so that it could be offered with YIP branding. Using the online platform, members would be able to adjust the percentage of their salary which is deducted from their wages and contributed to the fund, and select their preferred investment approach from schemes approved by the Trustee. Smart Pension Ltd is also developing tools to encourage people to engage with their pension. It is expected that these tools will be available to scheme members, and will help them to better understand their pension and their saving needs.

- 25.6. With its proprietary platform, Smart Pension Ltd is well suited to deliver the administration of this scheme. Although Your Island Pension is intended to represent a competitive offering, and will be open to any employer who wishes to use it, it is recognised that a great deal of its business will be higher volume and lower value from employers who may not be able to access an affordable service elsewhere. By offering a digital solution and a highly automated process, Smart Pension Ltd is able to deliver a service that can cope with scale, even with comparatively low value contributions.
- 25.7. Because the company was only founded in 2014, and is on a rapid upward growth curve, the Committee conducted extensive due diligence on the company in relation to its long term financial viability. Smart Pension Ltd has financial backing from Legal & General and JP Morgan, both of whom have a substantial ownership interest. Smart's core business as a UK master trust appears to be viable as a standalone business, and the Committee is confident that Smart has adequate plans and procedures in place to ensure that their plans for growth would not jeopardise their viability. Based on this due diligence, the Committee is satisfied that the company is a stable and reliable partner to deliver this service.
- 25.8. Smart Pension Ltd has come under scrutiny from two regulators. Firstly, it received a fine from the Pensions Regulator for failing to promptly report employers who were not making the required minimum payments into their employees' accounts. Despite this fine, Smart Pension Ltd retained their Master Trust Assurance status awarded by the same regulator, which indicates that they are a high calibre provider. Smart worked with the regulator to improve its procedures which are now robust. Secondly, Smart Pension Ltd has received three challenges from the advertising standards agency over direct marketing letters sent to employers between 2016 and 2018. One of these challenges was overturned on appeal. The project board reviewed this regulatory action and was satisfied that Smart had responded appropriately, and that the breaches were comparatively minor oversights which did not amount to disregard for the law and proper procedures.



Secondary Pension Scheme for Guernsey & Alderney

Scheme Projections & Economic Impact Assessment

Prepared by BWCI Consulting Limited &
Island Global Research Limited,
part of the BWCI Group.

3 January 2018

About the Authors

The report was prepared by BWCI Consulting Limited and Island Global Research Limited, which are part of the BWCI Group.

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Provision of Advice

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Professional Standards

The actuarial work in section 4 of this report has been prepared in accordance with the applicable Technical Actuarial Standards ("TASs") issued by the Financial Reporting Council:

- TAS 100: Principles for Technical Actuarial Work (version 1.0 effective from 1 July 2017).

The other sections of this report are not actuarial work and therefore fall outside the scope of the TASs.

Executive Summary

Background

1. In February 2016 the States agreed, in principal, to the introduction of a Secondary Pension Scheme¹ in Guernsey and Alderney to be phased in over a 7-year period (2020-2027). The Committee *for* Employment & Social Security (the Committee) are taking this forward.
2. The Secondary Pension Scheme has three objectives:
 - To encourage residents to take greater responsibility for saving for their own retirement;
 - To increase both the number of residents saving in a private pension and the total amount of private pension saving by residents, in order to reduce the likelihood of future generations of retirees falling back on the taxpayer funded benefits;
 - To provide residents with the opportunity to save for their retirement by establishing a well-governed, cost-effective pension saving vehicle (i.e. a States-facilitated Secondary Pension Scheme)
3. The Secondary Pension Scheme will require employers to automatically enrol their employees into either the States-facilitated Secondary Pension Scheme or an alternative qualifying scheme which satisfies some minimum criteria, which are yet to be specified. Eligible self-employed and non-employed people will be automatically enrolled through the Social Security system.
4. The Secondary Pension Scheme is not compulsory for individuals; anyone automatically enrolled into the Secondary Pension Scheme may opt out. However, those who opt out would be re-enrolled at regular intervals.

Scope of Report

5. This report was commissioned by the Committee to:
 - i) Project the size of the funds in the States-facilitated Secondary Pension Scheme over the 50-year period 2020-2069
 - ii) Consider the economic impact of the introduction of the Secondary Pension Scheme on the various stakeholders:
 - ◆ individuals
 - ◆ households
 - ◆ employers
 - ◆ the government
 - ◆ the economy

A wide range of assumptions are required for the development of the actuarial and economic projection models to address these two issues. Our central results are based on a “base case” set of assumptions. We have also considered the sensitivity of the projections to changes in key assumptions. The assumptions

¹ The Secondary Pension Scheme refers to a system of automatic enrolment into a private pension for residents in Guernsey and Alderney. It is expected that there will be both a States-facilitated secondary pension scheme and alternative qualifying secondary pension schemes.

and the range of sensitivities have been discussed and agreed with the Committee. **See section 3.4 for details of the assumption and Appendix 11 for a detailed discussion of the rationale.**

Size of the States-facilitated Secondary Pension Scheme

6. Under the base case assumptions, the assets of the States-facilitated fund are projected to grow, in real terms, to £1.3 billion (in 2017 terms) over the first 50 years of operation. The Secondary Pension Scheme is expected to reach an “equilibrium” towards the end of the projection period. From that point, the size of the fund is expected to increase in line with the population-related real growth in employment income, which is 1% per annum for the base case assumption.

Impact on individuals

7. No-one already receiving their States old age pension when the Secondary Pension Scheme is introduced will be directly affected. However, they may be affected indirectly by the impact on the economy, the government or their employer (if they are still in employment). It may make employment of those over pension age more attractive financially to employers since the employer would not need to pay any Secondary Pension Scheme contribution for these employees; this would be broadly a saving of 3.5% of earnings after the phasing in period in respect of any employees over pension age relative to those of working age.
8. The working age population is projected to be 41,500 in 2020. The introduction of the Secondary Pension Scheme is expected to increase the proportion of the working population saving for retirement in a pension scheme from 22% to 61%. Under the base case assumptions 20,200 individuals would be automatically enrolled into the Secondary Pension Scheme in 2020 and it is estimated that 16,200 would remain in the Secondary Pension Scheme, as shown in Figure 1 (**see also section 5.1**).

Figure 1. Membership of Secondary Pensions among working age population (2020)

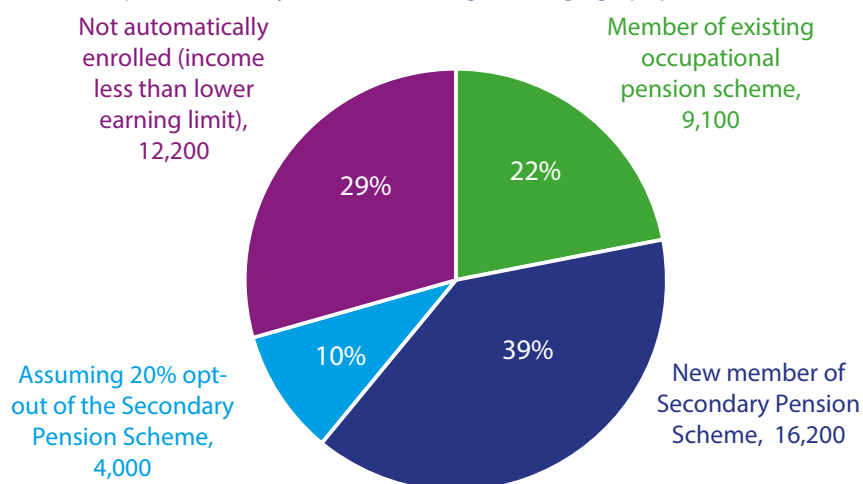
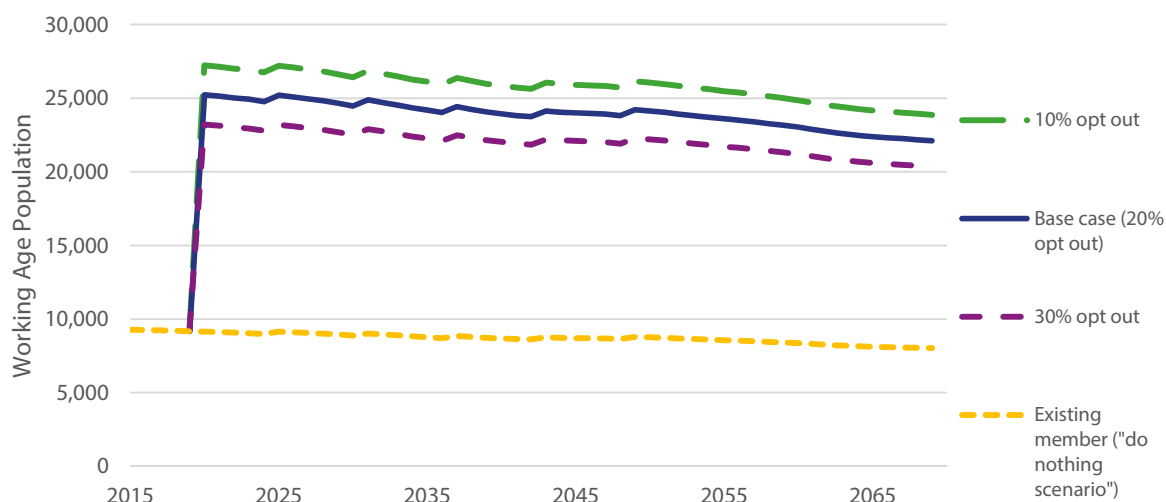


Figure 2 shows the projected membership of the Secondary Pension Scheme among the working age population until 2069 under the base case 20% opt out assumption, and sensitivity on the opt out rate. The projection assumes the proportion of the working age population who are members of the Secondary Pension Scheme remains constant, while the actual working age population is decreasing slightly over this period after allowing for both demographic changes and changes to the States pension age.

Figure 2. Membership of Secondary Pensions among working age population (2020-2069)²



At the end of the phasing-in period, employees would be saving 10% of their earnings each year into the Secondary Pension Scheme as follows:

- 6.5% of gross earnings from the individual³
- 3.5% of gross earnings from their employer

- The maximum contribution⁴ an employee would make (in 2017 terms), after the end of the phasing-in period, would be £9,014. 20% tax relief is generally available on contributions⁵, so for most contributors the reduction in their disposable income would be 80% of the amount contributed, provided that they are paying their contributions from earnings in excess of the personal allowance (£10,000 in 2017).
- The additional pension that these contributions are expected to provide at retirement is expressed in terms of an individual's level of income immediately before retirement; the income replacement rate. In view of the objective to reduce the likelihood of future pensioners falling back on taxpayer-funded benefits, the impact of the Secondary Pension Scheme is particularly important for those on relatively low earnings. Figure 3 illustrates that for the base case assumptions, the projected income replacement rate for a lower quartile earner increases from just below 40% (the old age pension alone) to up to around 80% for a person who contributes to the Secondary Pension Scheme throughout their

² In this and subsequent line charts the order of the categories in the legend corresponds to the order of the series at the end of the time period (i.e. with the highest value listed first).

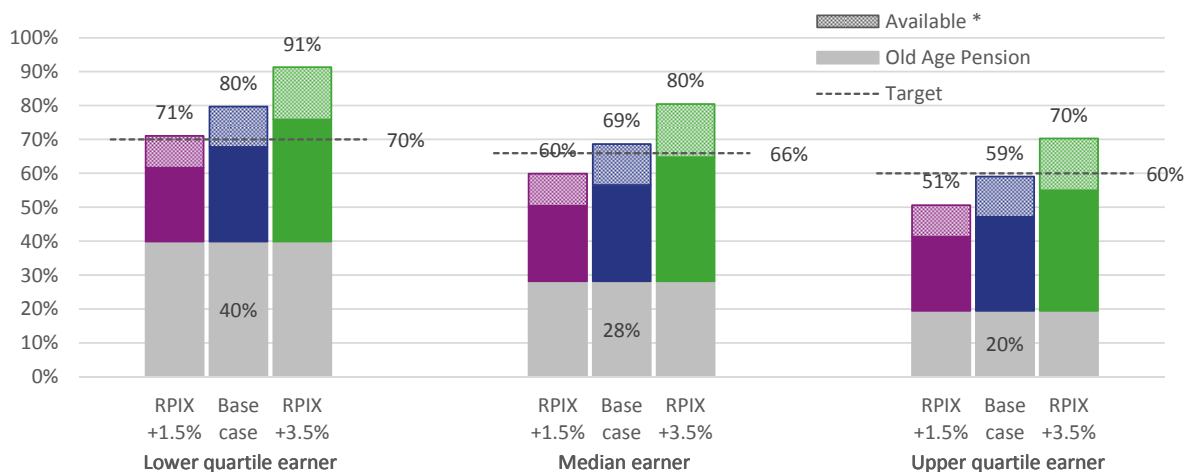
³ As pension contributions are tax-deductible, individuals contributing to the Secondary Pension Scheme would receive income tax relief up to 1.3% of their gross salary.

⁴ For those earning in excess of the Upper Earnings Limit ("UEL") of £138,684 in 2017

⁵ The 2018 budget reduced tax relief on pension contributions for those with income in excess of the UEL.

working life from age 25 to age 70 and takes no lump sum (**see also Section 5.2.3**). The chart shows the impact of members taking lump sums from their Secondary Pension Scheme. An additional amount is shown as available (dotted area) which can be accessed by taking less than the maximum lump sum of 30% of their Secondary Pension Scheme fund at retirement. The chart also illustrates how the ultimate pension from the Secondary Pension Scheme depends on the investment return achieved on the funds invested.

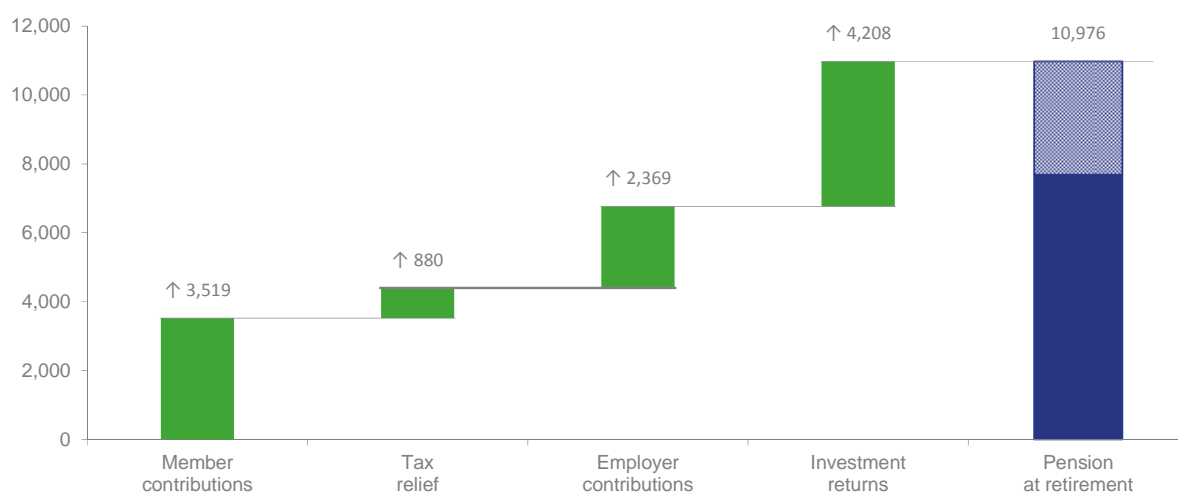
Figure 3. Income replacement rates⁶



* depending on lump sum taken from Secondary Pension

- Figure 4 illustrates the pension at retirement for the lower quartile earner for an individual who joins the Secondary Pension Scheme aged 25 (as per the income replacement rate examples in Figure 3). It shows how the different components of the Secondary Pension Scheme are expected to contribute to the size of the pension for the individual, under the base case assumptions.

Figure 4. Source of Secondary Pension Scheme pension for lower quartile earner



⁶ The RPIX references in the chart relate to sensitivities on the rate of investment return assumed.

The dotted area shows the amount of pension which would not be available if the maximum lump sum is taken at retirement. If no lump sum is taken then a pension of £10,976 per annum is available to the lower quartile earner. If the maximum lump sum of £64,441 is taken then a pension of £7,683 per annum is expected to be available to the lower quartile earner.

The chart shows that the contributions paid by the member provide a pension of £3,519 per annum at retirement, in terms of current prices. However, because of the positive impact of tax relief, employer contributions and investment returns (net of charges), the cumulative impact is to provide a pension of £10,796 per annum at retirement (if no lump sum is taken). Therefore, the pension that the lower quartile earner is expected to receive at retirement is worth around three times what the member has contributed.

Impact on Households

12. It is important to consider the impact of the Secondary Pension Scheme at a household level, since this is how eligibility for income support⁷ will be assessed. Income support is designed to top up a household's income to the level considered necessary to live on. The amount of capital that a household has is also included in the assessment. About 10% of households currently receive supplementary benefit. We have illustrated the impact on a range of different household types. **(See Table 8 and 8 in section 5.3).**
13. Those in the working age population who qualify for income support will not have their income reduced if they contribute to the Secondary Pension Scheme. This is because pension contributions are an allowable deduction for income support purposes. If the payment of Secondary Pension Scheme contributions reduced a household's income, it could result in some additional households becoming eligible for income support. For households which are not receiving income support, there would be a reduction in household income. However, part of the reduction would be offset by a lower income tax liability.
14. Joining the Secondary Pension Scheme is expected to yield additional pension income in retirement for all those who participate. In addition, the extra pension income created as a result of participation in the Secondary Pension Scheme is expected to remove some pensioner households from needing income support. It should be noted that if part of the pension were to be taken in lump sum form it could increase the household's capital and make them ineligible for income support until their capital falls below the income support threshold.

Impact on Employers

15. There are no reliable data on the number of employers who currently offer a pension as part of their remuneration package. There are around 2,500 employers in Guernsey; 69% of them are "micro employers" with up to 5 employees, and 82% of all employers have up to 10 employees.
16. We have estimated that about 7% of employers have an occupational pension scheme. Micro employers are the least likely to offer an occupational pension. Therefore, the vast majority of employers are expected to start to pay pension contributions for their employees for the first time when the Secondary Pension Scheme is introduced. The first-year contributions under the base case assumptions are expected to be around £5 million; this will increase to a projected £19 million (in 2017

⁷ Income support is expected to replace supplementary benefit and rent rebate in 2018

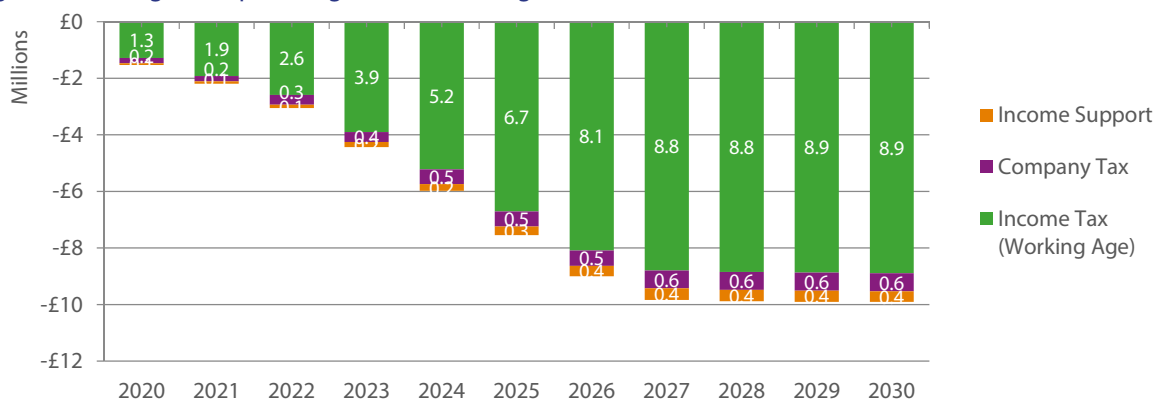
terms) by 2027. Thereafter the contributions are expected to increase in line with increases in real earnings: under the base case assumption of real earnings growth of 1%, employer contributions reach £25 million by 2069 (**see Section 6.2.1**).

17. It is difficult to know at this stage how employers will respond in practice. The net impact on their profits may be less than the costs they incur (in contributions and administration expenses) if they chose to take some mitigating action. This could be achieved in a number of different ways; by making changes that reduce the wage bill in real terms, increasing productivity or passing on some of the costs to consumers through increasing prices.
18. The projected impact is greater on the smallest employers because they are less likely to offer an existing pension, and in relation to resources allocated (e.g. staff time or professional advice) to ensure they comply with the new Secondary Pension Scheme legislation. It will be important to ensure that the Secondary Pension Scheme is effectively communicated to employers, easy to understand, and the process of auto-enrolment is straightforward and manageable for the smaller employer. However, only in some instances will the additional resources represent a monetary cost. In other cases, the additional resources required will be staff time that can be absorbed within the existing workload.

Impact on Government

19. We have estimated the marginal impact on government finances, which compares introducing the Secondary Pension Scheme to “doing nothing”. To put the figures in context, in 2016, total general revenue was £407 million. The largest single component was personal income tax, which accounted for 60% of the income (£246 million). Company tax made up a further 12% (£47 million).
20. The Secondary Pension Scheme will impact on the revenue from personal income tax in two ways:
 - Individuals contributing to a secondary pension will typically pay less in income tax since pension contributions are largely tax exempt
 - Individuals receiving income from a secondary pension may pay more in income tax since pension income is included in the income tax assessment.
21. Pensions are long-term savings and therefore it will take a considerable period (around 70 years) until the system reaches a broadly stable state. There will be a reduction in government revenue, largely due to the fall in personal income tax receipts, due to the tax relief on pension contributions (Figure 4). In the first year of the Secondary Pension Scheme, the projected loss in income tax revenue is £1.3 million. By 2027, when the employee contribution rate reaches 6.5%, the projected reduction in income tax revenue is £8.8 million (Figure 5). There will also be a small increase in the amount paid in income support and a fall in company tax revenue, since pension contributions are a deductible expense. The total projected impact on the government budget in 2027 is estimated to be a £9.8 million reduction (in 2017 terms). **See Section 7 for further details.**

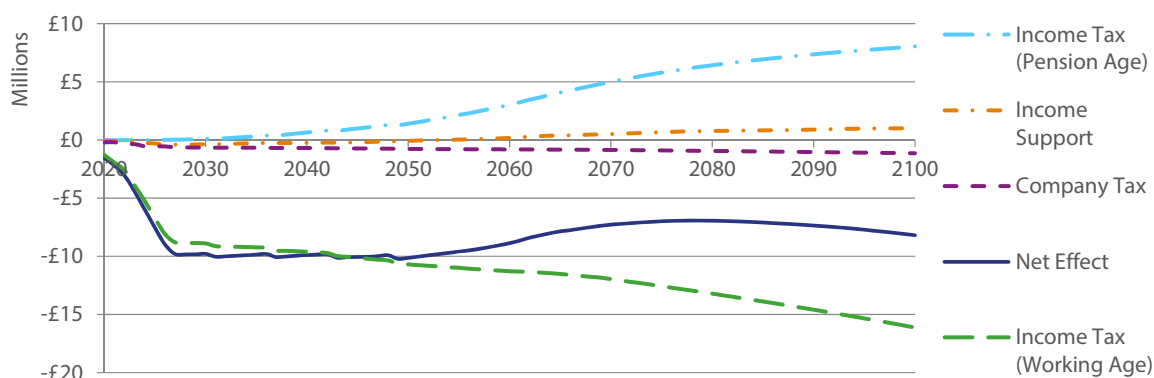
Figure 5. Marginal impact on government budget in the short-term (2020-2030)



22. In monetary terms, the magnitude of the fiscal impact reduces slightly over the medium-term but ultimately the net effect of the Secondary Pension Scheme is a sustained and increasing loss in government revenue compared to the “doing nothing” scenario. The net effect is shown as the dark blue line on Figure 6.

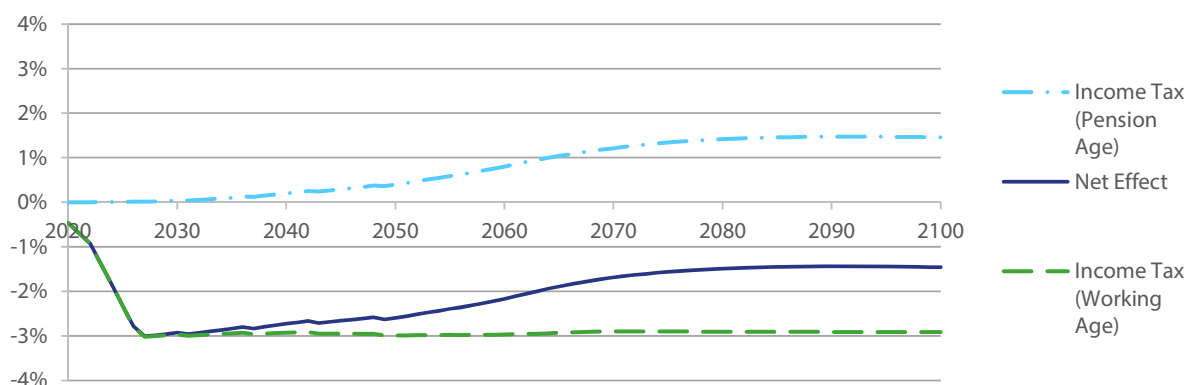
23. Figure 6 also illustrates the interaction of the different components. As shown, the loss in income tax revenue from the working age population increases over time. This loss is in part offset, as the additional pension income generated by the Secondary Pension Scheme will increase the taxable income of those over pension age. Initially this effect is small, as the first recipients of the Secondary Pension Scheme pension will only have contributed to it for part of their career. As contributions are invested for an entire working life, the amount of pension will increase as the Secondary Pension Scheme matures so increasing income tax payments. **See Sections 7.1, 7.5 and 7.6 for further details.**

Figure 6. Marginal impact on government budget in the long-term (2020 to 2100)



24. In the long-term loss in revenue is equivalent to 1.5% of the personal income tax revenue. Figure 6 focuses on personal income tax revenue, showing the loss as a percentage of the total. Relative to the total, the maximum impact over the projection period occurs in 2027 when the contributions reach 6.5%. Thereafter, the impact of the loss lessens, because there will be a growing number of pensioners receiving income from a secondary pension (Figure 6). **See Section 7.1 for further details.**

Figure 7. Marginal impact on personal income tax revenue, as a percentage of total personal income tax revenue



Impact on the Economy

25. Individuals who pay into a secondary pension will see a reduction in their disposable income. This will lead to a reduction in consumer spending in the short-term. However, in time consumption will increase as pensioners who have contributed to the Secondary Pension Scheme will have higher incomes in retirement and would be expected to spend at least some of their additional income.
26. The Secondary Pension Scheme is unlikely to impact on labour participation rates, but may impact on employment and suppress wage growth in the short-term. Firms may look to offset their pension contributions by limiting salary increases and bonuses. However, firms that want to recruit and retain high quality staff will need to offer an attractive remuneration package as the size of the workforce is limited and there are very low unemployment rates. This means firms will face some constraints on their ability to recover the additional wage bill through lower pay awards.
27. In the short-term the Secondary Pension Scheme will put pressure on economic growth, primarily reflecting the reduction in disposable income and consumer spending. Over time the impact will reduce, as the Secondary Pension Scheme will cumulate in an increase in the disposable income, consumption and economic activity of households in retirement. In the long term, the marginal cost of the Secondary Pension Scheme is likely to be small; the assumed rate of real earnings growth would be associated with higher levels of economic growth. The magnitude of the impact is likely to be relatively limited, and the risks will be small compared to other economic challenges, such as the impact of Brexit.

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1. Introduction

1.1 Introduction to the Secondary Pension Scheme

The States of Guernsey is proposing to introduce a new system of automatic enrolment into a private pension for residents of Guernsey and Alderney, known as the Secondary Pension Scheme⁸. As set out in the Billet d'État⁹ from 16 February 2016 ("the 2016 Billet"), the policy aims are:

- to encourage residents to take greater responsibility for saving for their own retirement;
- to increase both the number of residents saving in a private pension and the total amount of private pension saving by residents in order to reduce the likelihood of future generations of retirees falling back on taxpayer funded benefits;
- to provide residents with the opportunity to save for their own retirement by establishing a well-governed, cost-effective private pension savings vehicle (i.e. a States-facilitated Secondary Pension Scheme).

It is proposed that eligibility to join a Secondary Pension Scheme will be based on an individual's income and their social insurance classification:

- SI Class 1: Employed individuals will be eligible if their employment income exceeds the lower earnings limit ("LEL")¹⁰
- SI Class 2: Self-employed individuals will be eligible if either their employment income or their business income exceeds the LEL
- SI Class 3: Non-employed individuals will be eligible if their gross income exceeds the lower income limit ("LIL")¹¹

Non-employed individuals under pensionable age, who do not receive an income and do not make social security contributions, would not be automatically enrolled in the Secondary Pension Scheme, but would be able to opt in on a voluntary basis.

Employers will be responsible for enrolling eligible employees; eligible self-employed and non-employed individuals will be enrolled by the Committee for Employment & Social Security. Individuals who are automatically enrolled will be able to opt out of the Secondary Pension Scheme, but would be re-enrolled at regular intervals.

Employers will be able to choose to use either a States-facilitated Secondary Pension Scheme or an alternative qualifying scheme. The criteria for alternative qualifying schemes are yet to be finalised. However, occupational pension schemes that are as good or are better than the States-facilitated secondary pension scheme are expected to qualify.¹²

⁸ It is expected that there will be both a States-facilitated secondary pension scheme and alternative qualifying secondary pension schemes.

⁹ Billet d'Etat Volume III, page 816

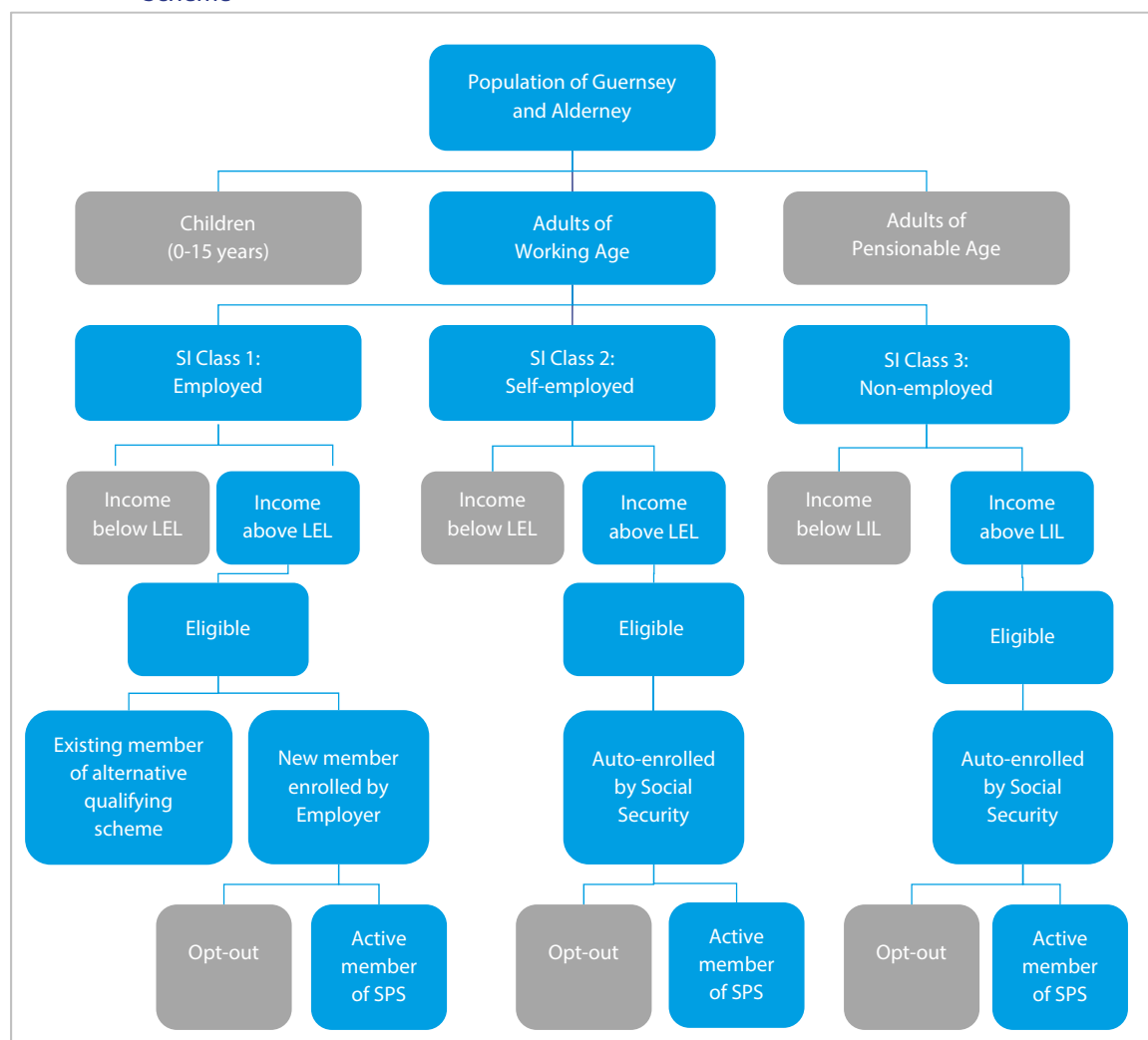
¹⁰ In 2017 the LEL was £6,968 and this value has been used in the modelling. The LEL will be £7,176 in 2018.

¹¹ In 2017 the LIL was £17,420 and this value has been used in the modelling. The LIL will be £17,940 in 2018.

¹² It is possible some employers may want to change their pension provision in light of the policy change and the introduction of a States-facilitated scheme.

Figure 8 illustrates eligibility for the Secondary Pension Scheme.

Figure 8. Flow chart depicting eligibility, auto-enrolment and participation in the Secondary Pension Scheme



It is proposed that the Secondary Pension Scheme will be introduced over an eight year period, with the proposed statutory minimum contribution rates gradually increasing over this period (Table 1). Individuals will also be able to make additional voluntary contributions or lump-sum investments into the Secondary Pension Scheme.

Table 1. Minimum individual and employer pension contribution rates

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 (onwards) |
|-------------------------|------|------|------|------|------|------|------|----------------|
| Individual contribution | 1% | 1.5% | 2% | 3% | 4% | 5% | 6% | 6.5% |
| Employer contribution | 1% | 1% | 2% | 2% | 3% | 3% | 3% | 3.5% |
| Total | 2% | 2.5% | 4% | 5% | 7% | 8% | 9% | 10% |

Source: Billet d'État III 2016 Table 2.

Contributions to the Secondary Pension Scheme will be assessed on an individual's income and depends on their social insurance classification, as described below:

| | |
|---------------------------------------|---|
| SI Class 1: Employed | Assessed on employment income up to the upper earnings limit ("UEL") ¹³ (£138,684 in 2017). |
| SI Class 2: Self-employed individuals | Assessed on i) employment income if employment income exceeds the LEL, and ii) business income if business income exceeds the LEL. Contributions would be based on combined earnings from employment and business income up to the UEL. |
| SI Class 3: Non-employed | Assessed on gross taxable income less allowance for non-employed ¹⁴ (£7,875 in 2017) up to the UEL. |

1.2 Estimating the size of States-facilitated Secondary Pension Scheme

The States-facilitated Secondary Pension Scheme will be built up from contributions paid in by individuals and their employers, along with investment returns achieved, less the benefits and expenses paid out. In order to project the future size of the fund, assumptions about each of these are required. The assumptions underlying the projections are set out in Section 3.4, which have been agreed with the Committee for Employment & Social Security.

¹³ In 2017 the UEL was £138,684 and this value has been used in the modelling. The UEL will be £142,896 in 2018.

¹⁴ In 2017 the allowance was £7,875 and this value has been used in the modelling. The allowance will be £8,110 in 2018.

2. Demographic and Economic Context

2.1 Estimating the Economic Impact

The Secondary Pension Scheme will have an economic impact on individuals and households, employers, government finances, and the economy as a whole. Specifically, the economic impact assessment considers the following effects:

Individuals & Households

- Impact on income of working age individuals who are automatically enrolled in a Secondary Pension Scheme (including income tax paid and effective tax rates)
- Impact on income of pension age individuals who contributed to a Secondary Pension Scheme and receive pension income in retirement, including income replacement rates
- Impact on household income, including eligibility for income support

Employers

- Short- and long-term impact on costs incurred by employers (by sector and size) as they enrol employees into a secondary pension and are required to make an employer contribution

Government Budget

- Marginal impact on income tax revenue
- Marginal impact on company tax revenue
- Net effect on tax revenue, including the implications of changing the tax strategy from EET to TEE
- Marginal impact on government expenditure
- Marginal impact on overall government budget

Economy

- Short- and long-term impact on consumption
- Potential impact on economic growth

2.2 Demographic Profile of Guernsey and Alderney

Guernsey has a population of 62,821 and Alderney has a population of 2,035 (Table 2). A notable difference between the demographic profiles of Guernsey and Alderney is the much higher proportion of the population in Alderney than in Guernsey who are aged 65 and over (35% compared to 19%).

Table 2. Prevailing age distribution of the population in Guernsey and Alderney

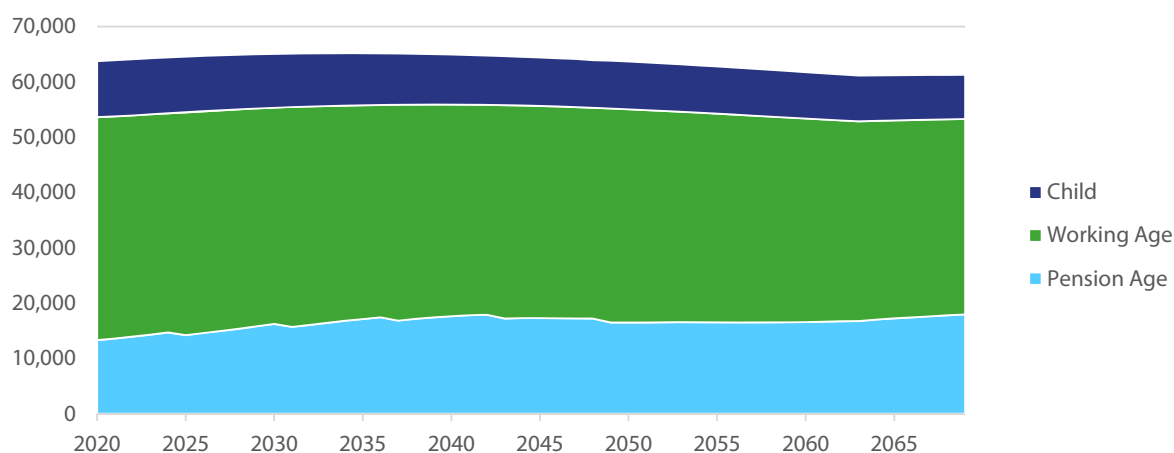
| | Guernsey (as at 31 September 2016) | | Alderney (as at 31 March 2016) | |
|--------------------------|--|-----|--|-----|
| Children 0-15 years | 10,242 | 16% | 202 | 10% |
| Adults 16-64 years | 40,492 | 65% | 1,133 | 56% |
| Adults 65 years and over | 12,087 | 19% | 700 | 34% |
| TOTAL | 62,821 | | 2,035 | |

Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017. States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

The projected population is expected to be reasonably stable over the next 50 years. However, there are demographic changes resulting in an ageing population. By 2069, it is expected that 29% of Guernsey's

population will be aged 70 years or older (i.e. of pension age). The projected changes to the age distribution are shown in Figure 9, and take into account the planned changes to the States pension age.¹⁵

Figure 9. Population Projection for Guernsey until 2069

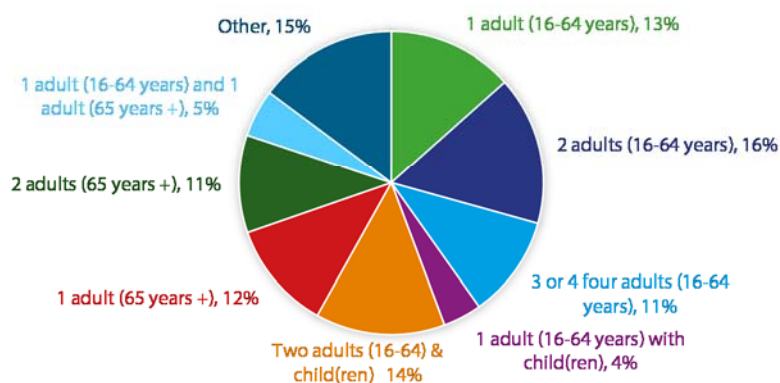


Source data supplied by States of Guernsey.

2.2.1 Household Composition

According to the recent Guernsey Household Income Report most households contain one or two adult members, as shown in Figure 10.¹⁶

Figure 10. Household Composition in Guernsey



Source: States of Guernsey (2017) Guernsey Household Income Report, which reports on 22,209 households in Guernsey as at 31 December 2014.

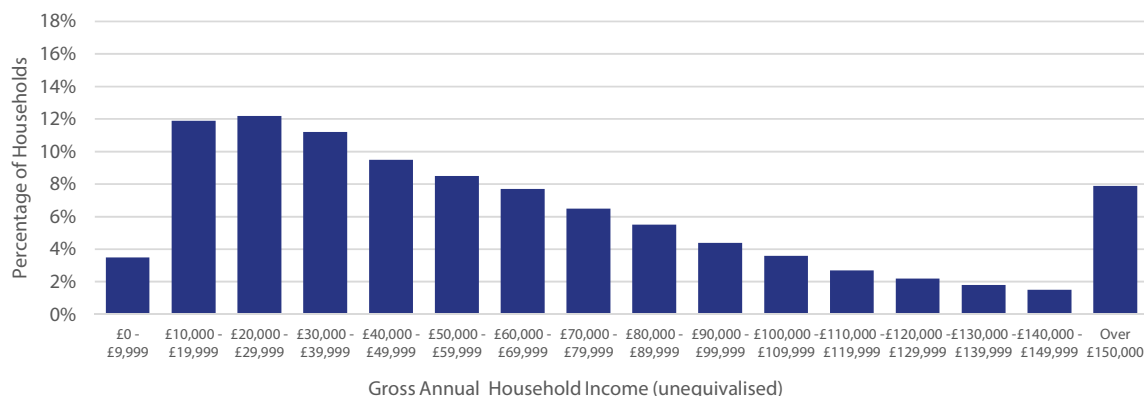
¹⁵ The State pension age will be gradually increased. From 1 March 2020 the pension age will increase by 2 months annually until it reaches 70 years of age (<https://www.gov.gg/oldagepension>). Our analysis takes into account the planned increases in the States pension age, but only when they reach the next full year. Thus, it has been assumed the State pension age will increase to 66 in 2025, 67 in 2031, 68 in 2037, 69 in 2041 and 70 in 2049. These step changes explain the ripples that occur at 2025, 2031, 2037, 2041 and 2049 in Figure 9.

¹⁶ There are no published statistics on the household composition and household income in Alderney.

2.2.2 Household Income

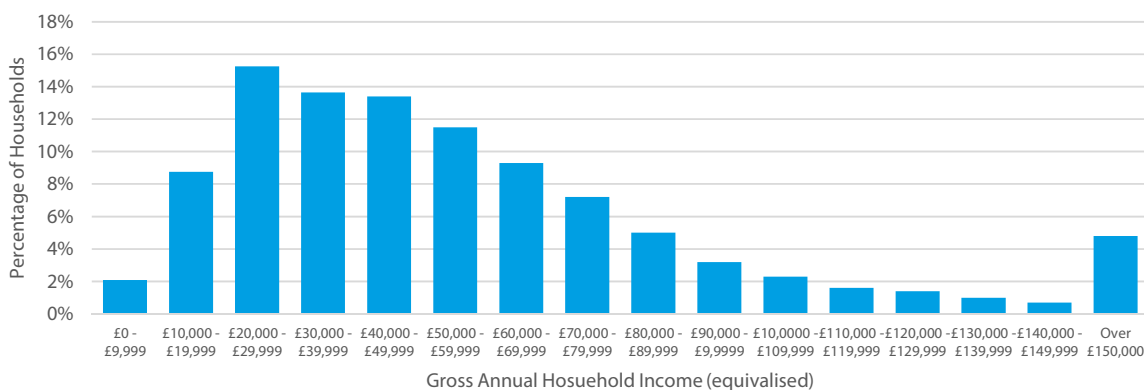
Mean annual gross household income¹⁷ in 2014 was £71,129, and median gross household income was £51,877.¹⁸ On an equivalised basis, mean gross annual household income was £61,099 and median gross annual household income was £47,838.¹⁹ Equivalised incomes take into account the exact size and composition of the household, and were determined for each household using an international standard adjustment. Income is then expressed relative to the level of income for a two adult household which would represent an equivalent level of resources. The distribution of annual gross household income for 22,209 households in 2014 is shown Figure 11 and Figure 12.

Figure 11. Distribution of annual gross income for households in Guernsey



Source: States of Guernsey (2017) Guernsey Household Income Report.

Figure 12. Distribution of annual gross income for households in Guernsey (equivalised to adjust for differences in household composition)



Source: States of Guernsey (2017) Guernsey Household Income Report.

¹⁷ Gross household income is defined as the total income of a household derived from the following sources: employment income, business income, old age (i.e. States) pension, private occupational pension, private personal pension, distribution income, annuity income, bank interest, loan interest, benefits and rent rebates.

¹⁸ States of Guernsey (2017) Guernsey Household Income Report, which reports on 22,209 households in Guernsey as at 31 December 2014

¹⁹ States of Guernsey (2017) Guernsey Household Income Report.

Individuals typically spend a large proportion of their net income. Total household expenditure (excluding capital investments and money transfers) was reported to be 74% of mean total household income and 90% of median total household income in Guernsey in 2012-13.²⁰ Housing, fuel and power are often a large portion of household expenditure, and these categories constituted 26% of overall household expenditure. Groceries (excluding alcohol) and transport were also key areas of spend, and each represented almost 10% of household expenditure. It should be noted that expenditure can be funded from income or savings.

2.2.3 Employment Status

Two-thirds (67%) of working age adults in Guernsey and Alderney are employed, and a further 8% are self-employed (Table 3). The remaining 25% are classified as non-employed for social security purposes (this includes individuals 16 years and over in full-time education).

Table 3. Social Insurance Classification

| | Guernsey (as at 31 March 2017) | Alderney* (as at 31 March 2016) | Guernsey and Alderney | |
|-------------------------|--|---|------------------------------|-------------|
| Class 1: Employed | 27,150 | 633 | 27,783 | 67% |
| Class 2: Self-employed | 3,094 | 148 | 3,242 | 8% |
| Class 3: Non-employed** | 10,248 | 352 | 10,600 | 25% |
| Total | 40,492 | 1,133 | 41,625 | 100% |

*Assumes all employees and self-employees are working age.

** Number non-employed is the total working age adults less number employed and self-employed.

Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017. States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

²⁰ States of Guernsey (2014). The 2012-13 Household Expenditure Survey Report.

2.3 Economic Profile of Guernsey and Alderney

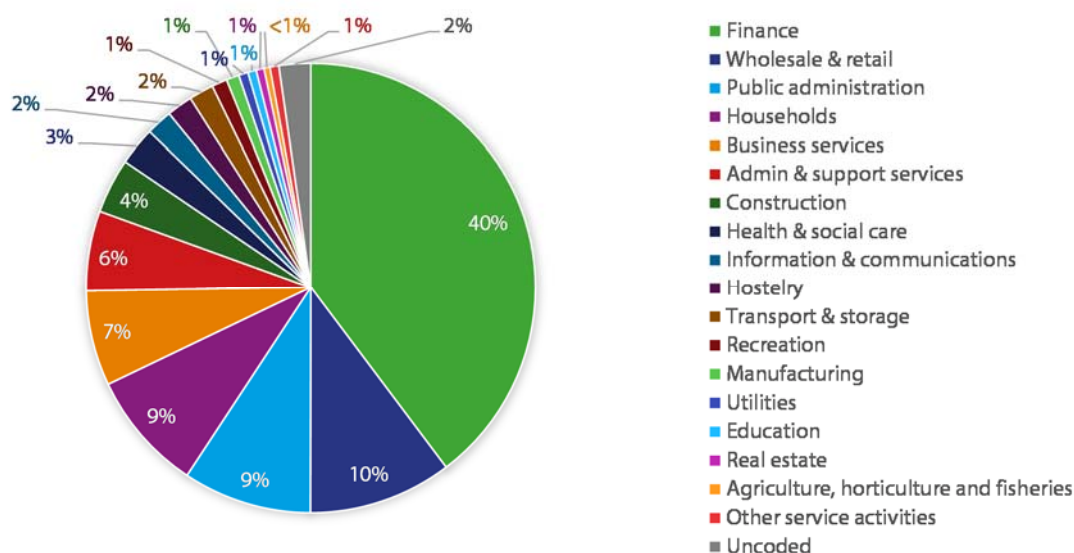
To understand the economic impact of the proposed Secondary Pension Scheme, it is useful to outline some of the important structural features of Guernsey and Alderney's economy:

- High Gross Domestic Product (GDP) per person
- An ageing population and a high dependency ratio
- Very low unemployment rates, representing "full employment" by international standards
- Labour constraints in Guernsey due to housing and migration controls, and compounded by geographic location and size
- Employment concentrated in a small number of sectors that are export-focused and compete globally (especially financial services).
- Employment in service sectors primarily satisfy local demand because of the islands' remote location. As such firms may find it easier to pass on additional costs in price increases, than businesses serving the export market.
- Seasonal variations in labour in some sectors, with employment rising in the summer and decreasing in the winter months.

2.3.1 Gross Domestic Product in Guernsey

GDP is the principle measure of economic output and economic growth is the change in economic output, usually measured as the change in GDP.²¹ In Guernsey, GDP is calculated as the sum of the island's income. The first estimate of GDP in 2016 was £2,868 million, of which 45% was compensation of employees, 38% was gross operating surplus, 8% was rental income of households, 6% was mixed income and 2% was taxes less subsidies.²² As Figure 13 shows, finance is by far the largest economic sector in Guernsey; in 2015 it contributed 40% of GDP. Wholesale and retail and, public administration are also relatively large contributors to GDP.

Figure 13. Contribution to Gross Domestic Product, by economic sector in 2016



Source: States of Guernsey (2017). Guernsey Annual GVA and GDP Bulletin

²¹ Annual GDP is the total value of a country's annual output of goods and services and is the sum of consumption, investment, public spending and the balance of trade (exports minus imports).

²² States of Guernsey (2017) Guernsey annual GVA and GDP Bulletin, Issue date 7 December 2017. The totals do not sum to 100% due to rounding.

2.3.2 Profile of Employers in Guernsey and Alderney

There are just over 2,500 employers; micro and small employers are prevalent (Table 4). Across the islands, 69% of employers have up to 5 employees, and 82% have up to 10 employees. Less than 4% of employers are medium and large firms. However, some employers are part of larger UK or international groups. It is also notable that just over a third of employers have a single employee.

Table 4. Number of employers in Guernsey and Alderney, by size

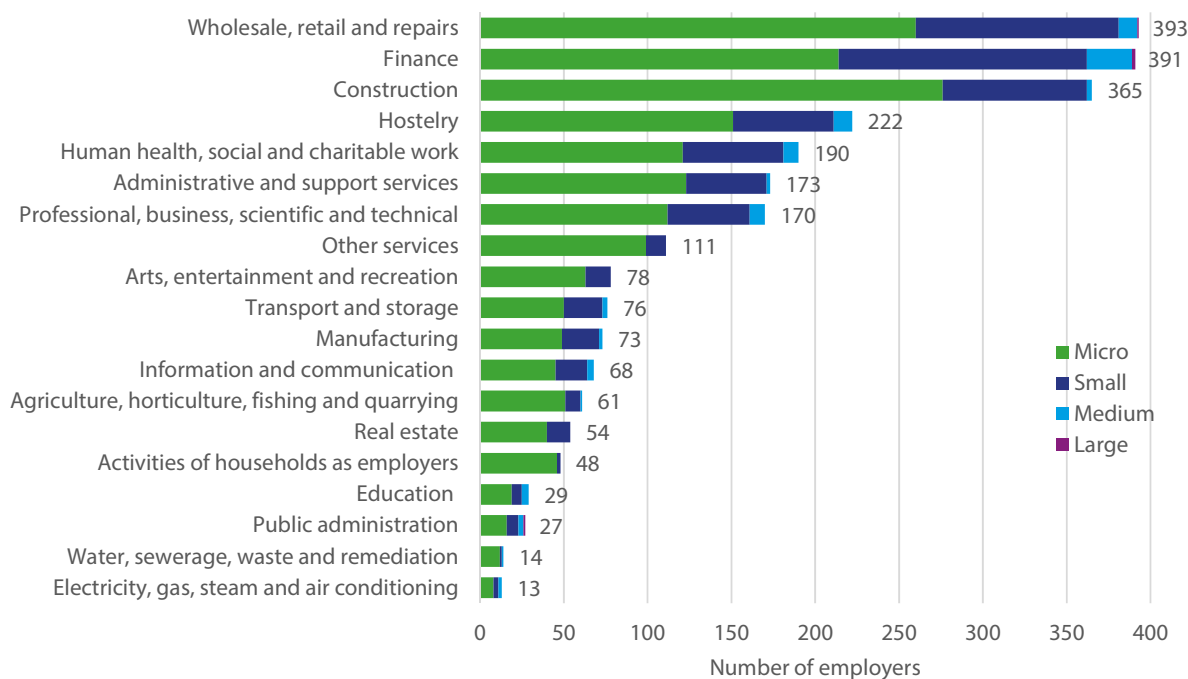
| Employer Size (number of employees) | | Guernsey (as at 31 September 2016) | | Alderney (as at 31 March 2016) | | Guernsey and Alderney | |
|--|-------------|---------------------------------------|-----|-----------------------------------|-----|-----------------------|-----|
| Micro | 1 | 802 | 33% | 60 | 44% | 862 | 34% |
| | 2 to 5 | 842 | 35% | 51 | 38% | 893 | 35% |
| Small | 6 to 10 | 325 | 13% | 10 | 7% | 335 | 13% |
| | 11 to 25 | 248 | 10% | 10 | 7% | 258 | 10% |
| | 26 to 50 | 108 | 4% | 4 | 3% | 112 | 4% |
| Medium | 51 to 100 | 57 | 2% | 0 | 0% | 57 | 2% |
| | 101 to 250 | 34 | 1% | 1 | 1% | 35 | 1% |
| Large | 251 to 1000 | 3 | <1% | 0 | 0% | 3 | 0% |
| | Over 1000 | 1 | <1% | 0 | 0% | 1 | 0% |
| TOTAL | | 2420 | | 136 | | 2556 | |

Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017.

States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

Figure 14 shows the distribution of employers by sector and size. Just over half (54%) are from four sectors of the economy: wholesale, retail & repairs (15%); finance (15%); construction (14%); and hospitality (9%).

Figure 14. Number of employers in Guernsey and Alderney, by economic sector and employer size

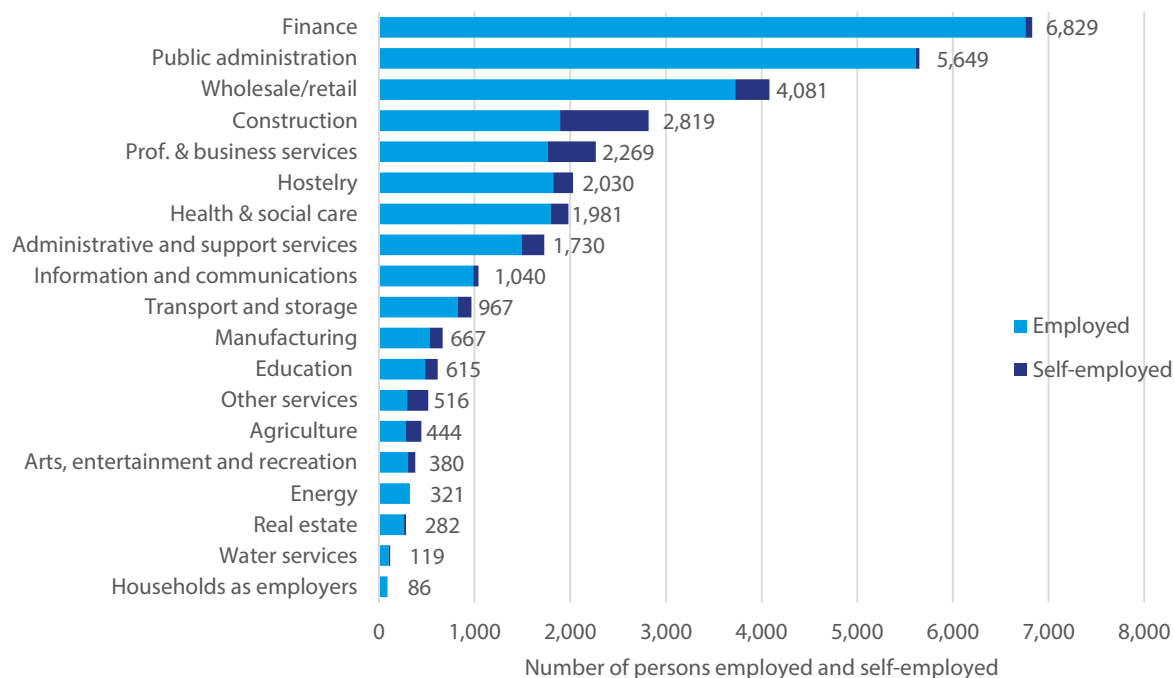


Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017.

States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

Figure 15 shows the number of people employed and self-employed across the two islands by sector. Half (50%) of the workforce are in three sectors: finance (21%); and public administration (17%); and wholesale, retail & repairs (12%).

Figure 15. Number of persons employed and self-employed, by economic sector

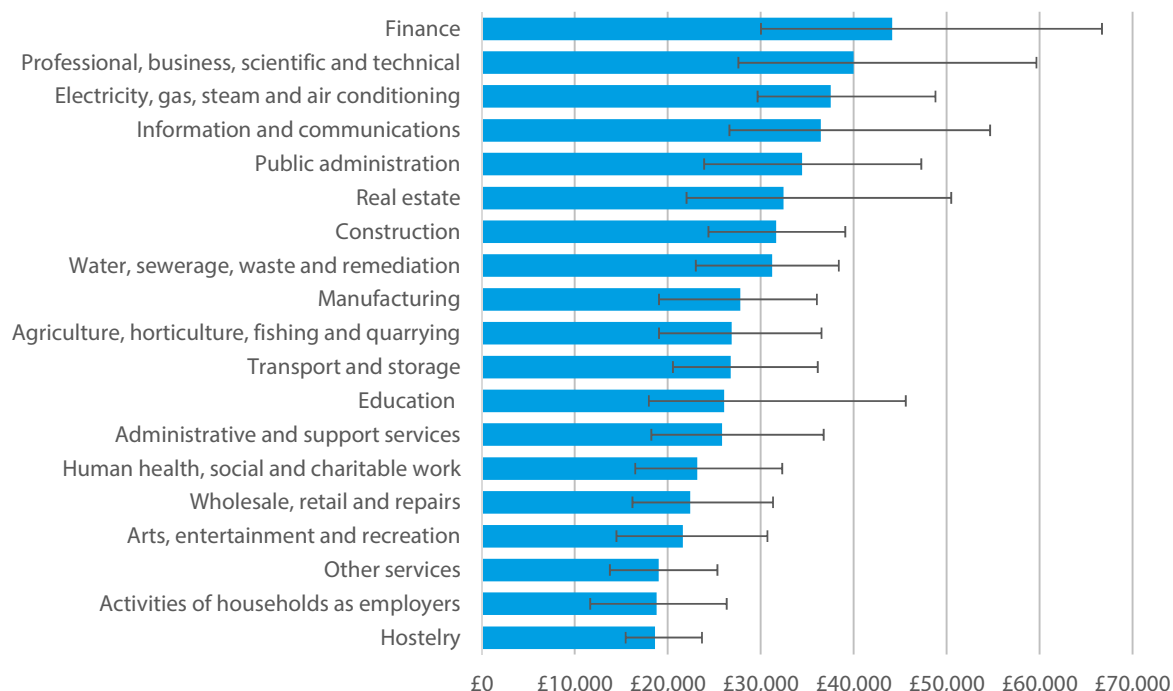


Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017.

States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

Median earnings were £31,773 in Guernsey (as at 31 March 2017) and £23,609 in Alderney (as at 31 March 2016).²³ Median earnings by sector for Guernsey are shown below (equivalent data for Alderney were not available).

Figure 16. Median Earnings, by sector in Guernsey (with lower and upper quartile range)



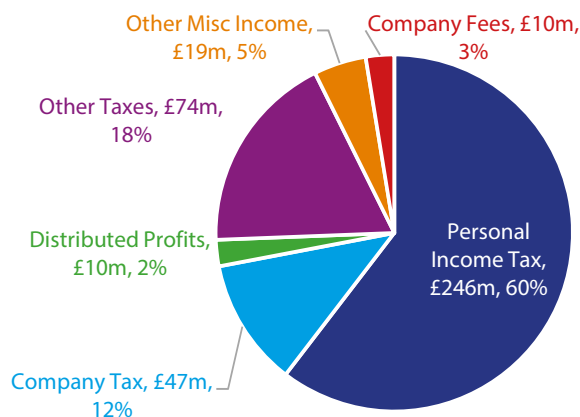
Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017.

²³ States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017.

2.3.3 Government Budget for the States of Guernsey

In 2016 the States of Guernsey received £407 million in general revenue income and further £37.4 million in operating income, £10.5 million in capital income.²⁴ As shown in Figure 17, personal income tax was the largest single source of revenue, yielding £246 million; a further £47 million was raised in company tax revenue.

Figure 17. Government Revenue Income



Source: States of Guernsey 2016 Government Accounts

Gross revenue expenditure was £400.5 million in 2016, and there was a further £60.4 million in formula led expenditure (which includes the cost of Social Insurance and Health Service grants). Net revenue expenditure for the Committee for Employment & Social Security was £70.2 million. There were 2,327 households receiving almost £21 million in supplementary benefit at the end of 2016.

²⁴ States of Guernsey (2017). Billet d'Etat XIII 2017. The States of Guernsey Accounts 2016.

3. Methodology

3.1 Actuarial Model

3.1.1 Projecting the States-facilitated Secondary Pension Scheme

The pension scheme projections model the impact of the introduction of the Secondary Pension Scheme over a 50 year period (from 2020 to 2069). The projections have been carried out for the States-facilitated Secondary Pension Scheme and do not include any alternative qualifying schemes.

3.1.2 Approach to projecting the States-facilitated Secondary Pension Scheme

The pension scheme model projects the future size of the States-facilitated fund over each year into the future over the 50 year time horizon. Assumptions are then varied in order to illustrate the sensitivity of the results to changes to a range of different assumptions. The assumptions underlying the projections are set out in the Section 3.4.

The following approach to the modelling has been adopted:

- The population has been split up into groups of individuals with similar characteristics
- A population profile has been created, consisting of model points representing each group of individuals (including those not yet born)
- Each model point has been projected into the future, in order to establish the expected contributions payable and the benefits expected to be received
- Results for the entire pension scheme have then been constructed from the model points by applying appropriate weightings

3.1.3 Model points

The model points represent an “average” individual within each population group. There is a separate group for each of the following factors:

- Age
- Income band
- Social Insurance Classification (employed, self-employed and non-employed)

3.1.4 Projecting individuals

In order to project future contributions and benefits for each model point, assessable income is projected up to retirement. The income projection is derived by considering the age dependent income percentiles of the current population and applying the same pattern of growth as the income percentiles imply (i.e. if a member is a median earner for their current age then they will continue as a median earner throughout their working lifetime).

The pension fund is accumulated in line with the investment return assumption. This assumption includes an Annual Management Charge (AMC) of 0.5% per annum. The investment return is assumed to reduce gradually over the period approaching retirement, in anticipation of members taking lower investment risk.

At retirement, a lump sum benefit is calculated and the remaining funds are converted into pension using expected market annuity rates. The model allows for the planned increases to the States pension age (see Section 2.1).

3.1.5 Constructing the scheme population

The individual projections for each model point were combined by applying weightings, reflecting the proportion that each model point represents of the total population. The weightings are adjusted to allow for

changes to the population over time, as provided by the States' General Economic Model under the States' central population projection assumptions.

When combining the results, the model applies the opt out rates and assigns the proportion of contributions and benefits which are expected to fall within the States-facilitated scheme (i.e. it excludes those expected to fall within existing occupational schemes and new qualifying schemes set up by employers).

3.1.6 Additional modelling to feed into the economic impact assessment

The economic impact assessment requires projections of pension benefits for any new pension income arising directly as a result of the Secondary Pension Scheme. In order to do this, the actuarial projections model is used to generate results that include both the States-facilitated scheme and all new alternative qualifying schemes.

3.2 Economic Impact Assessment

The economic impact assessment examines the introduction of the Secondary Pension Scheme compared to 'doing nothing' (i.e. Secondary Pension Scheme is not introduced) over a 50 year period (from 2020 to 2069).²⁵ It focuses on the marginal impact and does not differentiate between whether the individual contributes to the States-facilitated scheme or alternative qualifying schemes.

3.2.1 Conceptual Framework for Economic Impact Assessment

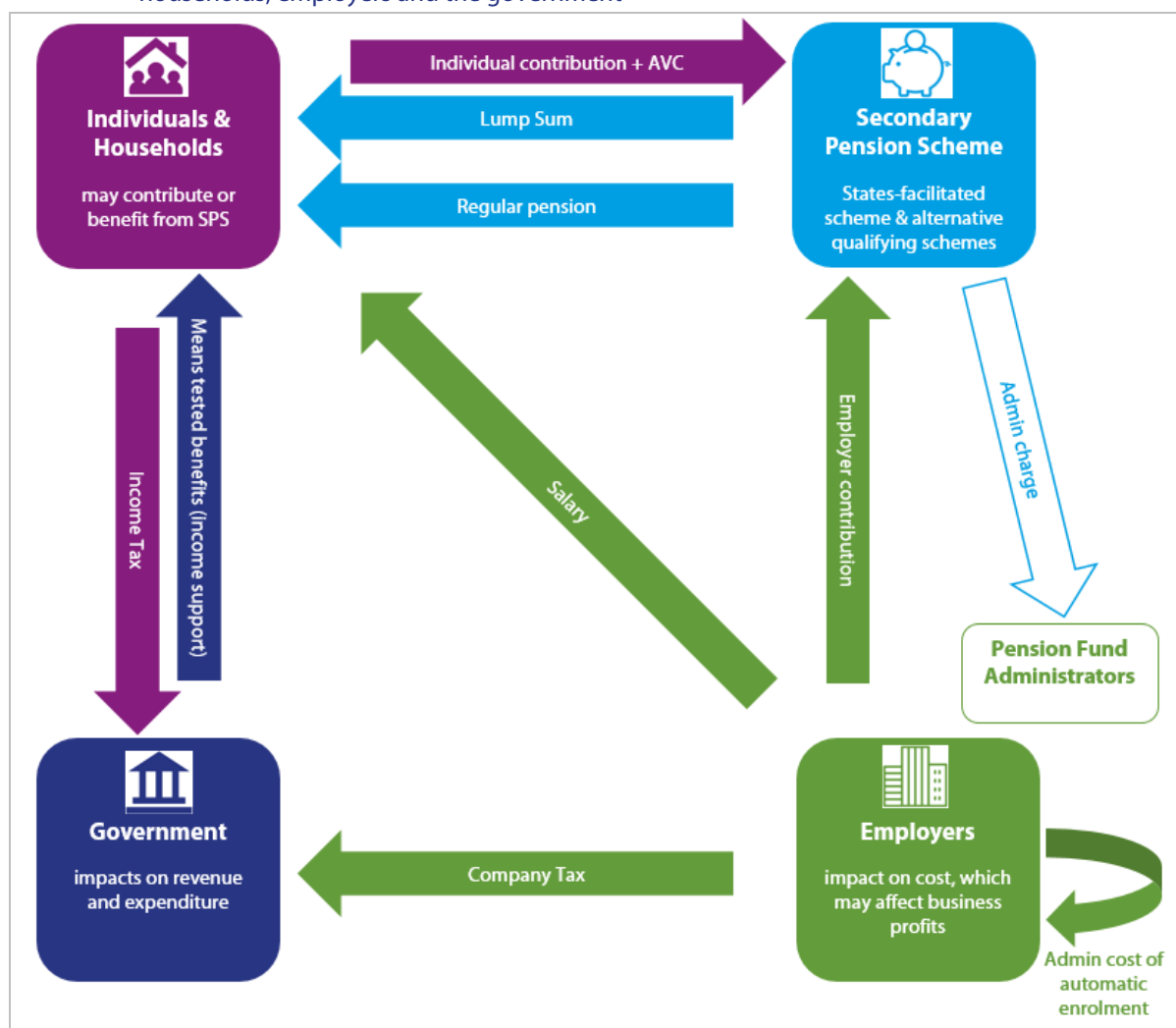
Figure 18 depicts the direct effects of the Secondary Pension Scheme on the financial flows that occur between individuals/households, employers and the government. These effects are summarised below and described in further detail in Sections 5-8 of the report.

Impact on individuals and households (see Section 5)

- Individuals of working age who meet the eligibility criteria and are not already in an occupational pension will be automatically enrolled into the Secondary Pension Scheme. Individuals who are automatically enrolled will be allowed to opt out.
- Individuals who pay income tax and contribute to a Secondary Pension Scheme will pay less in income tax since pension contributions will be tax exempt.
- Individuals of pensionable age who have contributed to a secondary pension would benefit from regular pension income when they reach the States pension age. They may then pay more in income tax, since the pension income will be included in their income tax assessment.
- Household income may be affected by the Secondary Pension Scheme. However, this will depend on household composition and whether household members contribute to or benefit from the Secondary Pension Scheme. The proportion of pensioners requiring income support (currently supplementary benefit and rent rebate) and any other means-tested benefits may also be reduced as they benefit from a secondary pension income. The income of working age individuals on income support is unlikely to be affected as pension contributions are included when calculating the benefit and income support may be increased.

²⁵ The results of the economic model would not be significantly affected by minor delays to the start date.

Figure 18. Direct effect of the Secondary Pension Scheme on financial flows between individuals and households, employers and the government



Impact on Employers (see Section 6)

- Employers will be required to make the minimum employer contribution for employees who do not opt out of the Secondary Pension Scheme.
- Employers may also incur administrative costs to comply with the legislation.
- The impact on the employer will depend on whether they already offer an occupational pension, salary levels, and how the employer responds to the policy change.

Impact on the Government Budget (see Section 7)

- Government revenue from personal income tax will be affected. Secondary pension contributions and any lump sum benefit payments are expected to be exempt from tax; regular pension income may be taxed and will be included in individuals' income tax assessment.
- Government revenue from company tax may also be affected if employers are unable to recover the costs relating to the Secondary Pension Scheme (through cost savings elsewhere, sales revenue or productivity gains) and company profits are reduced.

- As individual and household incomes increase in the pension age population, government expenditure on income support may be reduced. However, it is also expected that there would be an increase in the amount of income support paid to working age individuals, since the eligibility assessment for income support allows for pension contributions.

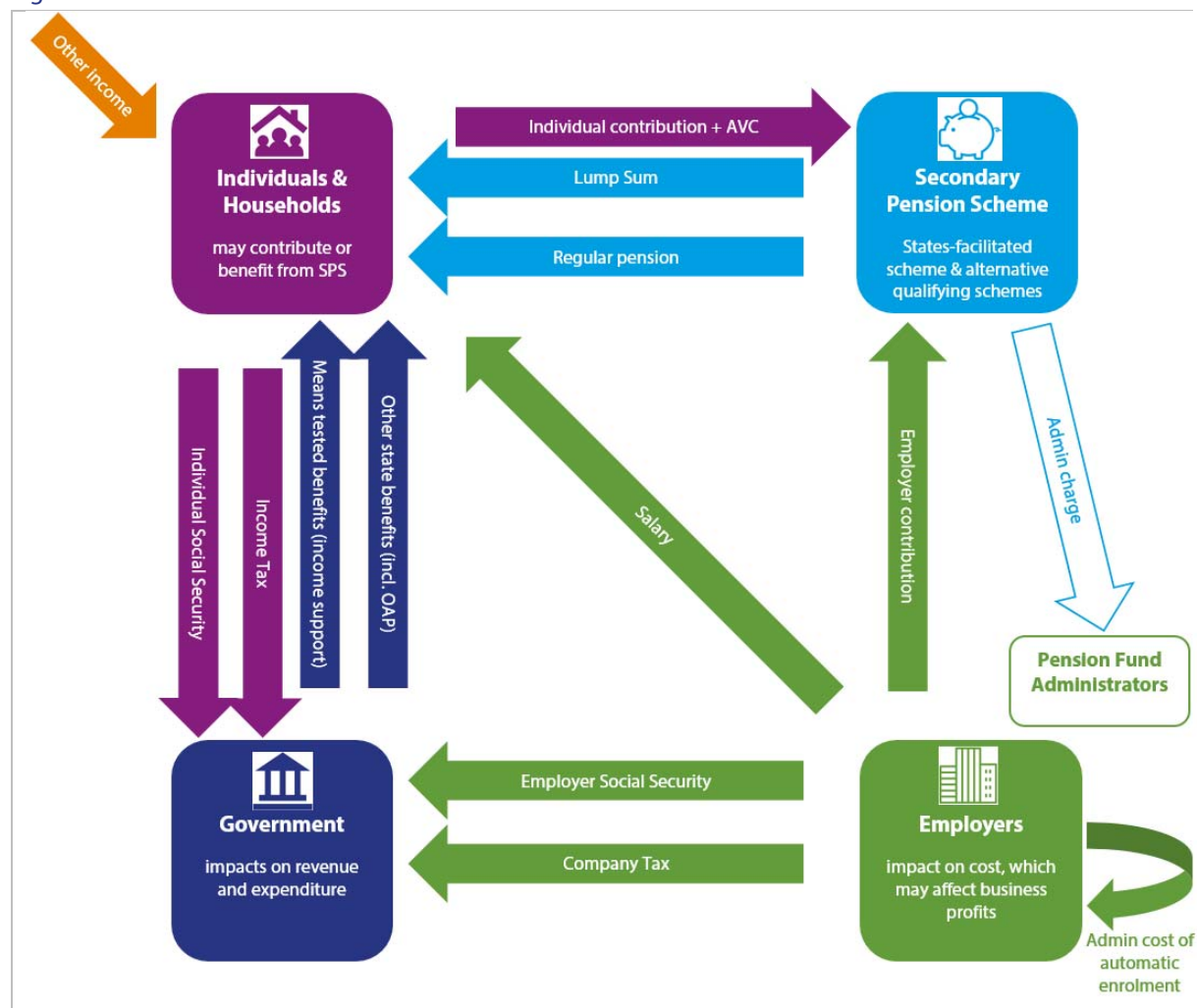
Impact on the Economy (see Section 8)

- Consumption (i.e. consumer spending) will be affected, as household disposable income is expected to change. An increase in disposable income would be expected to increase consumer spending, while a reduction in disposable income would be expected to lead to a reduction in consumer spending.
- It may also impact on economic growth, as this is a function of consumption, investment, government spending, and the value of exports less imports.
- The economic impact will evolve over time. In the short- to medium-term the costs will outweigh the benefits, as there will be many more contributors than beneficiaries. As time passes, the number of beneficiaries will increase. The amount an individual can expect in pension income as a result of the Secondary Pension Scheme contributions will also increase, since pension income is a function of the amount paid into the scheme and the investment return achieved. A steady state is expected to be achieved by the end of the century.

3.2.2 Economic model

The marginal impact of the Secondary Pension Scheme is estimated by comparing a future scenario in which the scheme is introduced to a scenario of 'doing nothing'. Estimating the magnitude of these impacts requires certain assumptions about how individual, employers and consumers behave, as well as about the wider policy environment. The structure of the economic model is illustrated in Figure 19.²⁶

Figure 19. Elements of the Economic Model



²⁶ Note – differs slightly from conceptual framework as does not include the pension fund administrator and needs to include other income and social security

3.2.3 Economic model for impact on individuals, households and government finances

The economic model has been structured to take into account the following inputs:

- Year (and corresponding contribution rate) from 2020 to 2069.
- Age profile of the population, and projected population changes
- Employment status of the working age population, as defined by social insurance classification: employed, self-employed and non-employed.
- Assumptions about the percentage of employees who are active members of an existing occupational pension
- Gross taxable income (and source of income)
- Household composition
- Proposed changes in the States pension age
- Prevailing tax and benefit rates and allowances
- Assumptions about the opt out rate

The model uses data provided from the Electronic Census in Guernsey and Alderney, population projections supplied by the States of Guernsey, and official States publications.

The model includes 80 profiles for individuals of working age, which are defined by:

- Gross taxable income: 20 income bands
- Social insurance classification: employed, self-employed, non-employed
- Whether employees are an active member of existing scheme: yes or no

Pension age profiles are defined by gross taxable income and take into account an individual's age and the year as these factors determine the pension income that an individual can expect from the Secondary Pension Scheme.

The profiles are combined to estimate the overall impact of the Secondary Pension Scheme using population weights. The weight assigned to each profile is derived from population projections supplied by the States of Guernsey and the 2014 Electronic Census dataset. The income and employment profile of the working age population is assumed to remain constant over time in the 'do nothing' scenario. The income profile of the pension age population is assumed to remain constant over time in the 'do nothing' scenario. Thus, changes in income that arise if the Secondary Pension Scheme is introduced can be attributed to it.

The economic model predicts the following outputs for each year of the projection:

- Number of individuals who are eligible to join the scheme
- Number of individuals who are active members of an existing occupational pension
- Number of new members of a secondary pension (auto-enrolled by employer or Social Security)
- Number of new members who opt out of the Secondary Pension Scheme
- Total income tax due
- Total social security contributions
- Individual and employer pension contributions
- Change in net income (gross taxable income less income tax, social security and pension contributions)
- Change in eligibility for means-tested benefits, and estimated change in income support payments

The model has been structured to enable sensitivity analysis on key parameters, as set out in Section 3.4. The model is comprehensive and, with some adaption, could be used to assess the economic impact of other changes to the tax and social security system.

3.2.4 Economic Model for Impact on Employers

The model predicts the impact on employers of different sizes and the impact on company tax revenue (which depends on sector). It has been structured to take into account the following inputs:

- Year (and corresponding contribution rate) from 2020 to 2069.
- Economic sector
- Employer size (i.e. number of employees)
- Assumption about the availability of existing occupational pensions
- Fixed and variable administration costs incurred by employers
- Mean employment income by economic sector
- An opt out rate
- Prevailing company tax rate
- Assumptions on the proportion of costs borne by the employer and ability of employers to recover costs incurred through productivity gains.

It has also been assumed that the Secondary Pension Scheme will be rolled out to all employers at the same time given the prevalence of micro and very small employers (82% of employers in Guernsey and Alderney have 10 or fewer employees).²⁷ Changes to the implementation start date, or adopting a staged implementation, would have a relatively minimal impact on the overall model results.

The model uses employment and earnings data published by the States of Guernsey and Alderney. Electronic Census data from Guernsey and Alderney were used to validate assumptions about the existing availability of occupational pensions by economic sector and employer size.

The model includes 116 profiles for employers, which combined data on economic sector and employer size. The profiles are combined to estimate the overall impact of the Secondary Pension Scheme in Guernsey and Alderney using employer weights. The weight assigned to each profile is taken from published data on the number of employers by sector and size for Guernsey and Alderney.

The economic model predicts the following outputs for each year of the projection:

- Number of new employers who offer a Secondary Pension Scheme (either the States-facilitated scheme or an alternative qualifying scheme)
- Number of employees who are automatically enrolled to a Secondary Pension Scheme
- Number of employees who opt out
- Individual and employer pension contribution
- Administrative cost incurred by employers
- Total cost of the Secondary Pension Scheme on employers
- Potential reduction in company profits
- Expected loss in company tax revenue

The model has been structured to enable sensitivity analysis on key parameters, as set out in Section 3.4.

²⁷ If a staged roll out were desired, then it may be preferable to stage by economic sector than by employer size.

3.3 Data Sources

We were provided anonymised individual level data from the Electronic Census for 2014, which contained data from 76,757 individual income tax and social security records. Raw data were cleaned following the steps set out in the Guernsey Household Income Report²⁸ and with advice from Data and Analysis, States of Guernsey. The clean dataset has records for 58,010 individuals from Guernsey and Alderney. These represent 36,905 adults of working age, 11,500 adults aged 65 and over and 23,109 households. Monetary values have been inflated to 2017 terms using RPIX²⁹. Missing data were accounted for in the analysis using population weights that take into account social insurance classification and age category.

Table 5. Cleaned Electronic Census Data vs Annual E-Census Reports for Guernsey and Alderney

| | Published Statistics (as at 31 March 2016) | | | Clean E-Census Data (as at 31 Dec 2014) | |
|---------------------------|---|--------------|---------------|--|------------|
| | Guernsey | Alderney | Combined | N | % missing |
| Children 0-15 years | 10,155 | 202 | 10,357 | 9,605 | 7% |
| Working Age (16-64 years) | 40,638 | 1,133 | 41,771 | 36,905 | 12% |
| Employees | 27,764 | 633 | 28,253 | 28,253 | <1% |
| Self-employed | 3,131 | 148 | 3,279 | 3,121 | 5% |
| Non-employed | 9,743 | 352 | 10,095 | 5,531* | 45% |
| Pension Age (65 years +) | 11,930 | 700 | 12,630 | 11,500 | 9% |
| TOTAL | 62,723 | 2,035 | 64,758 | 58,010 | 10% |

* of whom 658 made SI contributions in 2014

²⁸ States of Guernsey (2017). Guernsey Household Income Report, which reports on 22,209 households in Guernsey as at 31 December 2014. Appendix 1.

²⁹ States of Guernsey (2017). Guernsey Quarterly Inflation Bulletin Quarter 2 2017. Issue date 21 July 2017.

3.4 Assumptions for modelling

The actuarial and economic models are based on the following assumptions.

3.4.1 Secondary Pension Scheme Structure

| Feature | Assumptions | Sensitivity | Justification |
|---|---|-------------|----------------------|
| Launch date | 2020 | N/A | February 2016 Billet |
| Potential membership | Individuals of working age who pay Social Security contributions | N/A | February 2016 Billet |
| Contributions Structure (% of gross salary up to Upper Earnings Limit) | Employed, self-employed and non-employed: Initially 1%, increasing to 6.5% over 7 years, no additional voluntary contributions Employer: 1% initially, increasing to 3.5% over 7 years | N/A | February 2016 Billet |
| Retirement Age | Increasing with increases in States Pension Age (66 years from 2025, 67 years from 2031, 68 years from 2037, 69 years from 2043 and 70 years from 2049) | N/A | February 2016 Billet |

3.4.2 Population Projections

| Feature | Assumptions | Comment |
|---|---|--|
| Population projections | Generated by the States General Economic Model using the States of Guernsey's central projection assumptions | Projections over 2020 – 2069 |
| Working age population | Retirement age increases with increase in States Pension Age to 70 by 2049 | States agreed policy |
| Employment status of the working age population | 67% are employed, 8% are self-employed, 25% are non-employed (of whom 7% earn above the lower earnings limit) | Guernsey Quarterly Population, Employment and Earnings Bulletin. Alderney Electronic Census Report 31 March 2016. Electronic Census Data |

3.4.3 Behavioural Assumptions

| Parameter | Assumption | Sensitivity | Comment |
|--|---|--|---|
| Opt-out rate | 20% | 10%, 15%, 25%, 30% | This is a key assumption and UK experience has shown that it is difficult to predict. See Appendix 11.1 for more details. |
| Persistency | 100% | None | Simplifying assumption. Once employees are enrolled and contributing they are assumed to continue to contribute until States Pension Age. |
| Lump sum at retirement | 25% | ± 5% | The maximum permitted under current tax legislation is 30%. The availability of tax-relief on the lump sum is expected to make it a popular option. |
| Proportion of employers who use an alternative qualifying scheme (rather than the States-facilitated scheme) | 50% | ± 20% | This is difficult to estimate due to the lack of available data. |
| Proportion of employees who are existing active members of an occupational pension | 32% on average, though the model uses a % that varies by gross taxable income (see Appendix 11.2) | Lower and upper estimates in which base case values are scaled up and down by 10% (i.e. 28% to 36% on average) | Income Tax records from 2014 on proportion of employees contributing to an occupational pension, adjusted based on an assumption that 20% of private sector schemes are non-contributory. See Appendix 11.2 for more details. |
| Proportion of employers who currently offer an occupational pension | % varies by sector and employer size (see Appendix 11.3) | None, but have varied % of employees who are existing active members. | Estimate based on published data on Employment and Earnings and on the proportion of employees who are active members of an occupational pension. See Appendix 11.3 for more details. |
| Employer response | 100% costs borne by employer | 50% costs borne by employer | This is difficult to predict. Model the worst case and a moderate scenario in which employers reduce future pay awards. |
| Marginal propensity to consume (marginal change on consumption following a change in income) | 0.8 | 0.6, 1 | 2012-13 Household Expenditure Survey reported expenditure was 74% of mean total household income, and 90% of median household income. A study on the economic and fiscal impact of the increasing the minimum wage in Jersey assumed lower earners would spend all additional income. |

3.4.4 Financial and Economic Assumptions

| Parameter | Assumptions | Sensitivity | Comment |
|--|--|-------------|--|
| Investment return on Secondary Pension Scheme | <ul style="list-style-type: none"> RPIX +2.5% per annum up to 10 years before retirement Transitioning to RPIX in the last 10 years prior to retirement | ± 1% | A move to a lower risk / return strategy is assumed as an individual approaches retirement age. See Appendix 11.4 for more details |
| Earnings Growth | <ul style="list-style-type: none"> Increase at the rate of inflation RPIX + 1% per annum Promotional increases to maintain existing salary profile of the population by age | ± 0.5% | As advised by the States |
| Conversion of funds into pension at retirement | <ul style="list-style-type: none"> Market annuity rates | None | Current market rates for a level single life annuity will be adjusted to allow for expected future improvements in mortality. Conversion terms at age 70 in 2020 are assumed to be 6.2%, and in 2069 are assumed to be 5.1%. |
| Tax and Benefit Rates and Allowances | <ul style="list-style-type: none"> Tax and social security rates remain constant Tax and social security allowances increase in line with earnings growth Benefits increase RPIX plus at 1/3 of real earnings growth until 2024 and then at RPIX Income support (which combines supplementary benefit and rent rebate) is introduced as planned. | None | Benefit Payment & Contribution Rates for 2017 no. 50. March 2016 Billet Increases as advised by the States |
| Economic conditions | <ul style="list-style-type: none"> Underlying economic conditions remain stable over analysis period | N/A | Simplifying assumption so changes in the model reflect the impact of the Secondary Pension Scheme |

3.4.5 Other Assumptions

| Feature | Assumptions | Sensitivity | Justification |
|------------------------------------|--|-------------|---|
| Administrative costs for employers | <p>Year 1: fixed cost of £500 per firm + variable cost of £25 per employee</p> <p>Thereafter: £200 per firm + £10 per employee</p> | ± 50% | Based on UK experience of small and medium employers. See Appendix 11.5 |

4. Size of States-facilitated Secondary Pension Scheme

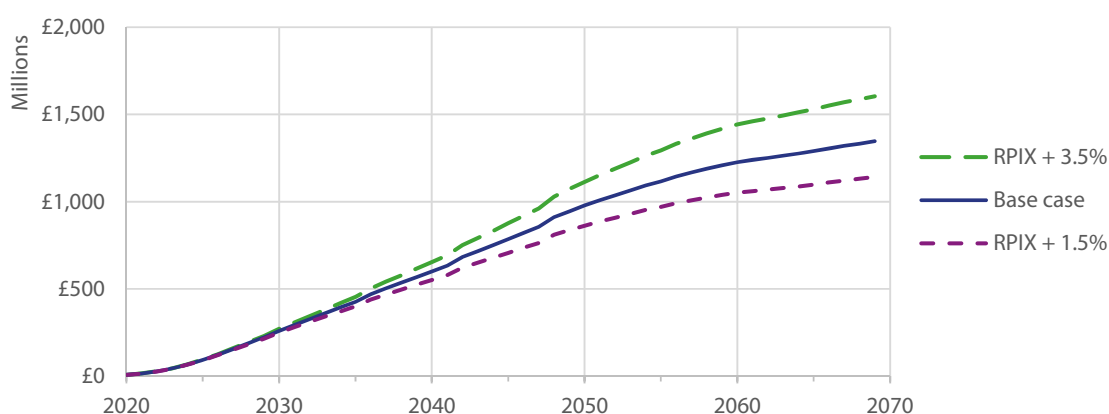
The States-facilitated Secondary Pension Scheme is projected to have assets of around £1.3 billion after 50 years, under the assumptions set out in Section 3.4. The results are sensitive to the assumptions chosen and the charts illustrate how the results change when certain key assumptions are changed. In each graph the “Base Case” assumptions are shown as the dark blue line.

The size of the fund is expected to begin to stabilise by the end of the 50 year period, when the benefit payments reach a level which broadly balances the total of the contribution income and investment returns. This is due to the maturing nature of the scheme, with benefit payments being lower in earlier years since those receiving benefits in the early years will not have contributed for their entire working life. The Secondary Pension Scheme is expected to reach an equilibrium towards the end of the projection period. From that point, the size of the fund is expected to increase in line with the population-related real growth in income, which is 1% per annum for the base case assumption.

4.1 Sensitivity to Investment Return

The size of the fund is sensitive to the investment returns achieved. Figure 20 shows that if investment returns are 1% per annum higher than assumed then the fund size is projected to be 19% higher after 50 years (the base case assumption is broadly an investment return of RPIX + 2.5% per annum). If investment returns are 1% per annum lower than assumed then the fund size is projected to be 15% lower after 50 years.

Figure 20. Fund size for States-facilitated scheme: sensitivity to investment return



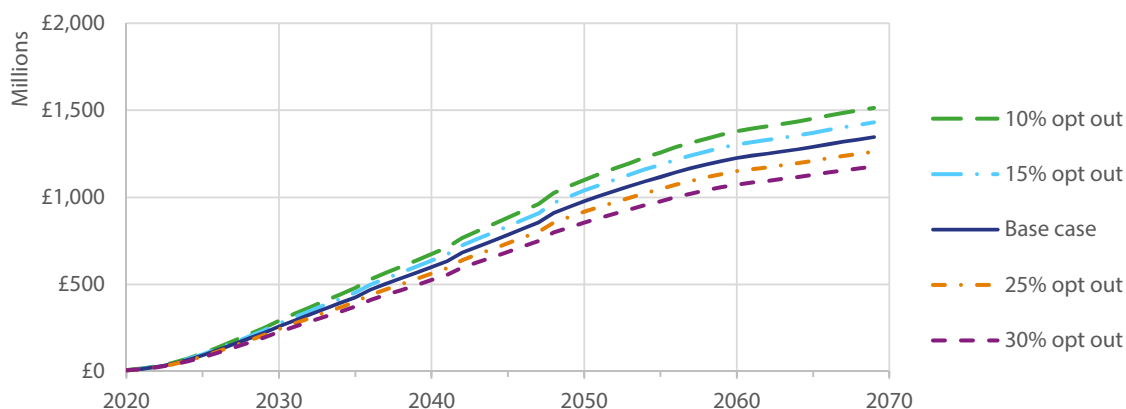
In addition, as the investment return assumption is net of the Annual Management Charge (AMC), Figure 20 also effectively illustrates the sensitivity of results to changes to the AMC. This is because an increase to the AMC has the same effect as a reduction to the investment return assumption (and vice versa). For example, a reduction to the investment return assumption of 1% per annum (i.e. RPIX + 1.5% per annum, the purple line on Figure 20) could also result from an increase to the AMC assumption of 1% per annum (i.e. from an AMC of 0.5% per annum to an AMC of 1.5% per annum).

This illustrates that it will be important to keep the expenses of the Secondary Pension Scheme (whether expressed as just an AMC or an AMC in conjunction with other expense types) as low as possible to maximise the funds available to provide retirement benefits.

4.2 Sensitivity to Opt Out Rates

As Figure 21 shows, if only 10% of employees opt out of the scheme then the fund size is projected to be 13% higher each year (the base case assumption is that 20% of members will opt out of the scheme). If 30% of members opt out of the scheme then the fund size is projected to be 13% lower each year.

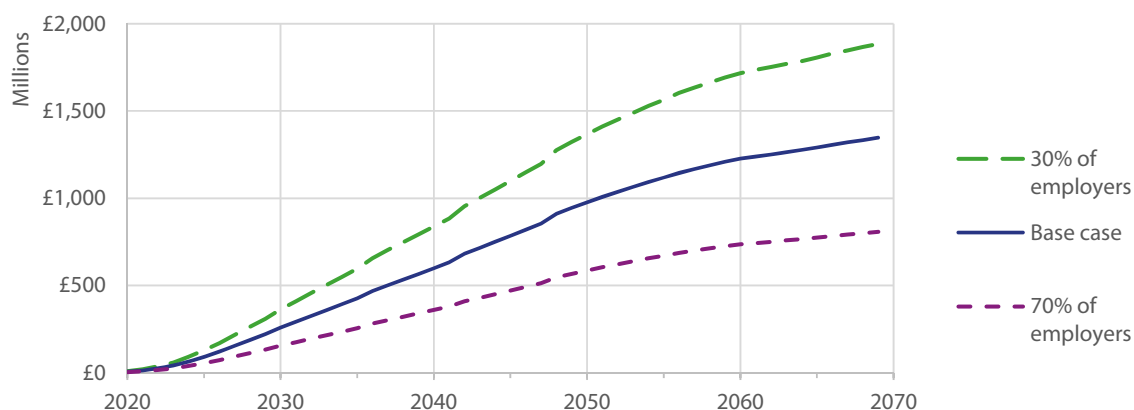
Figure 21. Fund size for the States-facilitated Scheme: sensitivity to opt out rates



4.3 Sensitivity to Employer's Choice of Scheme

Figure 22 shows that if 30% of employers set up their own qualifying scheme then the States-facilitated Secondary Pension Scheme fund size is projected to be 40% higher each year (the base case assumption is that 50% of employers set up their own qualifying scheme). If 70% of employers set up their own qualifying scheme then the fund size is projected to be 40% lower each year.

Figure 22. Fund size for States-facilitated Scheme: sensitivity to the percentage of employers setting up their own scheme



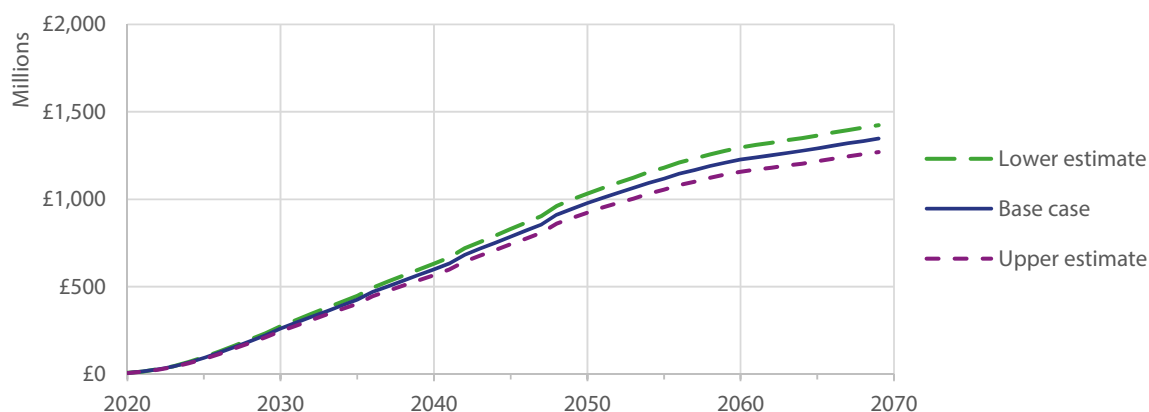
Of all of the sensitivities considered relating to the projected fund size of the States-facilitated Secondary Pension Scheme the proportion of employers who opt to use it is critical.

If the process to select the States-facilitated scheme is kept simple and assistance for employers is readily available this is likely to maximise the take up rate.

4.4 Sensitivity to Employees Already in an Occupational Pension Scheme

Figure 23 illustrates that if the lower estimate for the number of employees with an existing occupational scheme is used then the fund size is projected to be 6% higher each year (the base case assumption is an income related scale, as set out in Section 11.4). If the upper estimate for the number of employees with an existing occupational scheme is used then the fund size is projected to be 6% lower each year.

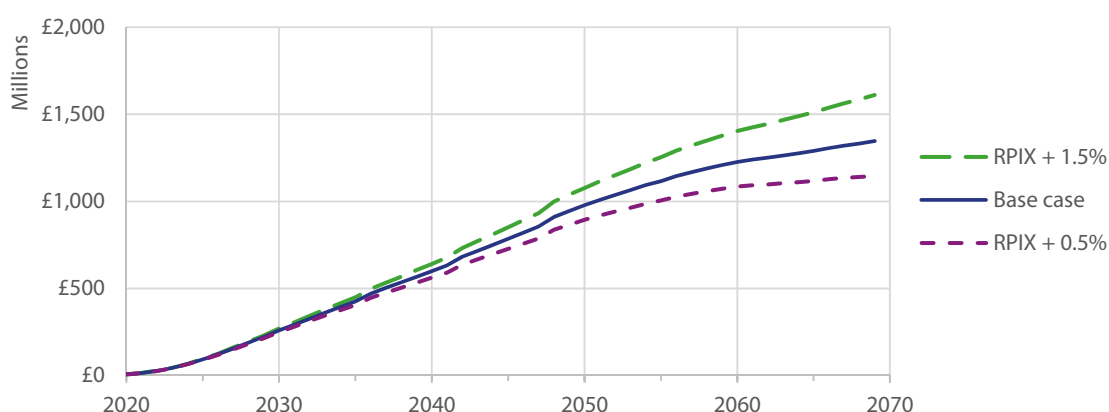
Figure 23. Fund size for States-facilitated scheme: sensitivity to the percentage of employees with existing occupational pension



4.5 Sensitivity to Income Growth

The size of the fund is sensitive to the growth in income. The growth in income can be separated into two elements. An age-related growth expected to be experienced by an individual as they get older (eg promotional growth for employees). In addition, the population as a whole can experience growth in incomes (ie a population-related growth). Figure 24 shows the sensitivity of the size of the fund to the population-related growth in income. It shows that if the population-related growth in income is 0.5% per annum higher than assumed then the fund size is projected to be 20% higher after 50 years (the base case assumption is a population-related growth in income of RPIX + 1.0% per annum). If the population-related growth in income is 0.5% per annum lower than assumed then the fund size is projected to be 15% lower after 50 years.

Figure 24. Fund size for States-facilitated scheme: sensitivity to the population-related growth in income



5. Economic Impact on Individuals and Households

The Secondary Pension Scheme will have a marginal impact on both the income and tax paid by individuals and households. This section describes the impact of the Secondary Pension Scheme on working age individuals, pension age individuals and on households. In summary:

- Working age individuals, who are not already in an occupational pension scheme, will see a reduction in their disposable income. However, they will also pay 20% less in income tax, since the pension contribution is deducted from income before tax is calculated. For most individuals the reduction in net income will be 80% of their pension contribution. However there will be some individuals whose income is less than the personal allowance and therefore will not benefit from the tax saving.³⁰
- Pension age individuals who have contributed to a Secondary Pension Scheme would benefit from secondary pension income when they reach the States pension age. They may pay more in income tax, since pension income is included in individual income tax assessment.
- The impact on household income will depend on its composition and whether household members contribute to, or benefit from, the Secondary Pension Scheme. Individuals who are eligible for income support may receive additional income support payments as pension contributions are taken into account in the income support assessment. There are also likely to be fewer pension age individuals eligible for income support as they will be receiving income from a secondary pension.

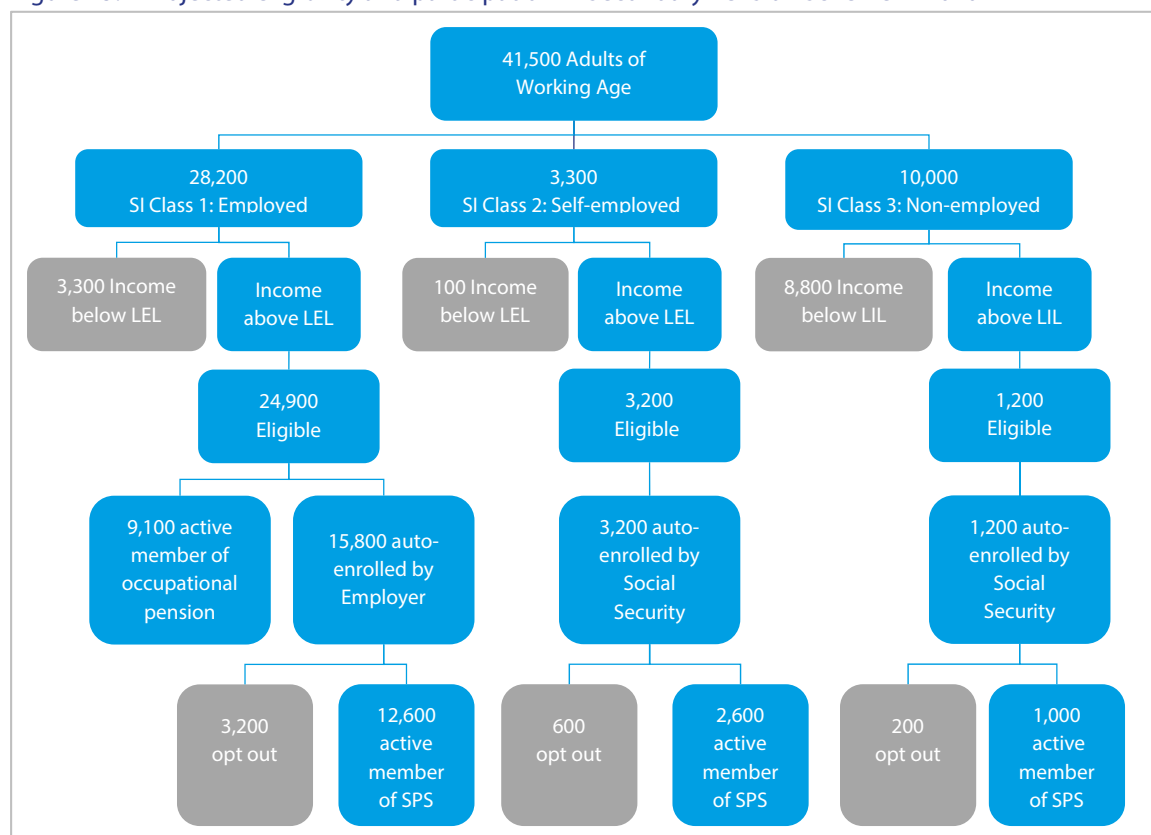
³⁰ The proposed phasing out of most of the pension contribution tax relief for high earners in the 2018 Budget proposals has not been taken into account in the modelling.

5.1 Impact on Working Age Individuals

5.1.1 Number of Individuals Eligible to join the Secondary Pension Scheme ("SPS")

Figure 25 depicts the estimated eligibility and participation in the Secondary Pension Scheme in 2020 for 41,500 adults of working age.³¹ We estimate that 29,300 individuals (aged 16-64 years) will be eligible to join the Secondary Pension Scheme, which represents 70% of the projected working age population. This includes 9,100 working age individuals who are already in an occupational pension (32% of employees, or 22% of all working age adults). Thus, we expect 20,200 individuals would be automatically enrolled into either the States-facilitated scheme or an alternative qualifying scheme following the introduction of the Secondary Pension Scheme. With an opt out rate of 20%, it is expected that 16,200 individuals will join a secondary pension for the first time.

Figure 25. Projected eligibility and participation in Secondary Pension Scheme in 2020



Note: Figures rounded to nearest 100.

³¹ SOG population projection for Guernsey was 40,298 and this has been adjusted by a factor of 1.03 to include an approximate allowance for the population in Alderney.

As Figure 26 shows, in 2020 the introduction of the Secondary Pension Scheme is expected to increase the number of working age adults who have a secondary pension from 9,100 (22% of working age adults) to 25,300 (61% of working age adults).

Figure 26. Impact of Secondary Pension Scheme on membership of secondary pensions among working age population in 2020

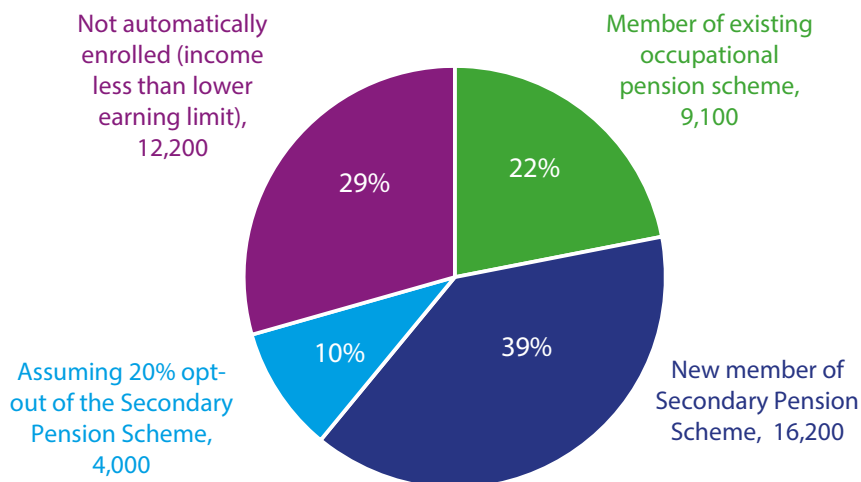
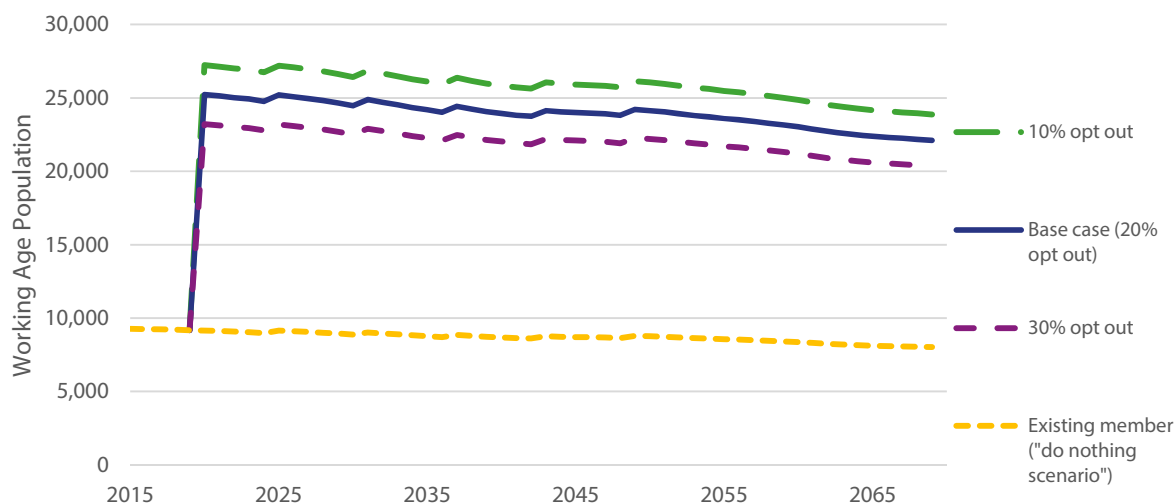


Figure 27 shows how the working age population saving for retirement is expected to increase as a result of the introduction of the Secondary Pension Scheme. The percentage in a pension scheme is expected to have increased from 22% (in the “do nothing” scenario) to 61% of the working age population.

Figure 27. Impact of Secondary Pension Scheme on number of working age individuals contributing to a secondary pension (2020-2069)



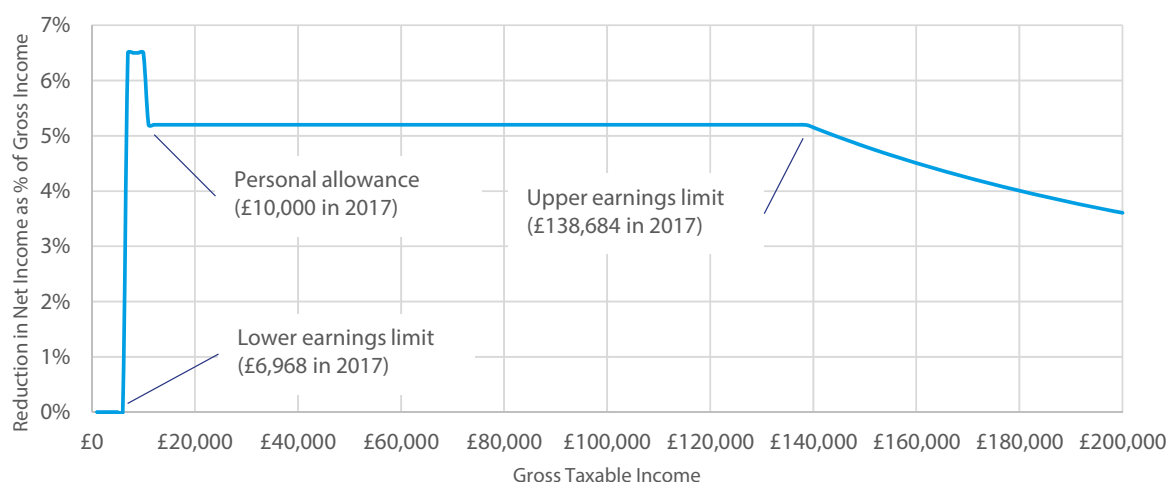
5.1.2 Impact on an Individual's Net Income

The amount an individual will contribute to the Secondary Pension Scheme will depend on their assessable income and the prevailing contribution rate (Table 1). The assessable income is calculated taking into account the individual's social insurance classification and income from employment, self-employment and other sources.

Working age individuals who participate in the Secondary Pension Scheme will see a reduction in their net income.³² As pension contributions are tax exempt³³, the reduction in net income is partly offset by a reduction in the amount paid in income tax.

Figure 28 shows the reduction in net income, expressed as a percentage of gross taxable income for different income levels, and a long-term individual contribution rate of 6.5%.

Figure 28. Reduction in net income, expressed as a percentage of gross taxable income



For the majority of individuals, who have income between personal allowance (£10,000 in 2017) and the UEL (£138,684 in 2017), the reduction in net income will be 80% of the pension contribution. Thus, once the contribution rate has reached 6.5%, individuals who contribute to a secondary pension will have a 5.2% reduction in net income. Individuals who have income below the personal allowance do not pay income tax and therefore would have a reduction equivalent to 100% of the pension contribution. This explains the peak on the line chart that occurs between the lower earnings limit and the personal allowance. Individuals who have income above the UEL will see a reduction of less than 5.2% since pension contributions are only paid on income up to the UEL. The maximum individual contribution would be £9,014 in (2017 terms). A person paying the maximum contribution would pay £1,803 less in income tax, so the net effect would reduce their income by £7,211. However, it is proposed that tax relief for those earning above the UEL is largely phased out in the 2018 budget.

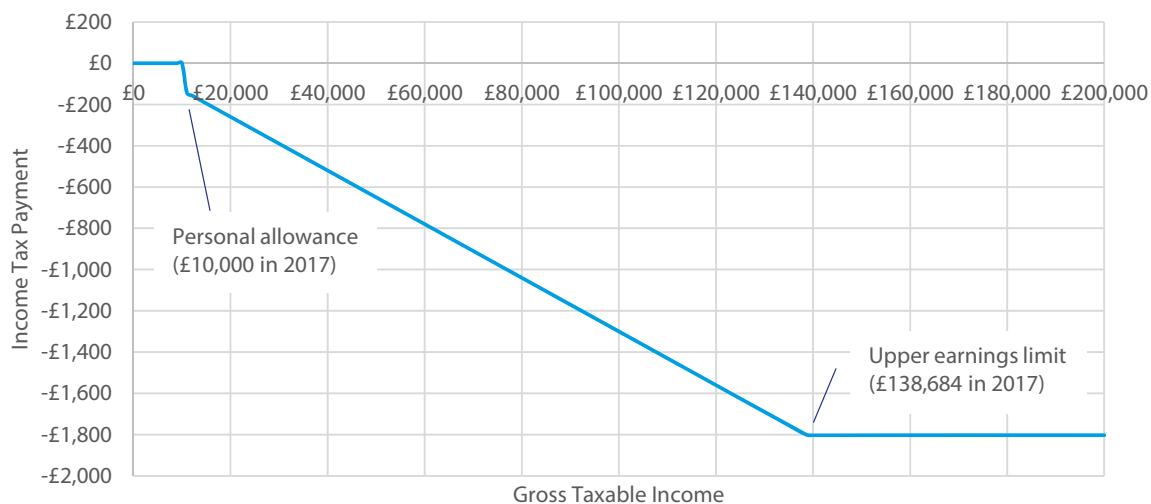
³² Net income is defined as gross taxable income less income tax, social insurance and pension contributions. Note, this definition does not include state benefits which are not assessed for income tax.

³³ In 2017 the maximum pension contribution that would be tax exempt is £50,000, though the 2018 budget has reduced this to £35,000.

5.1.3 Impact on Personal Income Tax Payment

Figure 29 shows the reduction in income tax paid by individuals on different income levels, based on a contribution rate of 6.5%.³⁴ As the graph shows, the tax saving is achieved when gross taxable income exceeds the personal allowance and continues up to the UEL.

Figure 29. Reduction in income tax at different levels of gross taxable income



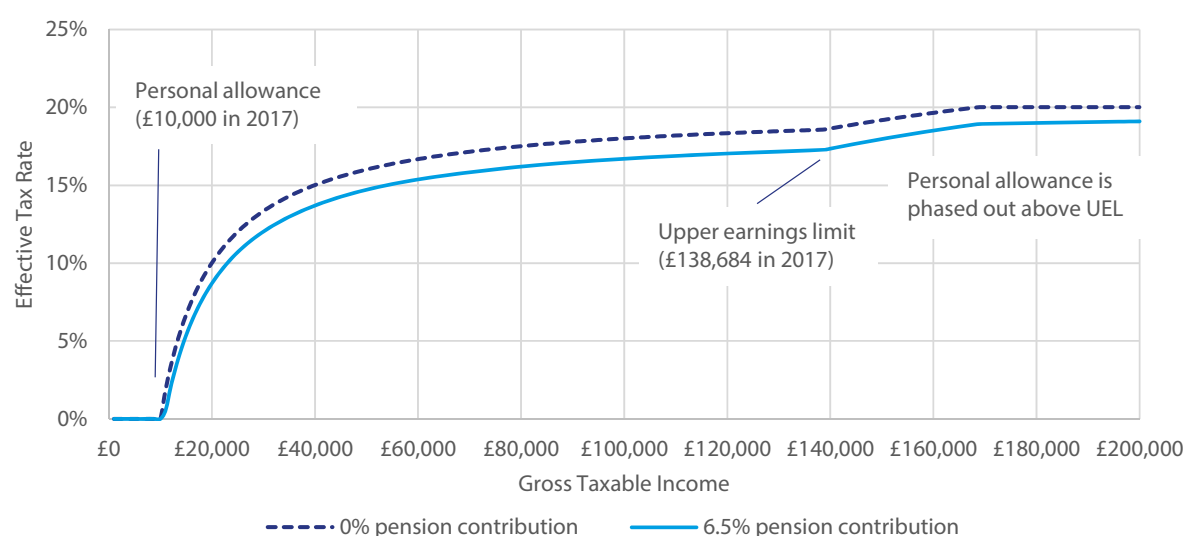
³⁴ This graph assumes all income is assessed when calculating the tax relief and does not illustrate the changes proposed in the 2018 Budget.

5.1.4 Impact on the Effective Tax Rate

The effective tax rate is an alternative metric for showing the impact of the Secondary Pension Scheme for different levels of income. The effective tax rate is the total amount of tax payable expressed as a percentage of gross income. It shows, for example, how the percentage of income paid in tax varies between the lowest and highest earners in society.

Income tax is paid once gross taxable income exceeds the personal allowance and increases up to a maximum level of 20%. The personal allowance is phased out once income exceeds the UEL, so that individuals earning above £168,684 (in 2017) pay income tax at 20% on all of their income. As tax relief is available on contributions up to the lower of 100% of earnings and £50,000, contributing to a secondary pension reduces the effective tax rate.³⁵ The impact is illustrated in Figure 30.

Figure 30. Impact of the Secondary Pension Scheme on the Effective Tax Rate



³⁵ The 2018 budget proposed some changes that are not shown here.

5.1.5 Illustrative Example: Employee with Gross Salary of £30,000 in 2020

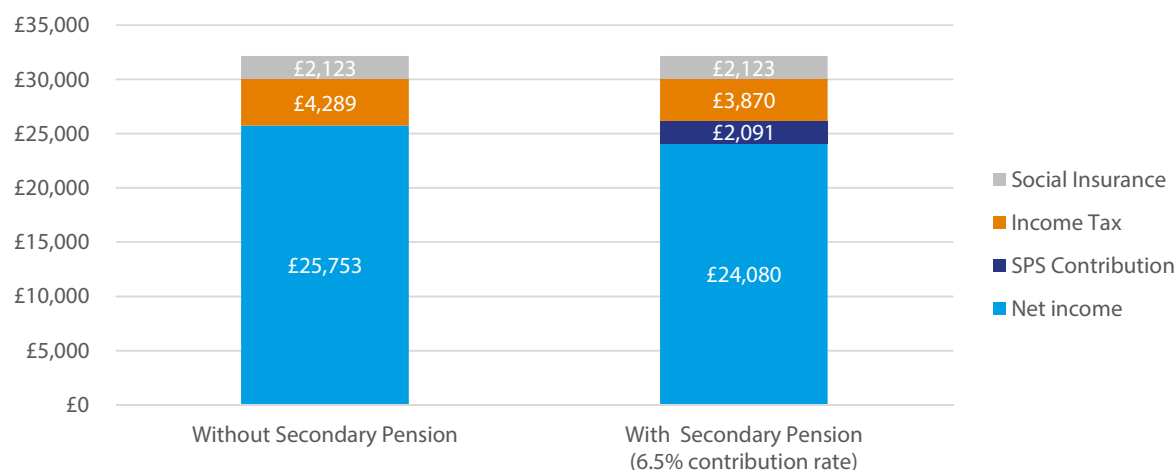
Table 6 shows how the Secondary Pension Scheme would affect an employee earning £30,000 in 2020³⁶ over the first eight years. From 2027 contribution rates will remain stable at 6.5% of eligible income. The results are presented in real terms, given the assumptions in the base case scenario.³⁷

Table 6. Net income for an employee with a gross salary of £30,000 in 2020

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 onwards |
|---|---------|---------|---------|---------|---------|----------|----------|--------------|
| Gross Income | £30,000 | £30,300 | £30,603 | £30,909 | £31,218 | £31,530 | £31,846 | £32,164 |
| Social Insurance | £1,980 | £2,000 | £2,020 | £2,040 | £2,060 | £2,081 | £2,102 | £2,123 |
| Secondary Pension Scheme Contribution | £300 | £455 | £612 | £927 | £1,249 | £1,577 | £1,911 | £2,091 |
| Income Tax | £3,940 | £3,949 | £3,958 | £3,936 | £3,913 | £3,889 | £3,864 | £3,870 |
| Net Income | £23,780 | £23,897 | £24,013 | £24,006 | £23,996 | £23,984 | £23,969 | £24,080 |
| Change in Tax Paid | (£60) | (£91) | (£122) | (£185) | (£250) | (£315) | (£382) | (£418) |
| Effective Tax Rate | 13.1% | 13.0% | 12.9% | 12.7% | 12.5% | 12.3% | 12.1% | 12.0% |
| Change in Net Income | (£240) | (£364) | (£490) | (£742) | (£999) | (£1,261) | (£1,529) | (£1,673) |
| Change in Net Income as % of Gross Income | 0.8% | 1.2% | 1.6% | 2.4% | 3.2% | 4.0% | 4.8% | 5.2% |

In 2027, once the Secondary Pension Scheme has been fully rolled out, the employee will pay £2,091 into a secondary pension, but pay £418 less in income tax. Net income is reduced by £1,673 from £26,010 to £24,080. The impact is also illustrated in Figure 31.

Figure 31. Impact of the Secondary Pension Scheme on an employee with a gross salary of £30,000 in 2020 (i.e. £32,164 in 2027)



Section 5.2.3 discusses how membership of the Secondary Pension Scheme increases expected retirement income. An individual earning £30,000pa in 2020 is expected to be slightly below the median earnings level. The Secondary Pension Scheme could potentially increase their income at retirement age to around double what they would have received from the old age pension alone.

³⁶ Earnings are adjusted to for real earnings growth of 1%. The individual has no other sources of income and was not an existing active member of an occupational pension scheme

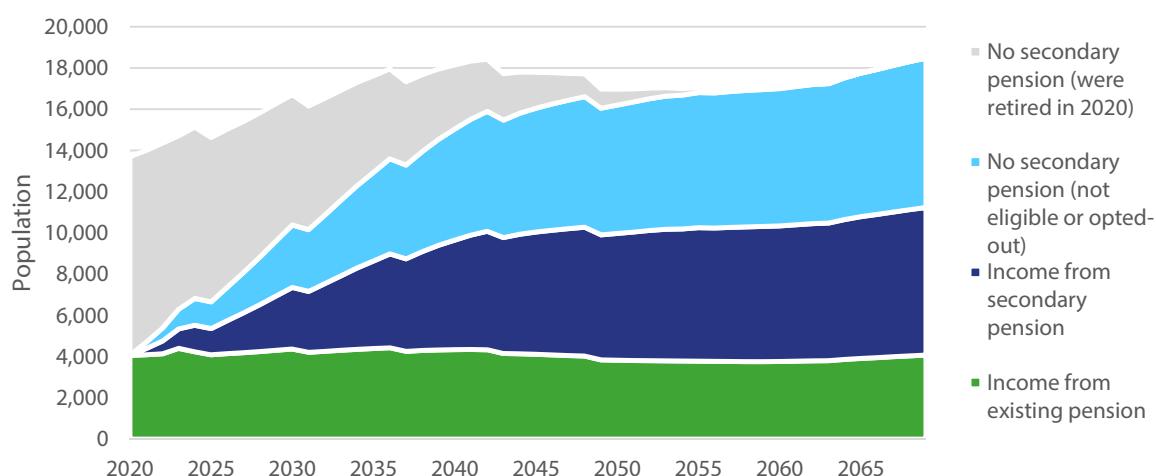
³⁷ Takes into account the personal tax allowance of £10,000 in 2020 (which is increased in line with real earnings). Mortgage interest relief has not been included in the calculations as it will be phased out by 2025.

5.2 Impact on Pension Age Individuals

5.2.1 Number of Individuals Expected to Benefit from Secondary Pension Scheme

The number of individuals who will be expected to benefit from the Secondary Pension Scheme will gradually increase over the next 50 years, as they reach the States pension age. As Figure 32 shows, the proportion of the pension age population who receive income from an occupational pension is expected to increase to 61% of the pension age population by 2069, compared with 22% currently. The remaining 39% either did not meet the criteria for automatic enrolment or are assumed to have opted out of the Secondary Pension Scheme.

Figure 32. Number of individuals with pension income in retirement following the introduction of the Secondary Pension Scheme



5.2.2 Impact on Income in Retirement

Individuals who contribute to the Secondary Pension Scheme will benefit from additional pension income in retirement. The amount of additional income will depend on various factors. A member is expected to receive a higher pension under the following conditions:

- joins at a younger age (without opting out)
- receives a higher amount of assessable income
- the scheme has a higher total contribution rate (employee plus employer)
- investment performance is better
- States pension age is higher
- lump sum taken at retirement is lower
- annuity purchased from insurance company is cheaper

The pension amounts are expected to be lower in the earlier years following the introduction of the Secondary Pension Scheme. This is because the accumulated funds will be smaller, since contribution rates will be lower initially and the period that the contributions will have been paid will only have been for a small proportion of working life.

5.2.3 Income Replacement Rates

A replacement rate is calculated as the percentage of an individual's pre-retirement earnings that would be replaced by the total pension income immediately after retirement. The replacement rates illustrated below are based on gross income (i.e. before tax and other deductions).

The 2016 Billet refers to the different levels of target replacement rates, depending on the level of pre-retirement income. Table 7 shows the latest published statistics for Guernsey, and the target replacement rate in retirement.

Table 7. Average earnings in Guernsey and target replacement rate in retirement

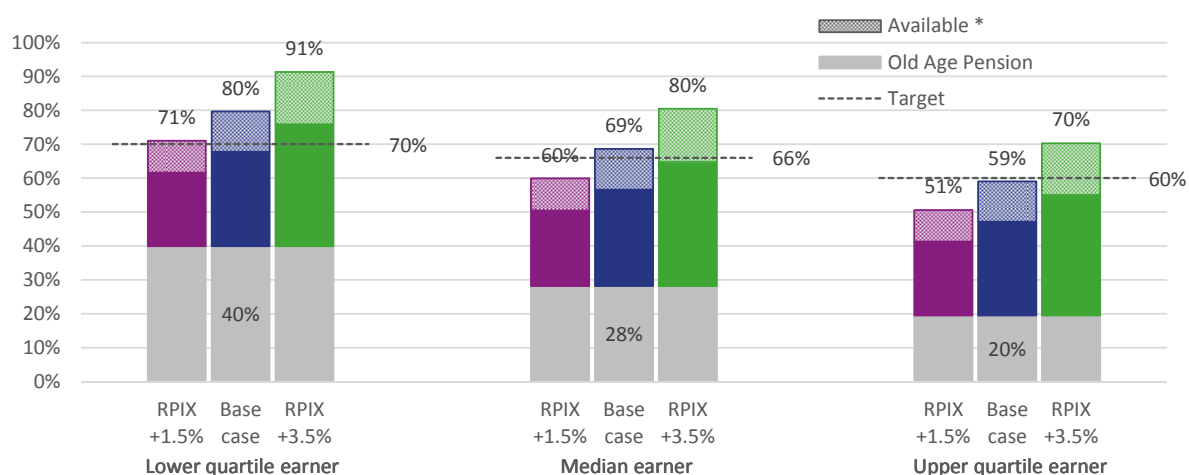
| Category of Earner | Four quarter average earnings (at June 2017) | Target Replacement Rate | Target Retirement Income per annum (2017 terms) |
|--------------------|---|-------------------------|--|
| Lower Quartile | £22,016 | 70% | £15,411 |
| Median | £31,906 | 66% | £21,058 |
| Upper Quartile | £46,838 | 60% | £28,103 |

Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 26 October 2017 and Billet d'État III 2016.

Figure 33 illustrates the income replacement rates for an individual who joins the Secondary Pension Scheme aged 25 and continues in employment until their States pension age. It is assumed that they have no other income in retirement other than from the States old age pension and from the Secondary Pension Scheme. The examples are based on the longer term stable structure of the scheme (i.e. the member has a States pension age of 70 and the phasing in of contribution rates has been completed before the member joins the scheme).

The chart shows the impact of individuals taking lump sums from the Secondary Pension Scheme. An additional amount is shown as available (dotted area) which can be accessed by taking less than the maximum lump sum of 30% of their Secondary Pension Scheme fund at retirement. The chart also shows the sensitivity of the replacement rates to the investment return assumption.

Figure 33. Income replacement rates



* depending on lump sum taken from Secondary Pension

The chart shows the expected replacement rates for three members, as follows:

- an individual earning at the lower quartile level throughout their working life

- an individual earning at the median level throughout their working life
- an individual earning at the upper quartile level throughout their working life.

The individual is assumed to have a full social security contribution record. Therefore, the chart reflects a full old age pension. In practice, it is understood that only around a quarter of people have a full contribution record. Consequently, the income replacement rates for those with an incomplete social security record are expected to be lower

The age-related growth in employment income has been taken from the age-specific income percentiles for the current working population, assuming individuals continue to earn at the same age-related percentile throughout their career. The population-related growth in income for the base case assumption has also been applied (the base case assumption is a growth in income of RPIX + 1.0% per annum in addition to the age-related growth).

The target replacement rates shown in Figure 33 are different from those shown in Volume III of the 16th February 2016 Billet d'État. This is due to differences in the assumptions including updated annuity rates and a lower level of growth in employment incomes. Higher rates of assumed growth in employment incomes would reduce the replacement rates.

Figure 33 illustrates that for the base case assumptions, the projected income replacement rate for a lower quartile earner increases from just below 40% (the old age pension alone) to up to around 80% for a person who contributes to the Secondary Pension Scheme throughout their working life from age 25 to age 70 and takes no lump sum at retirement.

It also illustrates that a median earner could expect to receive a retirement income of only around 28% of their pre-retirement income if they relied solely on the States old age pension, whereas they are projected to achieve the target level of 66% of their pre-retirement income if they contributed to the Secondary Pension Scheme throughout their working life.

Under the base case assumptions, the lower quartile earner and median earner are projected to have pensions which would achieve the target replacement rate. Furthermore, the lower quartile earner could achieve the target replacement rate even after taking 24% of their fund as a lump sum at retirement rate.

If investment returns are 1% per annum higher than the base case assumption (i.e. RPIX + 3.5% per annum) then the projected retirement income exceeds the target rates by a significant margin.

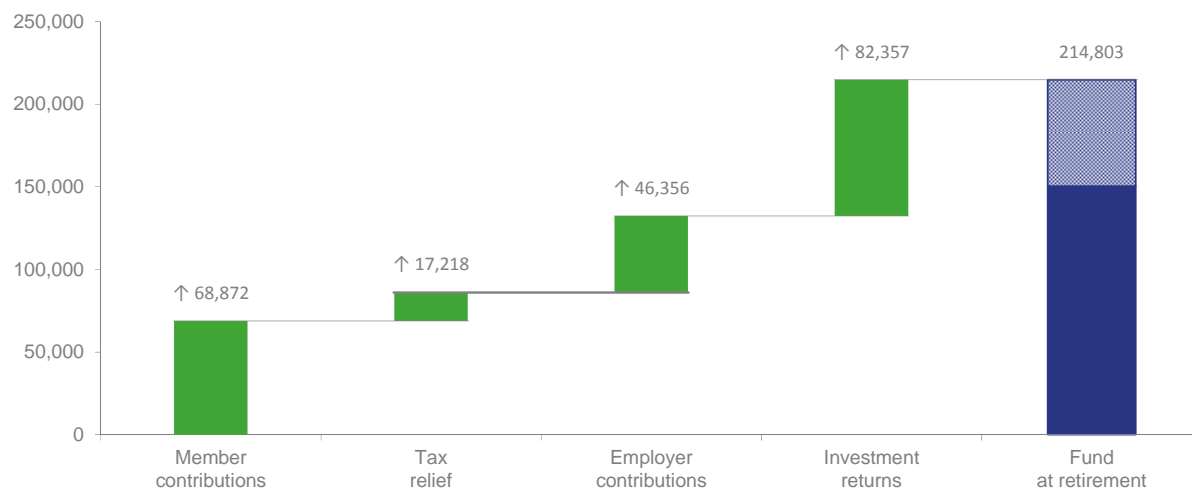
If investment returns are 1% per annum lower than the base case assumption (i.e. RPIX + 1.5% per annum) then the target replacement rates are generally achieved for the lower quartile earner. However, target replacement rates would not be expected to be achieved by the median earner and upper quartile earner.

Figure 33 clearly illustrates that the Secondary Pension Scheme will lead to a significant increase in retirement income. The projected income for the lower quartile earner under the base case is potentially double the rate of the full old age pension.

5.2.4 Impact over lifetime

Figure 34 illustrates the pension fund at retirement for the lower quartile earner for an individual who joins the Secondary Pension Scheme aged 25 (as per the income replacement rate examples in Section 5.2.3). It shows how different components of the Secondary Pension Scheme are expected to contribute to the size of the fund for the individual, under the base case assumptions.

Figure 34. Source of Secondary Pension Scheme fund for lower quartile earner



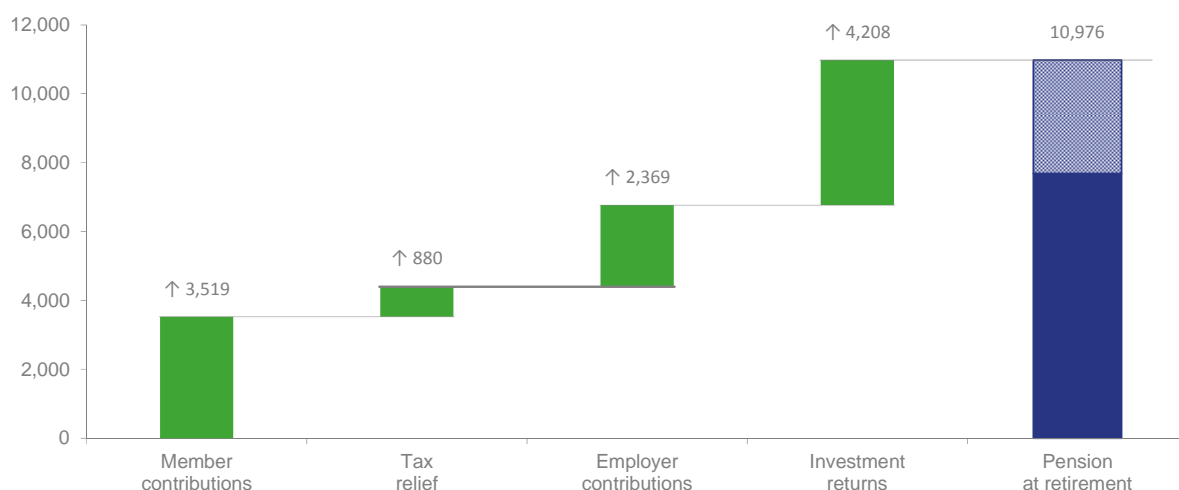
The investment returns shown in the charts are net of charges.

The chart shows that the member is expected to contribute £68,872 over their career, in terms of current prices. There is an additional £17,218 added to the fund due to tax relief on the member contributions. In addition, the employer is expected to pay in £46,356. These contributions are expected to increase in real terms with investment returns (net of charges), which add £82,357, resulting in a projected fund at retirement of £214,803.

This fund is then used to purchase an annuity at retirement. A lump sum may be taken prior to purchasing the annuity, which would reduce the funds available and also reduces the size of the pension purchased. The lump sum that can be taken is shown as a dotted area in the chart. Where no lump sum is taken, the full fund is available to purchase an annuity (ie £214,803). However, if the maximum lump sum is taken at retirement then the fund is reduced by the dotted area (a maximum lump sum of £64,441 in the above example, leaving a fund size of £150,362 with which to purchase an annuity).

The size of the resulting pension available (to the lower quartile earner example) is shown in Figure 35.

Figure 35. Source of Secondary Pension Scheme pension for lower quartile earner



The dotted area shows the amount of pension which would not be available if the maximum lump sum is taken at retirement. If no lump sum is taken then a pension of £10,976 per annum is available to the lower quartile earner. If the maximum lump sum of £64,441 is taken then a pension of £7,683 per annum is expected to be available to the lower quartile earner.

Figure 35 shows that an individual's contributions over their career, in terms of current prices, equate to a pension of £3,519 per annum at retirement. However, because of the positive impact of tax relief, employer contributions and net investment returns, the cumulative impact is a fund, which equates to a pension of £10,796 per annum at retirement (if no lump sum is taken). Therefore, the pension that the lower quartile earner is expected to receive at retirement is worth around three times what the member has contributed to the Secondary Pension Scheme.

5.3 Impact on Household Income

The impact of the Secondary Pension Scheme on household income will depend on the composition of the household and the circumstances of the individual members. Working age individuals who contribute to a secondary pension will have their net income reduced before retirement. However, they will ultimately benefit from additional pension income in retirement. To understand the magnitude of the impact of the Secondary Pension Scheme on disposable income, it is necessary to consider the impact at the household level. This is because the Secondary Pension Scheme may impact on the amount of income support a household would receive.

Income support is a new social welfare benefit that is expected to be introduced in 2018, combining supplementary benefit and rent rebate into a single system. Income support is a means-tested benefit assessed at the household level. It is paid to bring a household's income up to a level that is considered the minimum amount required to live on. This minimum amount, known as the requirement rate, reflects the household composition and circumstances of the household members. The assessment also takes into account the amount of capital the household has available.³⁸ This is why two households with the same income may not necessarily both be eligible for income support or may receive different amounts.

5.3.1 Illustrative Examples of Impact on Household Income

The potential impact of the Secondary Pension Scheme on household income is shown using a range of simple illustrative examples in Table 8 and Table 9 on different household types. We have assumed:

- Gross household income is defined as gross taxable income (which includes the old age pension) plus income support and family allowance.³⁹ Other benefits are presumed to be zero.
- Net household income is defined as gross household income less income tax, social security, and pension contribution.
- Eligible working age individuals do not opt out of the secondary pension and contribute 6.5% of their income to the Secondary Pension Scheme.
- Income tax is assessed on an individual basis.⁴⁰
- Income support will be implemented as set out in the Billet d'État Volume II from 8 March 2016.⁴¹
- Pension contributions are a deductible allowance in the income support assessment.⁴²
- Income support payment for eligible households is adjusted to take into account the change in the net household income.
- The income support payment can be increased, but only up to the maximum requirement rate and this depends on the household composition.⁴³

³⁸ States of Guernsey (2015). Supplementary Benefit Leaflet SPB 2.

³⁹ Family allowance is £13.50 per child per week in 2017.

⁴⁰ Since the married persons tax allowance will be gradually withdrawn. See States of Guernsey (2016). Summary of Allowances Year of Charge 2017.

⁴¹ The monetary values in the Billet d'Etat were presented in 2015 prices and have been inflated to 2017 terms.










⁴² This is consistent with the existing legislation (The Supplementary Benefit (Implementation) Ordinance, 1971) on supplementary benefit.

⁴³ The long-term requirement rate for a single adult was proposed to be £170.60 per week, for a couple £282.79 per week, per child (aged 11 years and over) £100.16 per week. The maximum rent allowance for a single or couple adult without children was £207.00 per week (2015 prices). The maximum rent allowance with two children was £316.10. Thus, for a single adult the maximum rate would be £19,635 per year (2015) or £20,354 in 2017 terms. For a couple without children the maximum rate would be £25,469 per year (2015) or £26,395 in 2017 terms. For a couple with two children the maximum rate would be £36,351 per year (2015) or £37,672 in 2017 terms.

For example, household E consists of two working age adults, one earning £15,000 per annum from employment. The other is not employed but receives £5,000 in other income. Without the Secondary Pension Scheme the couple have a gross income of £20,000 and pay £1,000 in income tax, and £990 in social insurance (not shown). Their net household income is £18,010. With Secondary Pension Scheme the maximum pension contribution the employed adult will pay is £975, pay £805 in income tax and £990 in social insurance. As a household, their net income will be reduced by £780 to £17,230. Comparing the household profiles shows the impact of the Secondary Pension Scheme is broadly proportionate to the amount of household income. However, the actual impact depends on their specific circumstances.

Several profiles show how income support can offset the reduction in household income (e.g. B&C, E&F, H&I). In two of these comparisons (B&C and E&F) the household is entirely reimbursed for the reduction in net income associated with the pension contribution. For example, households E and F are similar, though only Household F is eligible for income support and receives £5,000 per annum. The income support payment to Household F will increase by £780 to offset their reduction in net income due to Secondary Pension Scheme contributions. In the other comparison (H&I) the reduction in net income is only partly offset because of the maximum requirement rate.

Table 8. Illustrative examples to show the impact on working age households

| | Household Composition & Income ⁴⁴ | Receive Income Support | | Gross Income | Income Support Paid | Pension contribution | Income Tax Paid | SI Paid | Net Household Income |
|---|---|------------------------|---------|--------------|---------------------|----------------------|-----------------|-----------|----------------------|
| A |  1 Working Age £30,000 salary | No | No SPS: | £30,000 | n/a | | £4,000 | £1,980 | £24,020 |
| | | | SPS: | £30,000 | | £1,950 | £3,610 | £1,980 | £22,460 |
| | | | Change | | | -£1,950 | £390 | £0 | -£1,560 |
| B |  1 Working Age: £15,000 salary | No | No SPS: | £15,000 | n/a | | £1,000 | £990 | £13,010 |
| | | | SPS: | £15,000 | | £975 | £805 | £990 | £12,230 |
| | | | Change | | | -£975 | £195 | £0 | -£780 |
| C |  1 Working Age: £15,000 salary | Yes | No SPS: | £18,000 | £3,000 | | £1,000 | £990 | £16,010 |
| | | | SPS: | £18,780 | £3,780 | £975 | £805 | £990 | £16,010 |
| | | | Change | | £780 | -£975 | £195 | £0 | £0 |
| D |  2 Working Age: £30,000 salary; £30,000 salary | No | No SPS: | £60,000 | n/a | | £8,000 | £3,960 | £48,040 |
| | | | SPS: | £60,000 | | £3,900 | £7,220 | £3,960 | £44,920 |
| | | | Change | | | -£3,900 | £780 | £0 | -£3,120 |
| E |  2 Working Age: £15,000 salary; £5,000 other | No | No SPS: | £20,000 | n/a | | £1,000 | £990 | £18,010 |
| | | | SPS: | £20,000 | | £975 | £805 | £990 | £17,230 |
| | | | Change | | | -£975 | £195 | £0 | -£780 |
| F |  2 Working Age: £15,000 salary; £5,000 other | Yes | No SPS: | £25,000 | £5,000 | | £1,000 | £990 | £23,020 |
| | | | SPS: | £25,780 | £5,780 | £975 | £805 | £990 | £23,010 |
| | | | Change | | £780 | -£975 | £195 | £0 | £0 |
| G |  2 Working Age + 2 Children* £50,000 salary; £30,000 salary | No | No SPS: | £81,404 | n/a | | £12,000 | £5,280 | £64,124 |
| | | | SPS: | £81,404 | | £5,200 | £10,960 | £5,280 | £59,964 |
| | | | Change | | | -£5,200 | £1,040 | £0 | -£4,160 |
| H |  2 Working Age + 2 Children* £20,000 salary; £10,000 salary | No | No SPS: | £31,404 | n/a | | £2,000 | £1,980 | £27,424 |
| | | | SPS: | £31,404 | | £1,950 | £1,740 | £1,980 | £25,734 |
| | | | Change | | | -£1,950 | £260 | £0 | -£1,690 |
| I |  2 Working Age + 2 Children* £20,000 salary; £10,000 salary | Yes | No SPS: | £36,404 | £5,000 | | £2,000 | £1,980 | £32,424 |
| | | | SPS: | £37,672 | £6,268 | £1,950 | £1,740 | £1,980 | £32,002 |
| | | | Change | | £1,268 | -£1,950 | £260 | £0 | -£422 |









* Family allowance of £1,404 per annum for 2 children

⁴⁴ Images sourced from www.freepik.com

Table 9 illustrates the potential impact of pension income on the disposable income of pension age households and shows that the household income in retirement will either increase or stay the same (in current terms) as a result of contributing to the Secondary Pension Scheme. For example, Household N is a pension age couple with a gross income of £22,500. Contributing to a secondary pension could yield a pension income of £10,000 per annum. The couple will pay income tax and social insurance on the pension income, which in this example means that the household would have £7,963 more in disposable income each year.

Several household profiles show how receiving pension income would impact on eligibility for income support (K&L, N&O and P&Q). In all cases it is expected to reduce the amount of income support paid or eliminate it entirely. For instance, households L, O and Q would be expected to see a reduction in their income support payment. In two of these cases (L and O) the additional pension income exceeds the reduction in income support and so contributing to a secondary pension is expected to lead to a higher disposable income. In the remaining case (Q) the pension income is less than the income support, and their net income remains unchanged since income support payment is reduced by the amount received in pension income.

Table 9. Illustrative examples to show the impact on pension age households

| | Household Composition & Income ⁴⁵ | Receive Income Support | | Gross Income | Income Support Paid | Pension Income ⁴⁶ | Income Tax Paid | SI Paid | Net Household Income |
|--|--|------------------------|---------|--------------|---------------------|------------------------------|-----------------|---------|----------------------|
| J  | 1 Pension Age: £30,000 | No | No SPS: | £30,000 | | | £3,710 | £752 | £25,538 |
| | | | SPS: | £42,500 | | £12,500 | £6,210 | £1,177 | £35,113 |
| | | | Change | | | £12,500 | -£2,500 | -£425 | £9,575 |
| K  | 1 Pension Age: £15,000 | No | No SPS: | £15,000 | | | £710 | £0 | £14,290 |
| | | | SPS: | £23,000 | | £8,000 | £2,310 | £514 | £20,176 |
| | | | Change | | | £8,000 | -£1,600 | -£514 | £5,886 |
| L  | 1 Pension Age: £15,000 | Yes | No SPS: | £20,000 | £5,000 | | £710 | £0 | £19,290 |
| | | | SPS: | £23,000 | £0 | £8,000 | £2,310 | £514 | £20,176 |
| | | | Change | | -£5,000 | £8,000 | -£1,600 | -£514 | £886 |
| M  | 2 Pension Age: £20,000; £20,000 | No | No SPS: | £40,000 | | | £3,420 | £825 | £35,756 |
| | | | SPS: | £60,000 | | £20,000 | £7,420 | £1,505 | £51,076 |
| | | | Change | | | £20,000 | -£4,000 | -£680 | £15,320 |
| N  | 2 Pension Age: £12,500 £10,000 | No | No SPS: | £22,500 | | | £210 | £0 | £22,290 |
| | | | SPS: | £32,500 | | £10,000 | £1,920 | £327 | £30,253 |
| | | | Change | | | £10,000 | -£1,710 | -£327 | £7,963 |
| O  | 2 Pension Age: £12,500 £10,000 | Yes | No SPS: | £24,500 | £2,000 | | £210 | £0 | £24,290 |
| | | | SPS: | £32,500 | £0 | £10,000 | £1,920 | £327 | £30,253 |
| | | | Change | | -£2,000 | £10,000 | -£1,710 | -£327 | £5,963 |
| P  | 2 Pension Age: £10,000 £5,000 | No | No SPS: | £15,000 | | | £0 | £0 | £15,000 |
| | | | SPS: | £19,000 | | £4,000 | £510 | £0 | £18,490 |
| | | | Change | | | £4,000 | -£510 | £0 | £3,490 |
| Q  | 2 Pension Age: £10,000 £5,000 | Yes | No SPS: | £20,000 | £5,000 | | £0 | £0 | £20,000 |
| | | | SPS: | £20,510 | £1,510 | £4,000 | £510 | £0 | £20,000 |
| | | | Change | | -£3,490 | £4,000 | -£510 | £0 | £0 |

⁴⁵ The income given here is the amount of income for each individual, without income from the secondary pension.

⁴⁶ Note, the pension income values are indicative amounts rather than exact projections.

6. Economic Impact on Employers

The introduction of the Secondary Pension Scheme will require employers to review the benefits they offer their employees as they will be legally required to automatically enrol eligible employees into a secondary pension. Employees earning more than the LEL (which is £6,968 in 2017) will be eligible.

Employers will be required to contribute into the scheme at minimum statutory levels for each employee who has not opted out of the scheme. It is proposed that the employer contributions will be phased in over 8 years up to 3.5% of gross salary by 2027 (Table 1).

6.1 Number of employers affected by the Secondary Pension Scheme

All employers will need to comply with the Secondary Pension Scheme legislation. However, how they are affected depends on their existing occupational pension provision:

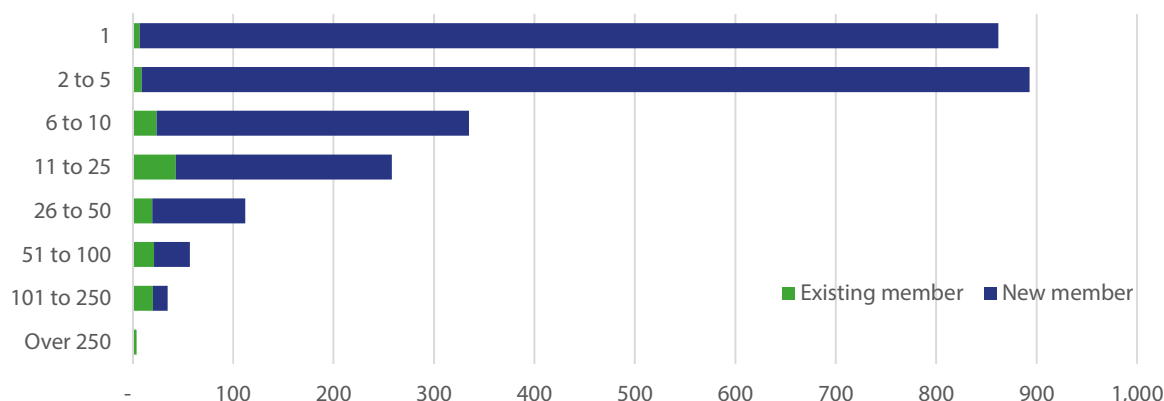
- Employers who do not currently offer employees an occupational pension will need to join a Secondary Pension Scheme (either the States-facilitated Secondary Pension Scheme or an alternative qualifying scheme).
- Employers who currently offer employees an occupational pension that satisfies the criteria for an alternative qualifying scheme and have high membership participation will be largely unaffected. They will, however, need to contact any employees who have previously opted out of the scheme and explain they will be automatically enrolled in a secondary pension, but can subsequently decide to opt out.⁴⁷
- Employers who currently offer employees an occupational pension that is not an alternative qualifying scheme will need to modify their pension arrangements. They could either revise their existing scheme (i.e. by changing the contribution rates) so that it qualifies or join a qualifying scheme (either the States-facilitated scheme or an alternative qualifying scheme).

There do not appear to be any reliable data on the percentage of employers who currently offer an occupational pension. Income Tax records for 2014 showed that the percentage of employees who contributed to an occupational pension varies considerably by economic sector. Unfortunately the available data do not show how this varies by employer size. The assumptions we have made are detailed in Section 11.3 of the Appendices. Based on these assumptions, it is estimated that of the 2,556 employers in Guernsey and Alderney, 148 currently offer an occupational pension, and 2,408 (94%) employers will be affected by the introduction of the Secondary Pension Scheme.

⁴⁷ Model assumes that all existing occupational schemes will meet the alternative qualifying scheme criteria – does not take into account that some occupational pensions will be improved.

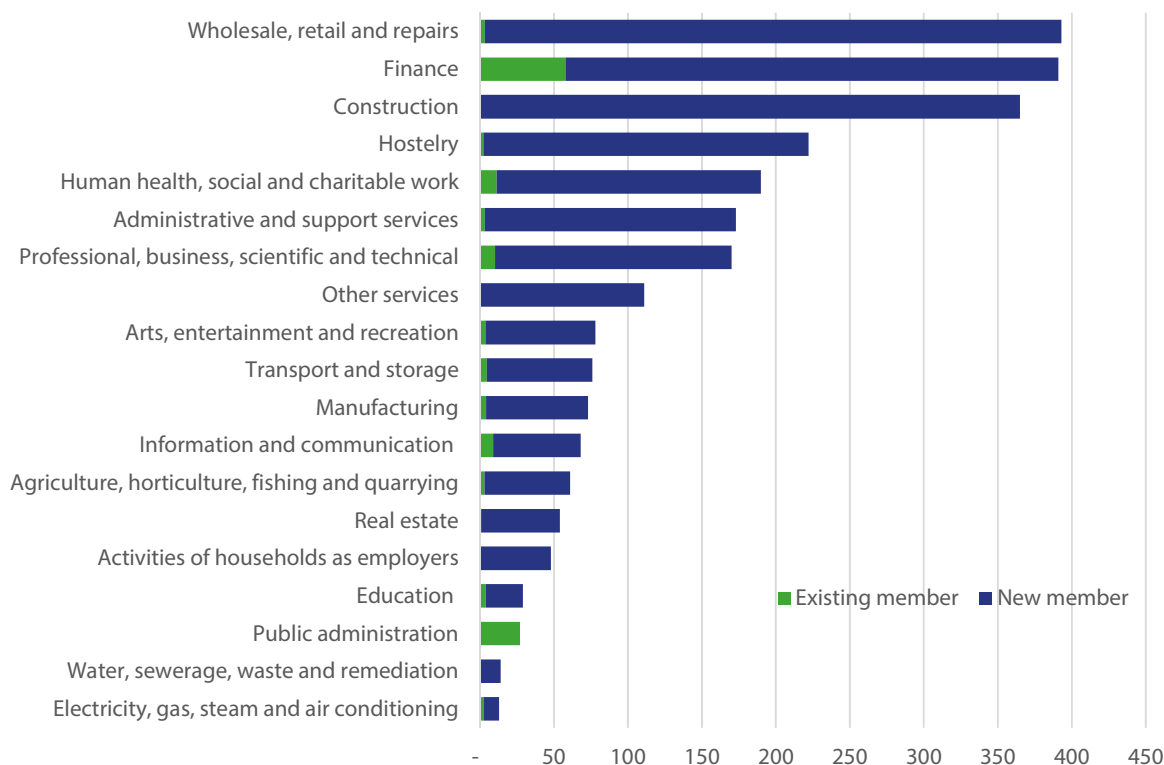
Employers of all sizes will be affected by the Secondary Pension Scheme, however micro-employers are likely to be the most affected since they are the least likely to offer an occupational pension. Figure 36 and Figure 37 show the number of employers who will need to join a Secondary Pension Scheme, by sector and by size.

Figure 36. Number of employers who will need to enrol employees in a Secondary Pension Scheme, by employer size



All economic sectors, except public administration, will be affected. Construction; hostelry; and wholesale, retail and repairs will be particularly affected. It is estimated that these sectors employ 25% of the workforce. These sectors are also likely to have the highest administrative burden, due to staff turnover and seasonal workers and part-time workers.

Figure 37. Number of employers who will need to enrol employees in a Secondary Pension Scheme, by economic sector



6.2 Marginal Impact on Employer Costs

Employers that do not currently offer an occupational pension will incur additional costs as they will be required to contribute to the Secondary Pension Scheme. These costs will be the pension contributions, together with any administrative costs incurred.

6.2.1 Employer Pension Contributions

Figure 38 shows the total projected additional amount that employers will contribute to secondary pensions each year. The amount employers contribute increases to £18 million by the end of 2027, as the contribution rate increases, and increases gradually thereafter in line with real earnings growth.

Figure 38. Marginal impact on the annual amount paid into secondary pensions schemes by employers in Guernsey and Alderney

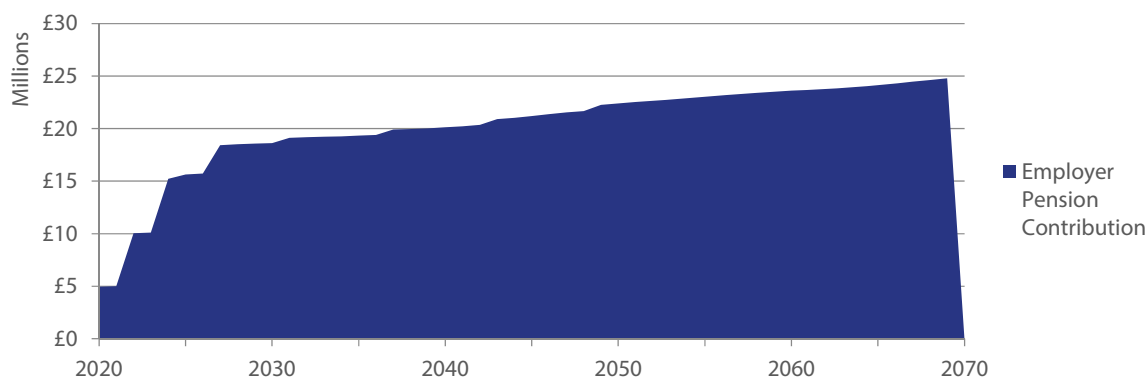


Figure 39, Figure 40 and Figure 41 show the sensitivity of the employers' pension contributions to assumptions about the rate of real earnings growth, opt out rates, and the percentage of employees who are members of an existing scheme.

Figure 39. Marginal impact on employers' secondary pension contribution: sensitivity to the assumption on real earnings growth

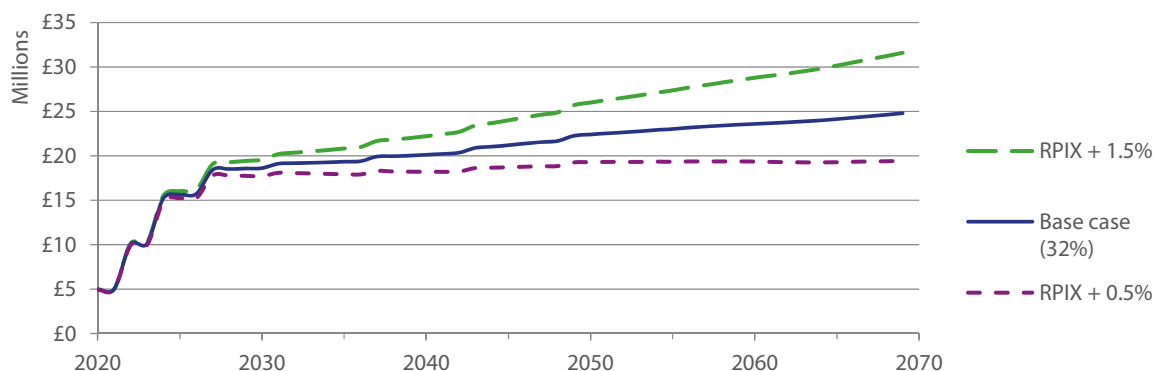


Figure 40. Marginal impact on employers' secondary pension contribution: sensitivity to opt out rate

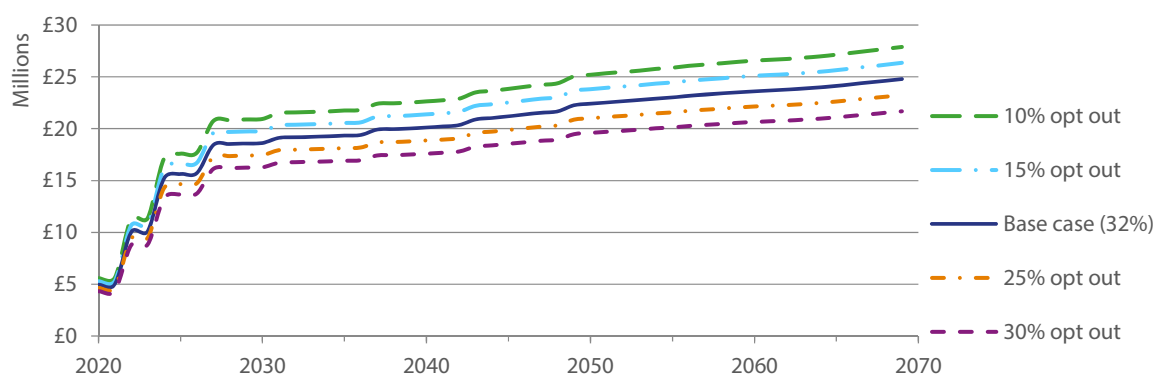
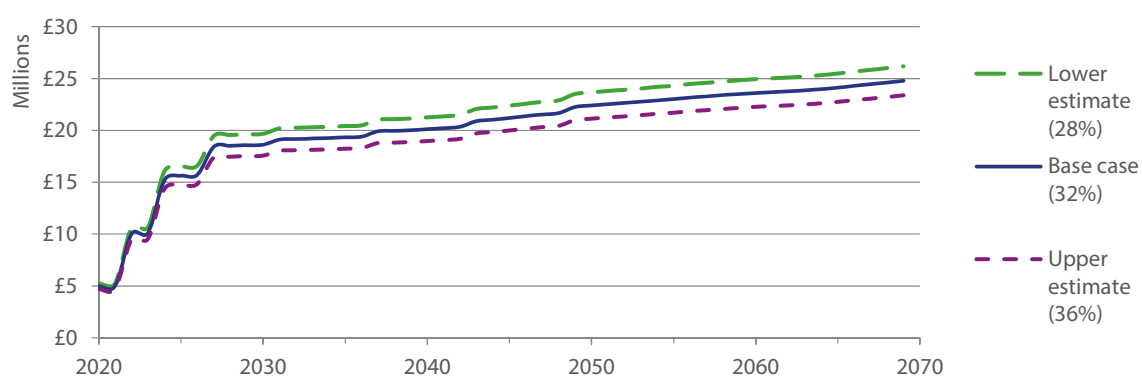


Figure 41. Marginal impact on employers' secondary pension contribution: sensitivity to the assumption on percentage of employees with existing occupational pension

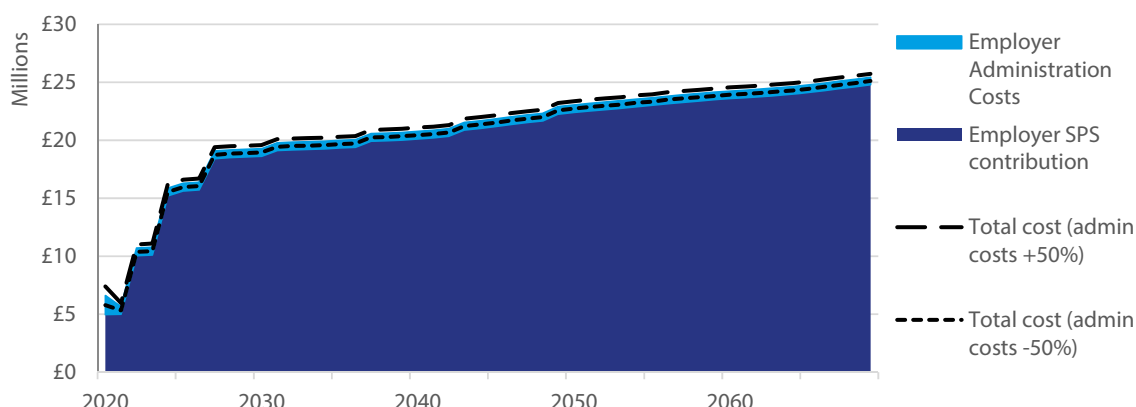


6.2.2 Employer Administration Costs

The economic model also acknowledges employers may face some additional administrative costs to comply with the Secondary Pension Scheme. Administration costs have been included in the economic model since they represent an opportunity cost. In other words, resources will need to be allocated to administering the Secondary Pension Scheme that could have an alternative productive use. However, it should be noted that only in some instances will the additional resources represent a monetary cost. Employers who pay for professional advice, who outsource their payroll may incur additional charges. However, there will be others for whom the additional resources required are staff time that can be absorbed within the existing workload.

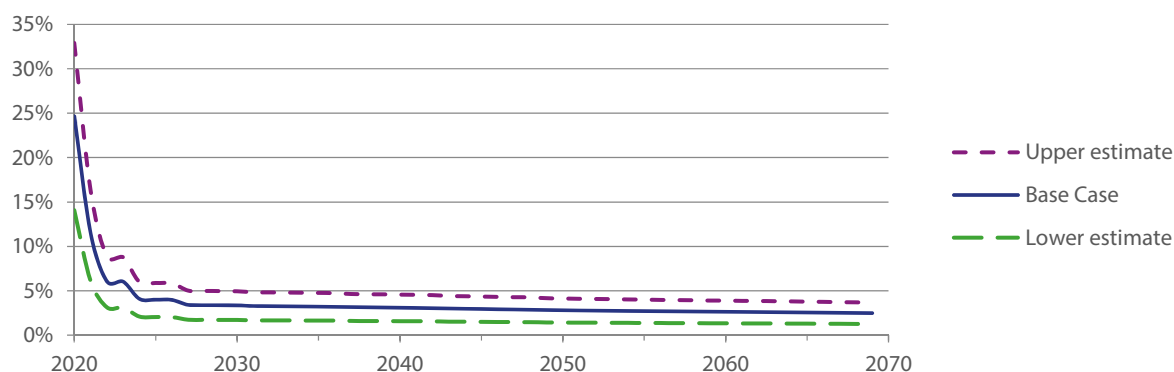
In the base case scenario it has been assumed employers will incur a fixed cost of £500 per employer in the first year and £200 in subsequent years, together with a variable cost of £25 per employee in the first year and £10 per employees in subsequent years. In the first year the fixed component reflects the time and/or advice required to understand their statutory duties and make system changes to human resource or payroll systems. In subsequent years the fixed costs reflect the time and/or advice required to monitor policy changes (such as increases to the contribution rate). The variable costs reflects the staff time required to enrol each employee. The projected costs are shown in Figure 42.

Figure 42. Total annual cost of the Secondary Pension Scheme on all employers



After the first year, under base case assumptions the administration costs represent a relatively small proportion (3.8%) of the overall cost on employers. This is illustrated in Figure 43.

Figure 43. Employers' administration costs as a percentage of the total employer cost



6.2.3 Impact on employers of different sizes

This section considers how the Secondary Pension Scheme will impact on employers of different sizes. For illustrative purposes, in this section it has been assumed that all employees receive a gross salary that remains fixed at £30,000 throughout the implementation period.

Figure 44 shows the average annual cost of the Secondary Pension Scheme per employee over the implementation period. For employers with a single employee the administrative costs are larger than the pension contribution in the first year of the scheme.

Figure 44. Average annual cost of the Secondary Pension Scheme per employee, by employer size

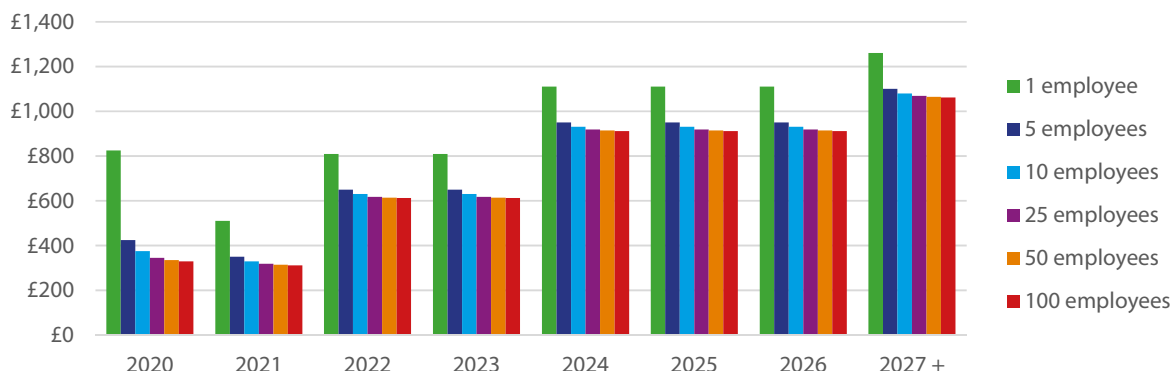


Figure 45, Figure 46, Figure 47 and Figure 48 illustrate the total cost per employer for employers of different sizes, split between the employers' pension contribution and the administrative cost.

Figure 45. Projected total cost of the Secondary Pension Scheme for an employer with one employee

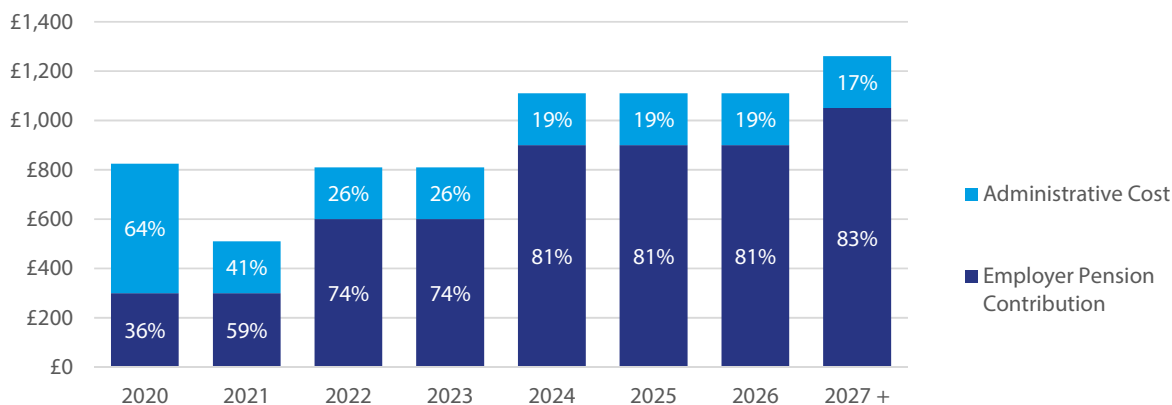


Figure 46. Projected total cost of the Secondary Pension Scheme for an employer with five employees

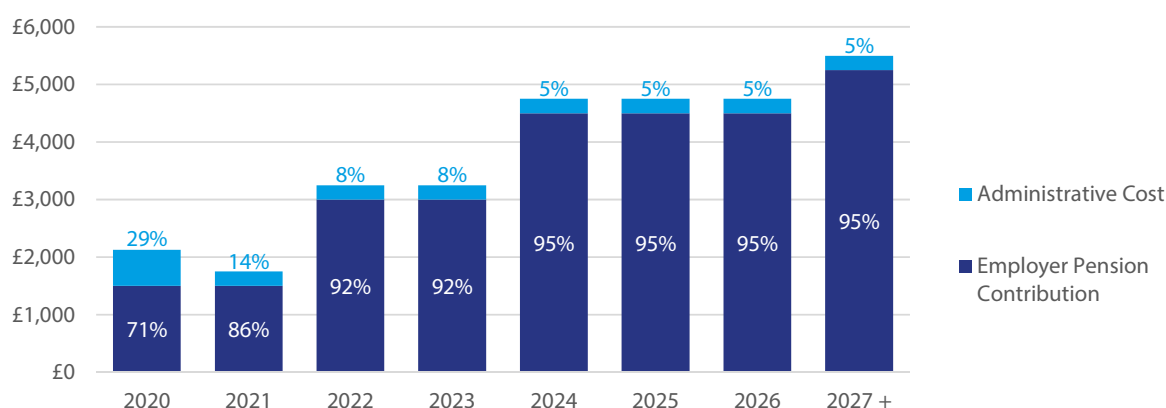


Figure 47. Projected total cost of the Secondary Pension Scheme for an employer with 15 employees

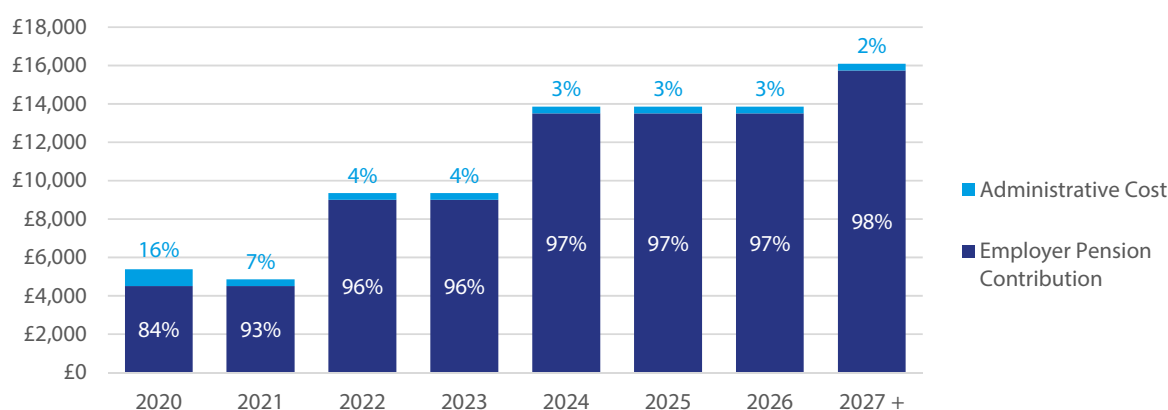
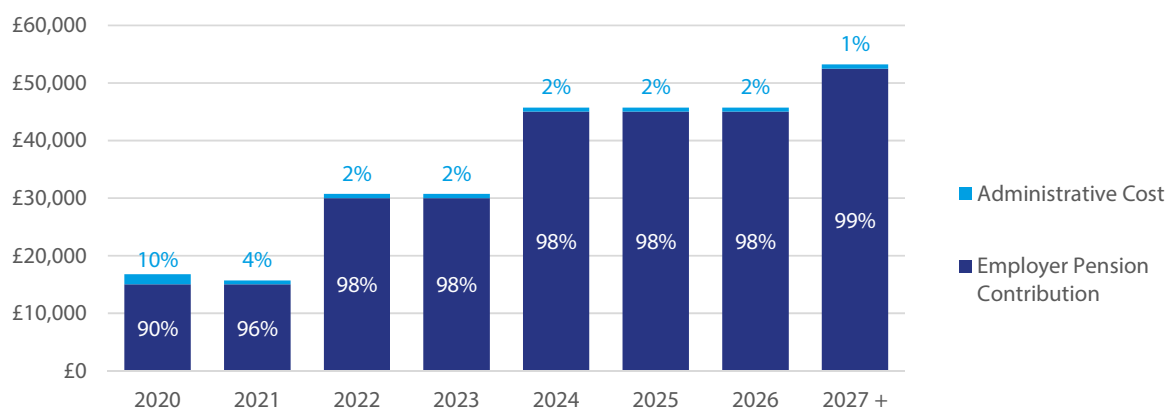


Figure 48. Projected total cost of the Secondary Pension Scheme for an employer with 50 employees



The cost of the employers' pension contribution is proportionate to the payroll. However, as Figure 45, Figure 46, Figure 47 and Figure 48 illustrate the Secondary Pension Scheme will have a disproportionate impact on sole traders and the smallest employers and this is because the fixed component of the administration costs will be distributed across fewer employees.

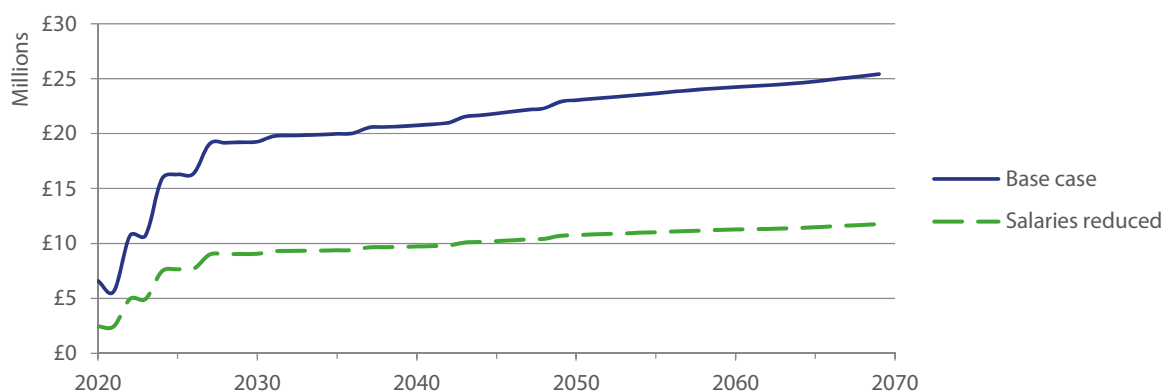
6.3 Employer Response to Secondary Pension Scheme

The base case scenario assumes 100% of the costs are borne by employers, with a corresponding reduction in company profits and therefore company tax. It is difficult to predict exactly how employers will response, but the base case is the worst case scenario. In practice, employers may be able to recover some of the additional costs and could respond using one or a combination of the following strategies:

- Reduce the number of hours worked or overtime available in order to limit the payroll
- Reduce the number of people employed, freeze recruitment or make redundancies in order to limit the payroll
- Defer or reduce future pay rewards to offset the increased pension costs
- Cut costs in other areas
- Increase productivity
- Increase prices to pass on increased labour costs to consumers
- Reduce their profits or dividends

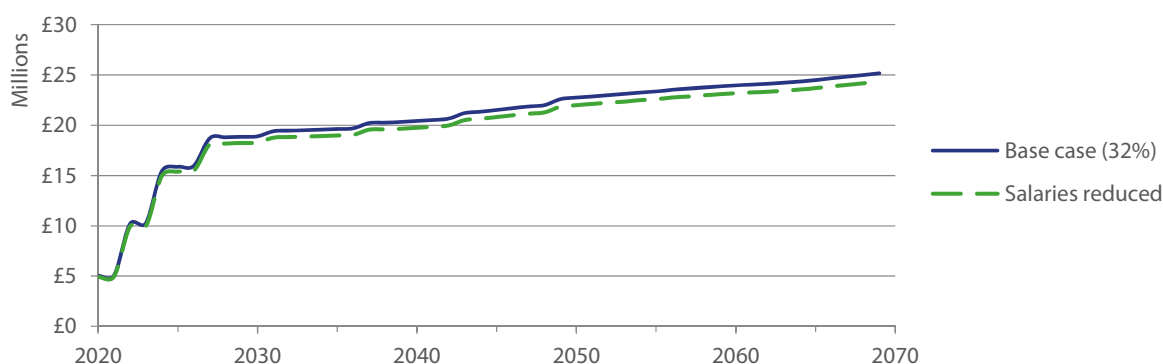
Sensitivity analysis has been used to assess an alternative scenario where employers recover 50% of the Secondary Pension Scheme costs by reducing future pay awards. The marginal cost to employers is show in Figure 49.

Figure 49. Marginal cost of Secondary Pension Scheme on employers if offset 50% of the additional costs by reducing salaries



As Figure 50 shows, reducing salaries to recover some of the Secondary Pension Scheme costs will also reduce the amount that employers contribute to the Secondary Pension Scheme.

Figure 50. Marginal impact on employers' secondary pension contribution: sensitivity on employers response (recover 50% of additional costs by reducing salaries)



7. Impact on the Government Budget

This section describes the estimated marginal impact of the Secondary Pension Scheme on government finances. We present the results of the economic model on the following components, before describing the overall impact:

- income tax revenue from working age population
- income tax revenue from pension age population
- company tax revenue
- expenditure on income support

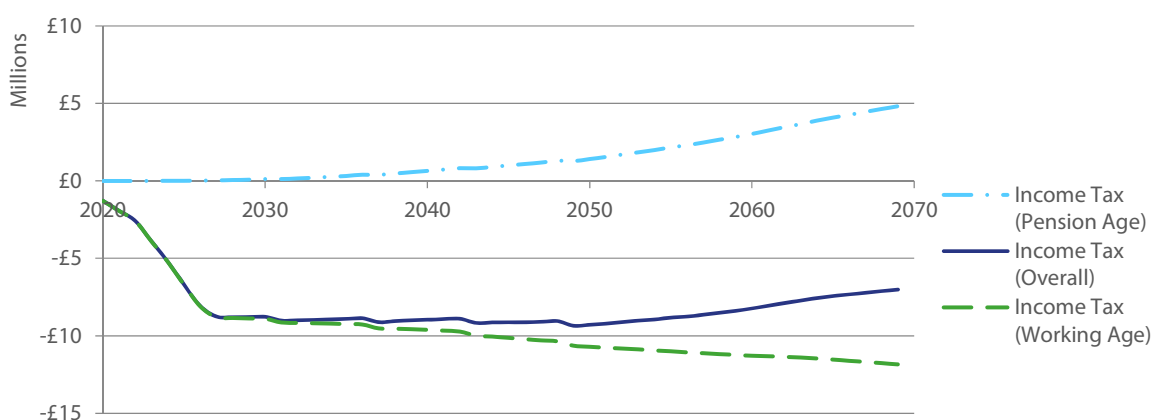
7.1 Marginal impact on Income Tax Revenue

The Secondary Pension Scheme will impact on the revenue from personal income tax in two ways:

- Individuals contributing to a secondary pension are likely to pay less in income tax since pension contributions are tax exempt
- Individuals receiving income from a secondary pension may pay more in income tax since pension income will be included in the income tax assessment.

The economic model focuses on the marginal impact on income tax at the population level, based on a 20% income tax rate, assumptions about the age, income and employment profile of the population, and that personal allowances increase in line with real earnings (as set out in Section 3.4). Figure 51 shows the estimated marginal impact of the Secondary Pension Scheme on income tax revenue over the next 50 years overall, and for the working and pension age populations in the base case scenario.

Figure 51. Marginal impact of Secondary Pension Scheme on Income Tax Revenue



The introduction of the Secondary Pension Scheme will lead to an overall loss in income tax revenue. This is because of the reduction in income tax revenue from the working age population in tax relief on pension contributions is greater than the increase in income tax revenue from the pension age population who benefit from additional pension income in retirement.

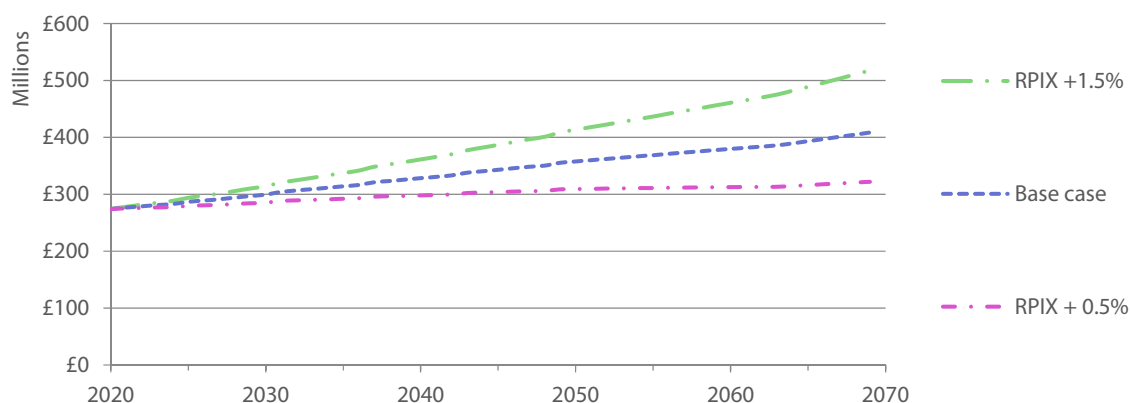
Figure 51 shows the reduction in income tax revenue from the working age population as the contribution rate increases. In 2027, when the individuals' contribution rate reaches 6.5%, the projected loss in income tax revenue is £8.8 million (in 2017 terms).⁴⁸ By 2069 the net effect on income tax revenue is projected to be a loss

⁴⁸ States of Guernsey (2017). Billet d'Etat XIII 2017. The States of Guernsey Accounts 2016. The accounts reported total revenue from personal income tax was £246 million in 2016. Total revenue from personal income tax in 2027 is projected to be £275 million, based on the assumption of real earnings growth of 1%.

of £7 million (in 2017 terms). The impact of the Secondary Pension Scheme lessens over time. This is because there will be an increasing number of pension age individuals who have participated in the Secondary Pension Scheme and will pay income tax on their Secondary Pension Scheme pension. In addition, the average pension income will increase (as they will have contributed for more of their working life). The ripples occurring in 2031, 2037, 2043 and 2049 reflect the planned changes to the States pension age, which have been modelled on a full year basis.⁴⁹

The Secondary Pension Scheme will mean total income tax revenue is lower than it would be than if the Secondary Pension Scheme was not introduced, However, it is important to note that the States' assumption of real earnings growth of 1% per annum (i.e. at the population level employment and self-employment income increase at 1% per annum above inflation) means that total income tax revenue is projected to increase over the next 50 years. Figure 52 shows the projected increase in income tax revenue under different assumptions for real earnings growth (allowing for demographic changes and increases in the States' pension age).

Figure 52. Projected total income tax revenue 2020 to 2069: sensitivity to the assumption on real earnings growth



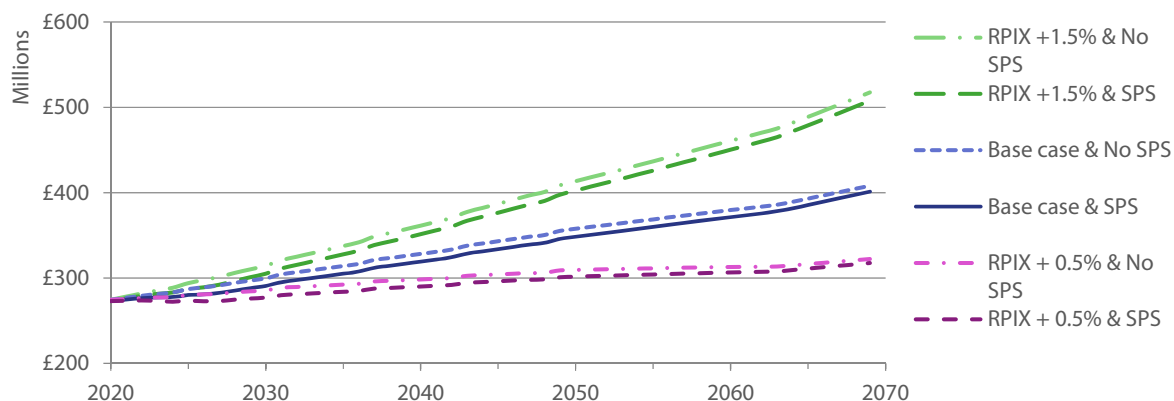
In the base case scenario, where real earnings grow by 1% per annum then total income tax revenue is projected to increase from approximately £265 million in 2020 to £400 million by 2069 (in 2017 terms). As the alternative scenarios show, real earnings growth of 0.5% per annum would yield £325 million in total personal income tax revenue by 2069, while real earnings growth of 1.5% per annum would yield income tax of more than £500 million by 2069 (again in 2017 terms).

This chart illustrates that the assumption about real earnings growth over the projection period is a key factor in how much income tax is expected to be generated. However it is important to put the impact of introducing the Secondary Pension Scheme in context.

⁴⁹ From 1 March 2020 the pension age will increase by 2 months annually until it reaches 70 years of age (<https://www.gov.gg/oldagepension>). Our analysis takes into account the planned increases in the States' pension age, but only when it reaches the next full year. Thus, it has been assumed the State pension age will increase to 66 in 2025, 67 in 2031, 68 in 2037, 69 in 2041 and 70 in 2049.

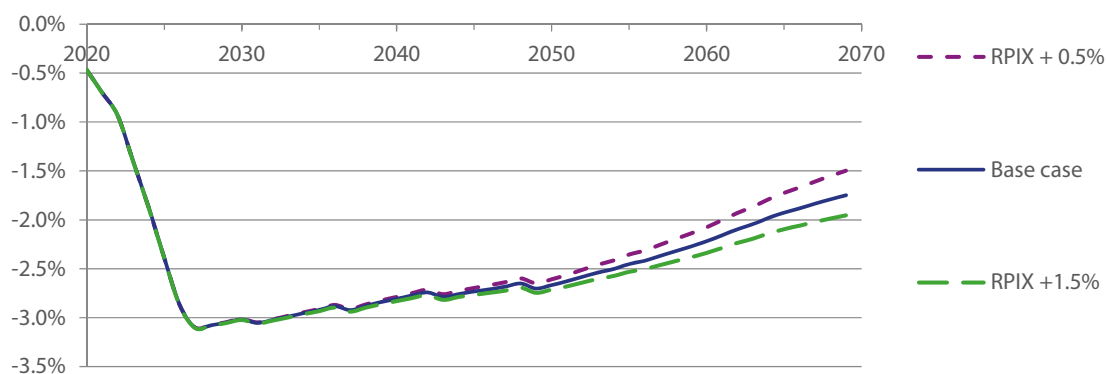
The impact of the Secondary Pension Scheme on total income tax revenue is shown in Figure 53. This shows that the Secondary Pension Scheme will reduce income tax revenue relative to 'doing nothing'. The marginal impact on income tax revenue is the difference between the two lines under each earnings growth scenario.

Figure 53. Impact of Secondary Pension Scheme on total personal tax revenue: sensitivity to the assumption on real earnings growth



We have also illustrated this as the marginal impact of the Secondary Pension Scheme on income tax revenue as a proportion of total income tax revenue. Figure 54 shows that the maximum loss in income tax revenue relative to total income tax revenue occurs in 2027, and the loss is equivalent to 3% of total income tax revenue. The impact of the Secondary Pension Scheme, relative to the total income tax revenue lessens over time.

Figure 54. Marginal impact of Secondary Pension Scheme on income tax revenue as a proportion of total income tax revenue



Finally, in the short-term, the loss in income tax revenue from the introduction of the Secondary Pension Scheme could be viewed against the expected increases in income tax revenue arising from real earnings growth. Figure 55 shows the projected increases in income tax revenue compared to 2020 alongside the projected loss in revenue from the Secondary Pension Scheme. The line shows the difference between the two values. Under the States' assumption of real earnings growth of 1% per annum, the additional in income tax revenue from real earnings growth is expected to exceed the cost of the Secondary Pension Scheme after 7 years.

Figure 55. Loss in income tax revenue compared to expected increases in income tax revenue with real earnings growth of 1% per annum

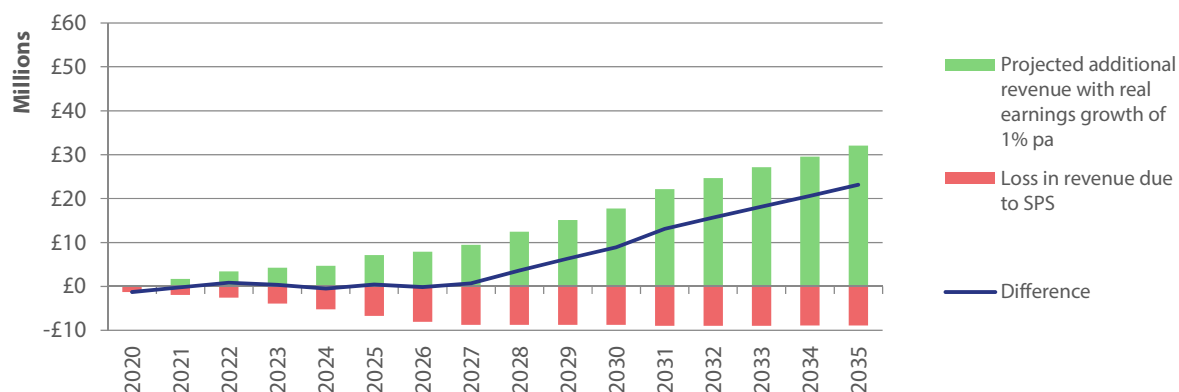


Figure 56 and Figure 57 also show the loss in income tax revenue compared to the expected increases in income tax revenue under alternative assumptions for real earnings growth. These graphs illustrate how the short-term fiscal impact of the Secondary Pension Scheme is sensitive to the assumption on real earnings growth.

- With real earnings growth of 0.5% per annum, the additional in income tax revenue from real earnings growth is expected to exceed the cost of the Secondary Pension Scheme after 14 years.
- With real earnings growth of 1.5% per annum, the additional in income tax revenue from real earnings growth is expected to exceed the cost of the Secondary Pension Scheme after one year.

Figure 56. Loss in income tax revenue compared to expected increases in income tax revenue with real earnings growth of 0.5% per annum

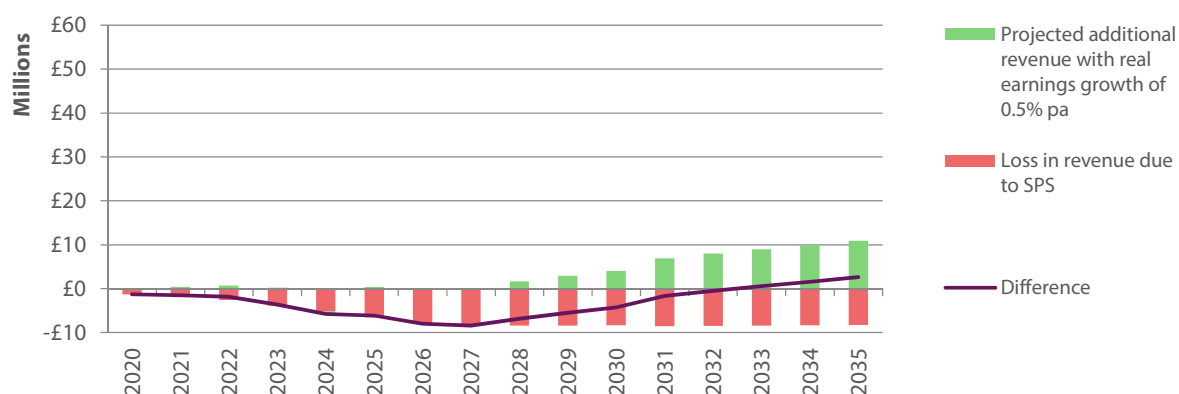
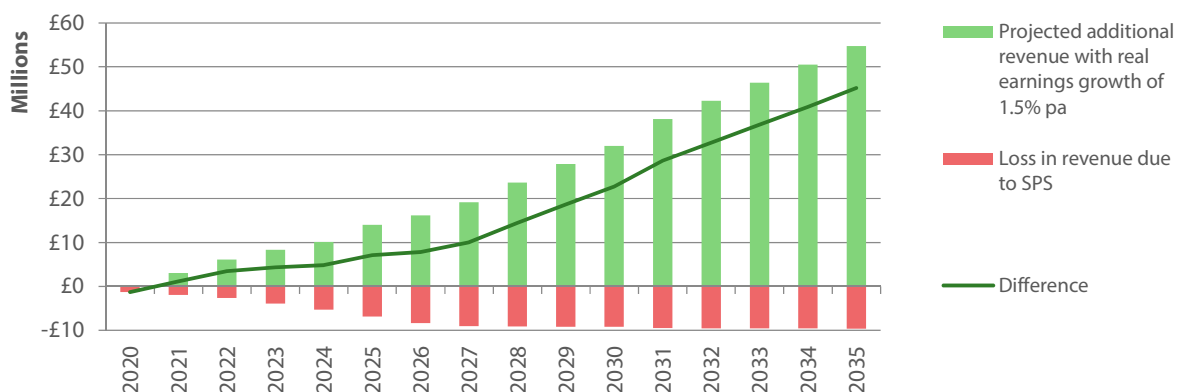


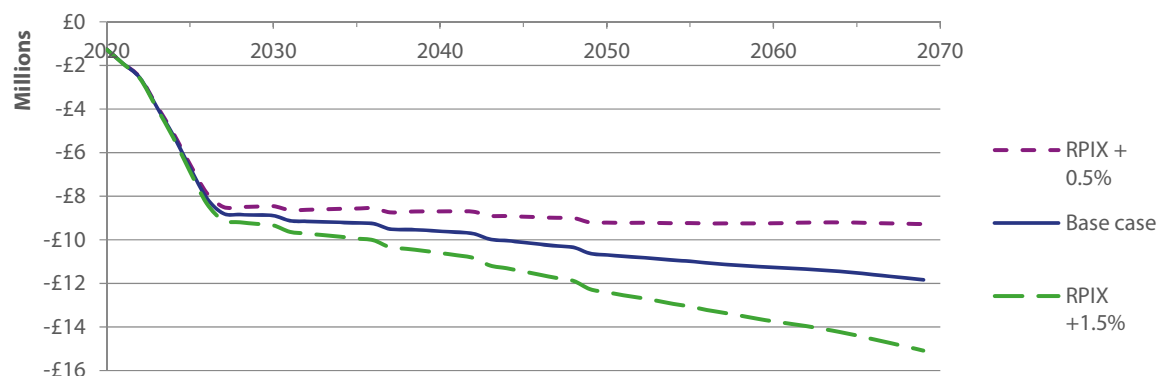
Figure 57. Loss in income tax revenue compared to expected increases in income tax revenue with real earnings growth of 1.5% per annum



7.1.1 Impact on Income Tax Revenue from Working Age Population: Sensitivity Analysis

Sensitivity analysis has been undertaken to estimate the impact of the Secondary Pension Scheme on income tax revenue from the working age population, with respect to the assumptions on real earnings growth, the opt out rate and membership of existing occupational pensions.

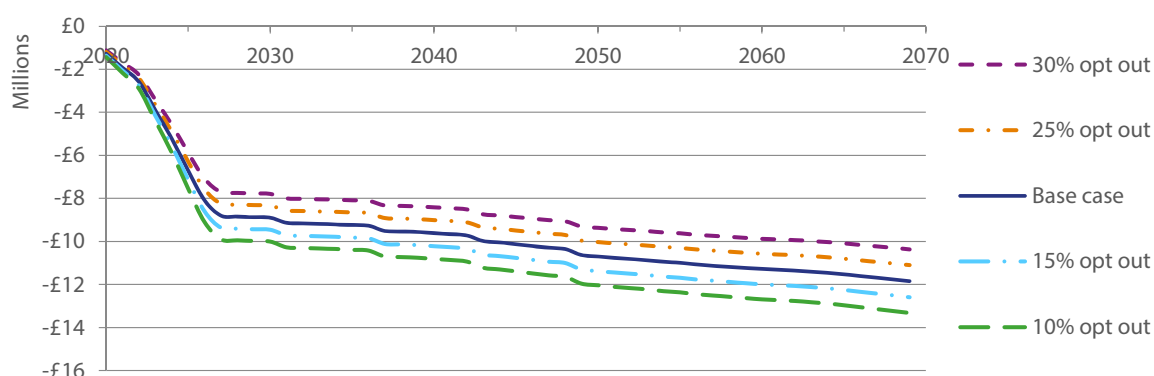
Figure 58. Marginal impact on Income Tax Revenue from Working Age Population: sensitivity to the assumption on real earnings growth



The income tax projections are sensitive to the assumption on real earnings growth. In monetary terms, higher rates of real earnings growth will lead to greater reductions in income tax revenue.

- If real earnings growth is RPIX +0.5% per annum then the loss in income tax revenue is projected to be 22% lower than in the base case by 2069.
- If real earnings growth is RPIX +1.5% per annum then the loss in income tax revenue is projected to be 27% higher than in the base case by 2069.

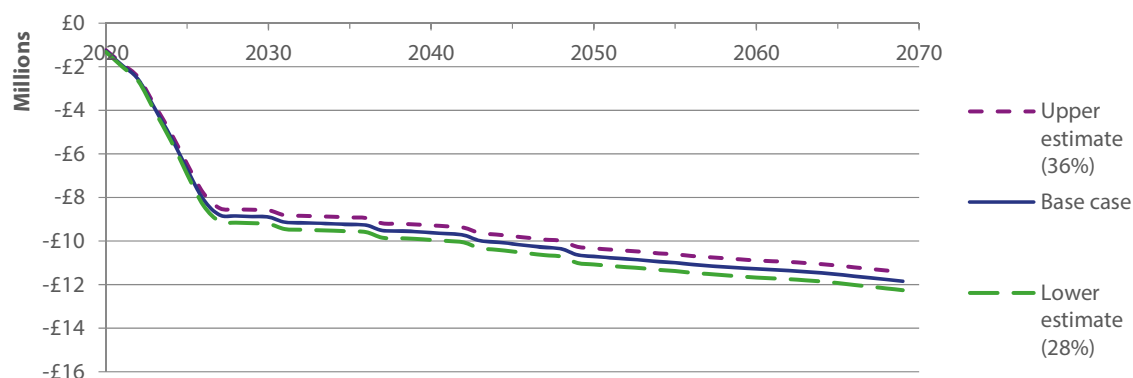
Figure 59. Marginal impact on Income Tax Revenue from Working Age Population: sensitivity on opt out rates



If opt out rates are lower than assumed then the loss in income tax revenue from the working age population would be higher than in the base case, whilst higher opt out rates would have a smaller impact:

- If the opt out rate is 10%, the loss in income tax revenue would be 12.5% higher than the base case
- If the opt out rate is 15%, the loss in income tax revenue would be 6.3% higher than the base case
- If the opt out rate is 25%, the loss in income tax revenue would be 6.3% lower than the base case
- If the opt out rate is 30%, the loss in income tax revenue would be 12.5% lower than the base case.

Figure 60. Marginal impact on Income Tax Revenue from Working Age Population: sensitivity to the assumption on percentage of employees with existing occupational pension



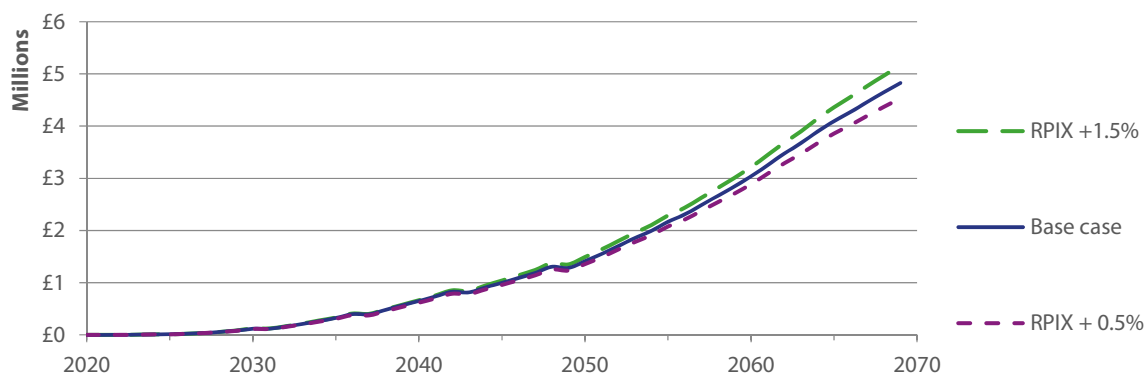
The income tax projections are less sensitive to the percentage of employees already in an occupational pension than they are to the opt out rates. The lower estimate means that more people would be eligible to join the new Secondary Pension Scheme than assumed, so the loss in income tax revenue would be greater, whilst the upper estimate means that fewer people would be enrolled to the new secondary pension and the loss in income tax revenue would be smaller:

- If 28% of employees are active members of an occupational pension, the loss in income tax revenue would be 3% higher than the base case
- If 36% of employees are active members of an occupational pension, the loss in income tax revenue would be 3% smaller than the base case.

7.1.2 Impact on Income Tax Revenue from Pension Age Population: Sensitivity Analysis

We have considered the sensitivity of income tax revenue from pensioners, with respect to the assumptions on real earnings growth, opt out rates, membership of existing occupational pensions, investment return and the percentage of pension income taken as a lump sum. The results are set out in Figure 61, Figure 62, Figure 63, Figure 64 and Figure 65 respectively.

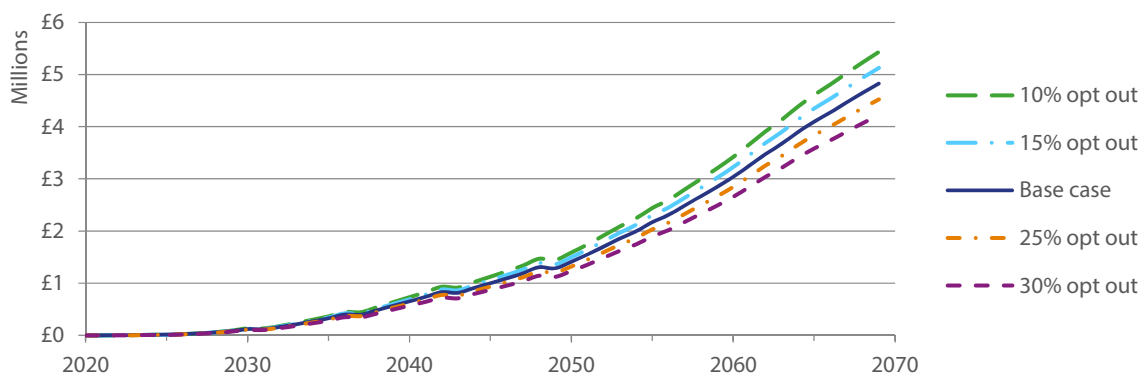
Figure 61. Marginal impact on income tax revenue from pension age population: sensitivity to the assumption on real earnings growth



The assumption on real earnings growth will impact on the amount contributed to the Secondary Pension Scheme and will therefore impact on the tax paid on pension income.

- If the real earnings growth is 0.5% lower than expected, then in income tax revenue from the pension age population would be 4% lower than the base case by 2069
- If the real earnings growth is 0.5% higher than expected, then in income tax revenue from the pension age population would be 7% higher than the base case by 2069

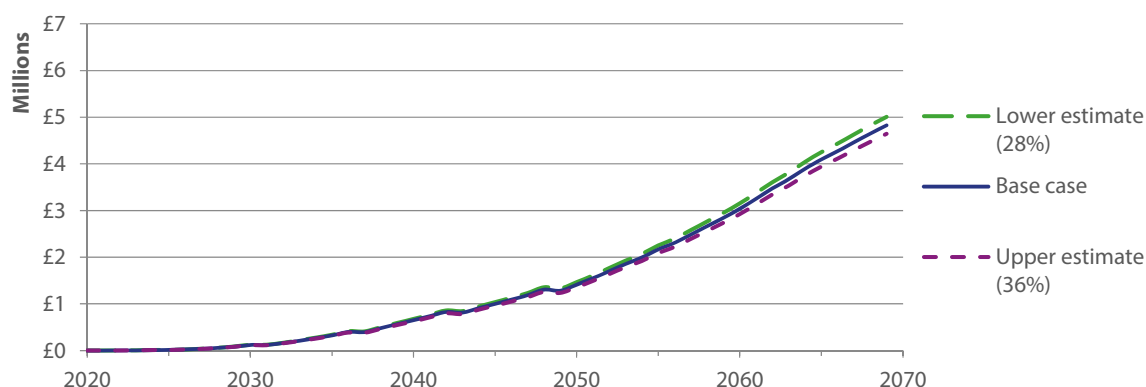
Figure 62. Marginal impact on income tax revenue from pension population: sensitivity to opt out rates



If opt out rates are lower than assumed then the income tax revenue would be proportionately higher than in the base case, while at higher opt out rates would have a smaller impact:

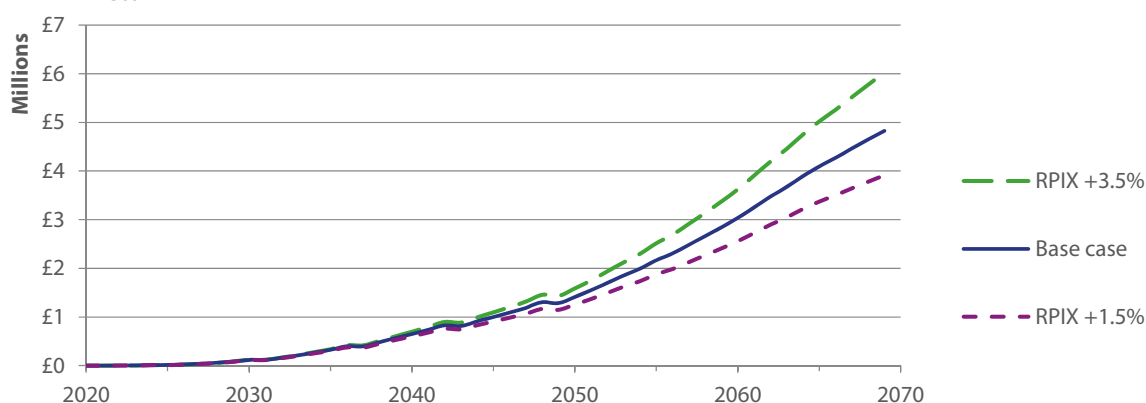
- If the opt out rate is 10%, the gain in income tax revenue would be 12.5% higher than the base case
- If the opt out rate is 15%, the gain in income tax revenue would be 6.3% higher than the base case
- If the opt out rate is 25%, the gain in income tax revenue would be 6.3% lower than the base case
- If the opt out rate is 30%, the gain in income tax revenue would be 12.5% lower than the base case.

Figure 63. Marginal impact on income tax revenue from pension population: sensitivity to assumption on percentage of employees with existing occupational pension



The income tax projections are less sensitive to the assumption on the percentage of employees with an existing occupational pension than they are to the opt out rates. The lower estimate means that more people would contribute to the new Secondary Pension Scheme than assumed, so more people would receive pension income in retirement, and the income tax revenue from the pension age population would be greater. Conversely, if fewer people contribute to a secondary pension, the income tax revenue would be smaller. The variation around the base case is $\pm 4\%$.

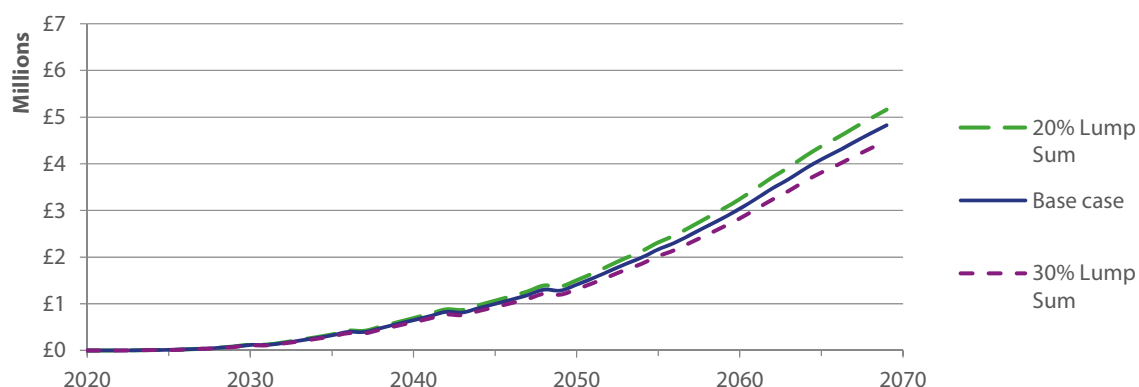
Figure 64. Marginal impact on income tax revenue from pension population: sensitivity to investment return



The income tax projections are sensitive to the assumption on investment return. If the investment return is lower than assumed then pension incomes will be lower and the gain in income tax revenue would be lower. Conversely, if the investment return is higher than assumed, pension incomes would be higher and the gain in income tax revenue would be higher.

- If investment return is RPIX +1.5% per annum then the gain in income tax revenue is projected to be almost 20% lower than in the base case by 2069.
- If investment return is RPIX +3.5% per annum then the gain in income tax revenue is projected to be 25% higher than in the base case by 2069.

Figure 65. Marginal impact on income tax revenue from pension age population: sensitivity to percentage taken as lump sum



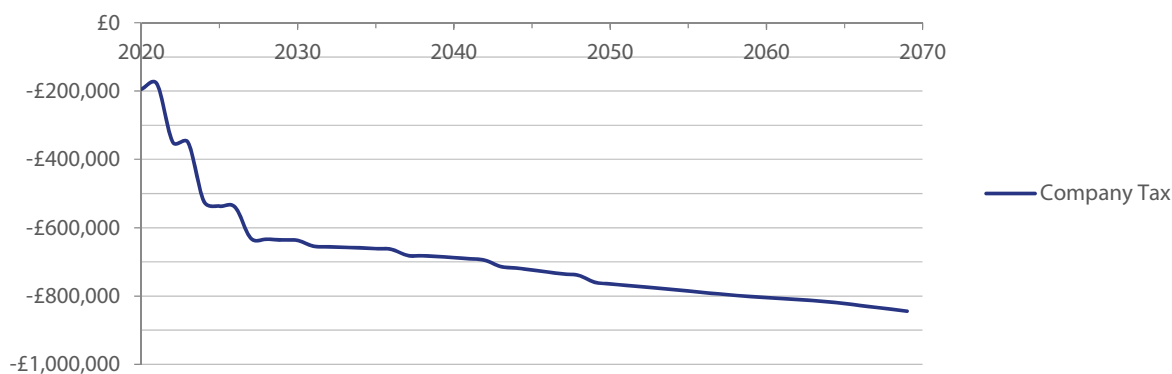
The amount an individual receives in pension income depends on how much is taken as a tax-free lump sum upon retirement. The maximum lump sum permitted by the income tax legislation is 30% of the value of a person's benefits. The first £188,000 of the lump sum (in 2017) is tax-free.

- If individuals take 20% as a lump sum payment (compared to 25% in the base case), then the marginal impact on income tax revenue would be 7% higher than in the base case.
- If 30% is taken as a lump sum, the marginal impact on income tax revenue would be 7% lower than in the base case.

7.2 Marginal Impact on Company Tax Revenue

The introduction of the Secondary Pension Scheme is expected to reduce company tax revenue. As firms incur additional costs, this will have a negative impact on company profits. The economic model estimates the marginal impact on company tax revenue, taking into account the economic sector and employer size. We have assumed there are no changes to the existing company tax policy and rates.⁵⁰ The estimated marginal impact of the Secondary Pension Scheme on company tax revenue over the next 50 years is shown in Figure 66.

Figure 66. Marginal impact of the Secondary Pension Scheme on company tax revenue



By 2027 the loss is projected to be approximately £630,000, which is 1.3% of the total revenue from company tax that was received in 2016.⁵¹ From 2027 the loss in company tax revenue increases gradually, in line with real earnings. The impact on company tax revenue is relatively limited, since most companies do not pay company tax, and those sectors (such as finance, energy and large retail) are already more likely to provide their employees with an occupational pension.

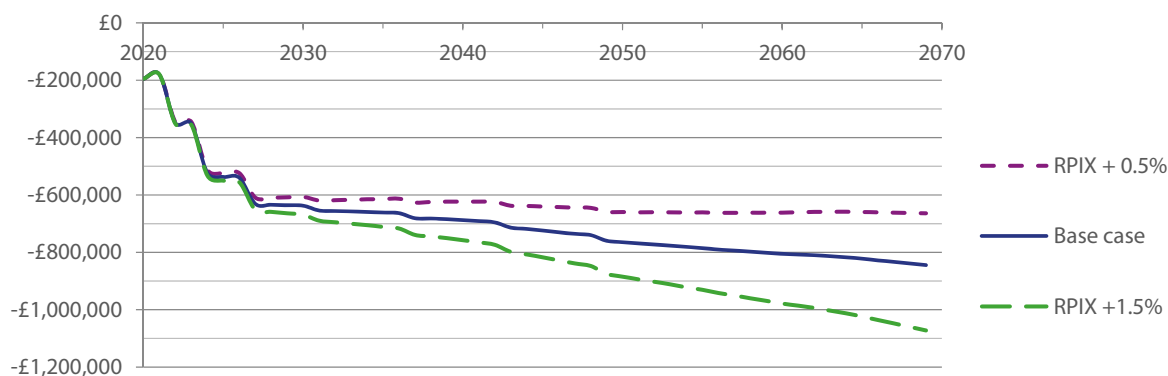
⁵⁰ Tax for businesses, companies and employers: <https://www.gov.gg/article/120167/Tax-for-businesses-companies-and-employers>. Accessed on 28 October 2017. The amount paid in company tax depends on the source of income. The company standard rate of 0% applies to most companies, though companies in the finance sector typically pay the company intermediate rate of 10%. There are also some sources of income subjected to a company higher rate of 20%.

⁵¹ States of Guernsey (2017). Billet d'Etat XIII 2017. The States of Guernsey Accounts 2016. The accounts reported that total revenue from company tax was £47 million in 2016.

7.2.1 Impact on Company Tax Revenue: Sensitivity Analysis

We have considered the sensitivity of the company tax revenue with respect to the assumptions on real earnings growth, the opt out rate, membership of existing occupational pensions, and the extent to which employers incur the additional cost of the Secondary Pension Scheme. The results are shown in Figure 67, Figure 68, Figure 69 and Figure 70.

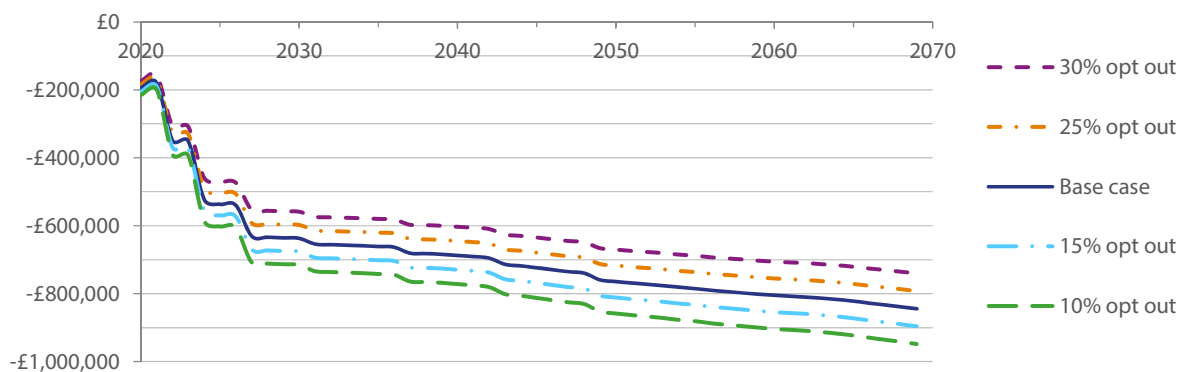
Figure 67. Marginal impact on company tax revenue: sensitivity to the assumption on real earnings growth



The company tax projections are sensitive to the assumption on real earnings growth.

- If real earnings growth is RPIX +0.5% per annum then the loss in income tax revenue is projected to be 21% lower than in the base case by 2069.
- If real earnings growth is RPIX +1.5% per annum then the loss in income tax revenue is projected to be 27% higher than in the base case by 2069.

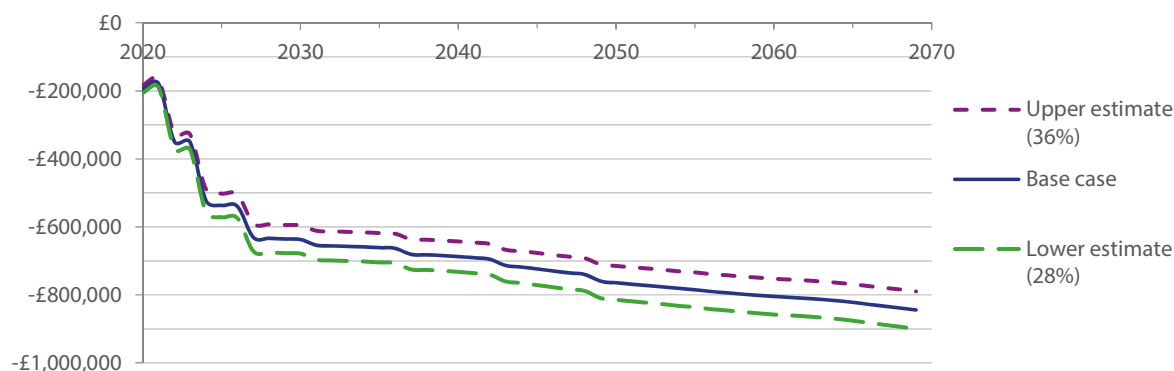
Figure 68. Marginal Impact on company tax revenue: sensitivity on opt out rates



If opt out rates are lower than assumed then the loss in company tax revenue would be greater than in the base case, while higher opt out rates would have a smaller impact on company tax revenue:

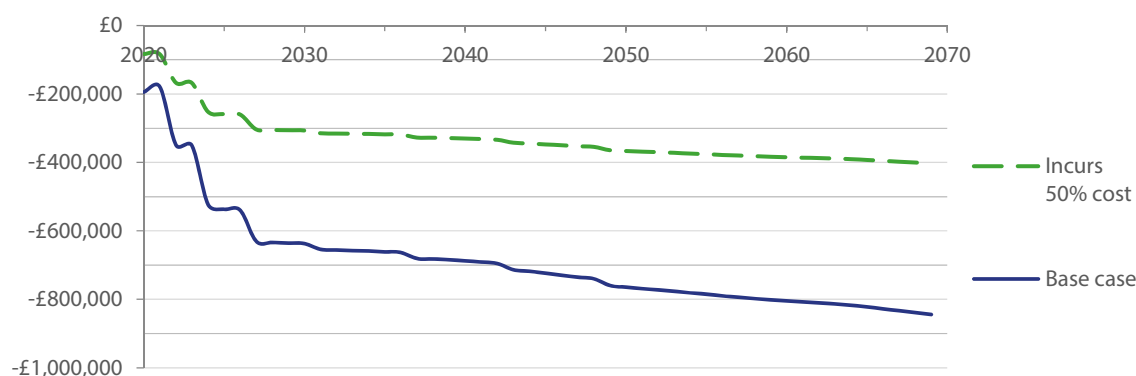
- If the opt out rate is 10%, company tax revenue would be 12% higher than the base case
- If the opt out rate is 15%, company tax revenue would be 6% higher than the base case
- If the opt out rate is 25%, company tax revenue would be 6% lower than the base case
- If the opt out rate is 30%, company tax revenue would be 12% lower than the base case.

Figure 69. Marginal impact on company tax revenue: sensitivity on assumption on percentage of employees with existing occupational pension



The company tax projections are also sensitive to the assumption on the percentage of employees with an existing occupational pension. The lower estimate means that more employees would contribute to the new Secondary Pension Scheme than assumed, so employers would contribute more into secondary pensions, incur higher costs, have lower profits and the marginal impact on company tax revenue would be greater. Conversely, if fewer employees are enrolled into the new secondary pension than assumed, there would be a smaller impact on company profits and the marginal impact on company tax would be smaller. The variation around the base case result is $\pm 6.5\%$.

Figure 70. Marginal impact on company tax revenue: sensitivity on employer response

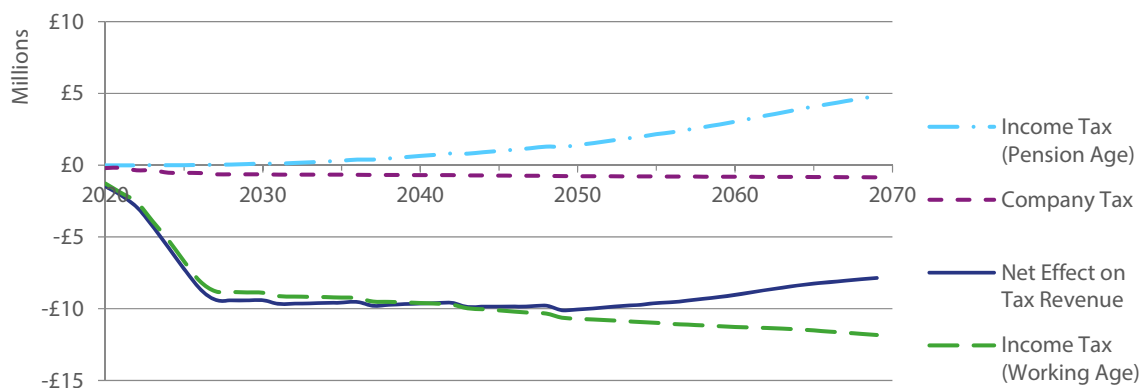


The marginal impact on company tax revenue is especially sensitive to the assumption about the employers' response to the introduction of the Secondary Pension Scheme. In this respect, the base case represents a worst case scenario, as it is assumed that 100% of the cost of the secondary pension is borne by the employer. As discussed in Section 6, employers are likely to look to mitigate the cost and may do this in a number of ways. The sensitivity analysis shows the marginal impact on company tax revenue if employers are able to recover 50% of the costs they incur. In this scenario, the marginal impact on company tax revenue is halved.

7.3 Marginal Impact on Government Revenue

The net impact of the Secondary Pension Scheme on government revenue is illustrated in Figure 71, along with its component parts: the marginal impact on income tax from the working age and pension age populations, and marginal impact on company tax. It should be noted that the impact of Secondary Pension Scheme on distributed profits has not been estimated. This omission may mean the impact is underestimated but is unlikely to be significant as distributed profits yield only 2% of government revenue.⁵²

Figure 71. Marginal impact of the Secondary Pension Scheme on government revenue



This figure is very similar to Figure 51 since the loss of company tax is small relative to the loss in income tax revenue. By 2027, the loss in government revenue is projected to be £9.4 million.⁵³ By 2069 the projected loss in government revenue is projected to be £7.9 million. Over time, the magnitude of the loss in revenue is reduced as there will be an increasing number of pension age individuals who have participated in the Secondary Pension Scheme. In addition, pension incomes will be increasing over this period as the individuals retiring will have contributed to a secondary pension for more of their working life.

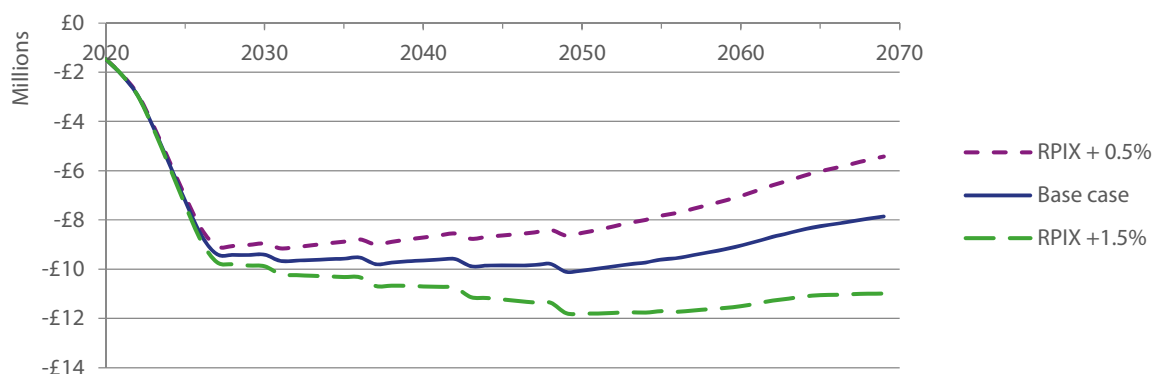
⁵² States of Guernsey (2017). Billet d'Etat XIII 2017. The States of Guernsey Accounts 2016. Distributed profits were £10 million in 2016.

⁵³ States of Guernsey (2017). Billet d'Etat XIII 2017. The States of Guernsey Accounts 2016. Total general revenue income was £407 million in 2016.

7.3.1 Impact on Government Revenue: Sensitivity Analysis

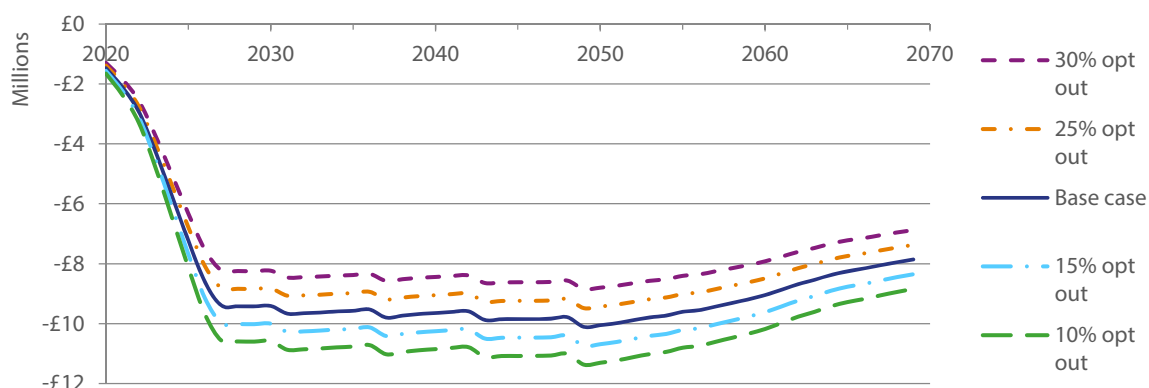
We have considered the sensitivity of government revenue with respect to the assumptions on real earnings growth, the opt out rate, membership of existing occupational pensions, the investment return and the percentage of pension income taken as a lump sum. The results are shown in Figure 72, Figure 73, Figure 74, Figure 75 and Figure 76 respectively.

Figure 72. Marginal impact on government revenue: sensitivity to the assumption on real earnings growth



The results are diverging in Figure 72 as the assumption on real earnings growth has a compounding impact over time. Figure 72 shows the combined effect of the loss in income revenue from the working age population, the gain in income revenue from the pension age population and the loss in company tax revenue (Figure 58, Figure 61 and Figure 67).

Figure 73. Marginal impact on government revenue: sensitivity to opt out rates



The lines converge slightly, reflecting the combined effect of the loss in revenue from the working age population and the gain in revenue from the pension age population (Figure 58 and Figure 61). The working age population eligible to participate in the Secondary Pension Scheme remains relatively stable over the next 50 years, however the proportion of the pension age population who will have contributed to a secondary pension will increase gradually. By 2100 almost all individuals of pension age would have had the opportunity to participate and have contributed for their entire working lives.

Figure 74. Marginal impact on government revenue: sensitivity to assumption on percentage of the employees with existing occupational pension

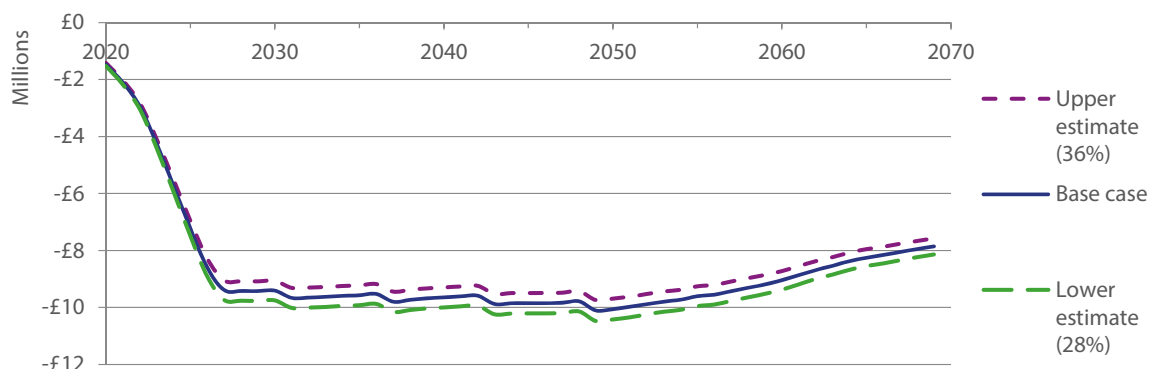
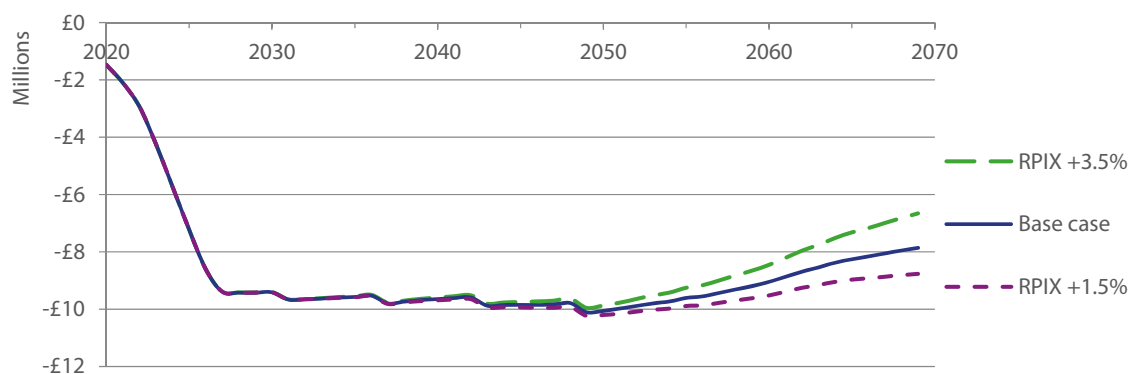


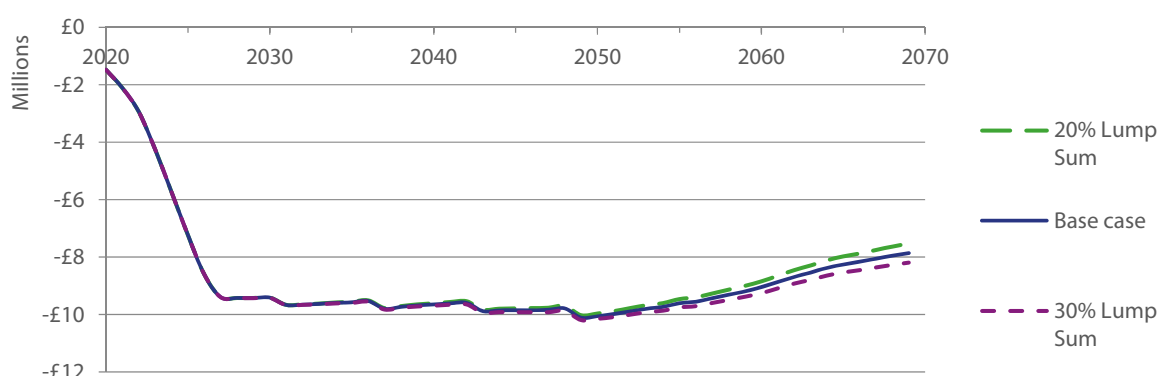
Figure 74 shows the marginal impact on the sensitivity around the assumption about the percentage of individuals who are a member of an existing occupational pension. The impact is small compared to the opt-out rates.

Figure 75. Marginal impact on government revenue: sensitivity to the investment return



The results are diverging in this scenario, since the investment return assumption only impacts on the income tax revenue from the pension age population. If the investment return is higher than assumed, the loss in government revenue would be smaller.

Figure 76. Marginal impact on government revenue: sensitivity to percentage taken as lump sum



Again, the results are diverging in this scenario (Figure 76) and this is because the assumption on the amount taken as a lump sum only impacts on the income tax revenue from the pension age population. The projections are less sensitive to the assumption on the lump sum than they are to the investment return.

7.4 Marginal Impact on Government Expenditure

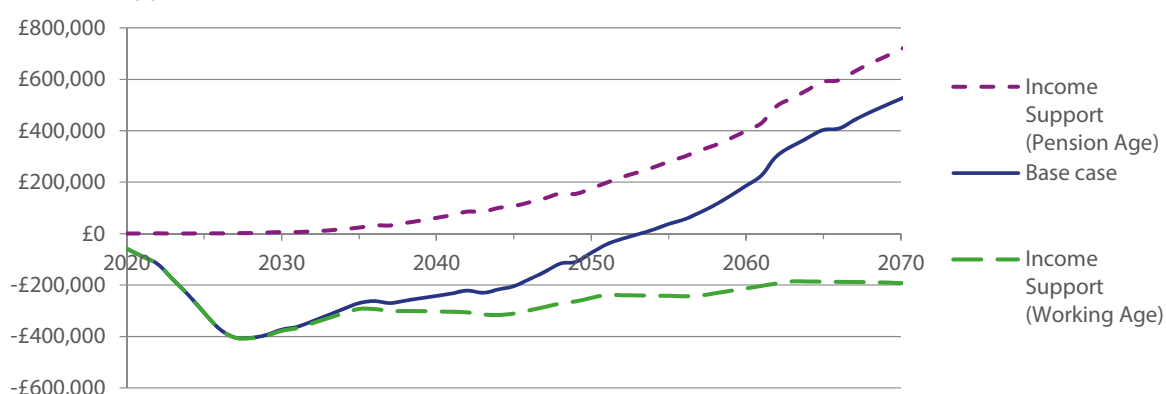
The Secondary Pension Scheme will impact on the amount the government will spend on income support in two ways:

- Individuals contributing to a secondary pension who are eligible for income support may receive more income support as pension contributions are deducted as an allowable expense.
- Individuals receiving income from a secondary pension may no longer be eligible for income support or receive a reduced payment.

The assumptions in the economic model around the impact of the Secondary Pension Scheme on income support on household income are set out in Section 5.3.1. In estimating the marginal impact on income support at the population level, we also take into account the profile of those currently receiving either supplementary benefit or rent rebate with respect to their age, gross taxable income, and employment status. We also take into account the States' assumption that earnings will grow in real terms, while benefits will remain constant in real terms from 2025. However, some simplifying assumptions were necessary and the inflections from 2060 onwards correspond to the income profile on which the modelling was based.

Figure 77 shows the cost of income support on the government budget, with an increase in expenditure shown as a cost (i.e. negative) and a reduction in expenditure is cost saving (i.e. positive).

Figure 77. Marginal Impact of the Secondary Pension Scheme on Government Budget relating to income support



In the short-term the Secondary Pension Scheme will mean income support expenditure is expected to be slightly higher, since pension contributions are allowed for in the income support assessment. In the base case scenario, the spending on income support expenditure will increase to a maximum around £400,000. This occurs in 2027 and the cost is equivalent to 2% of the amount spent on supplementary benefit in 2016.⁵⁴

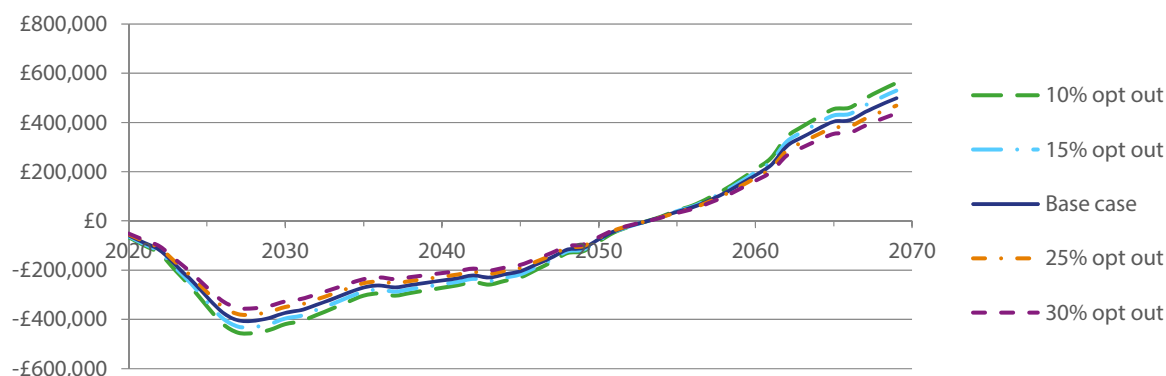
The marginal cost will reduce over time and ultimately becomes cost saving. By 2069 it is estimated that the government would be saving £500,000, which is equivalent to 2.5% of the amount spent on supplementary benefit in 2016. The cost reduces because, the real earnings growth assumption means there will be fewer individuals eligible for income support, and also because there will be more individuals receiving an income from a secondary pension and so fewer pensioners who need income support. In addition, pension incomes will be increasing over this period as the individuals retiring will have contributed to a secondary pension for more of their working life.

⁵⁴ States of Guernsey (2017). Billet d'Etat XIII 2017. The States of Guernsey Accounts 2016. The accounts reported net revenue expenditure on supplementary benefit was £20.983 million in 2016.

7.4.1 Impact on Government Expenditure on Income Support: Sensitivity Analysis

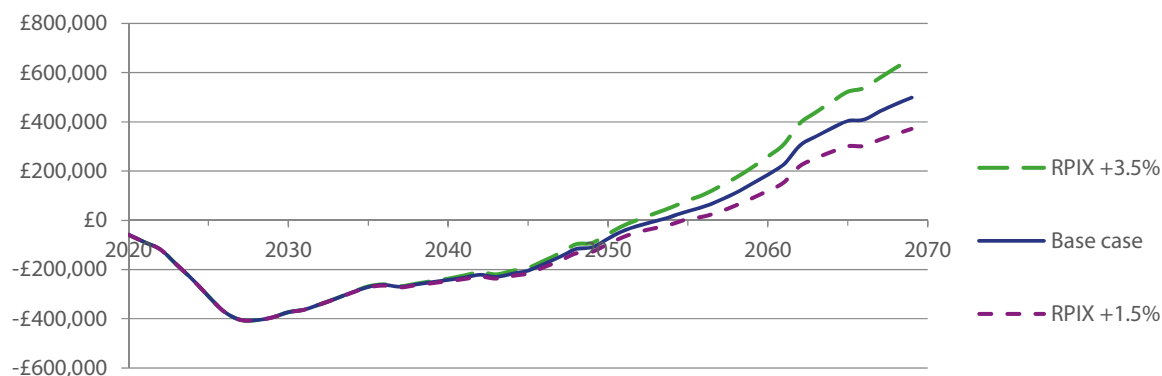
We have considered the sensitivity of government expenditure on income support, with respect to the assumptions on opt out rates, and the investment return and the percentage of pension income taken as a lump sum. The results are presented in Figure 78, Figure 79 and Figure 80 respectively.

Figure 78. Marginal impact on income support: sensitivity to opt out rates



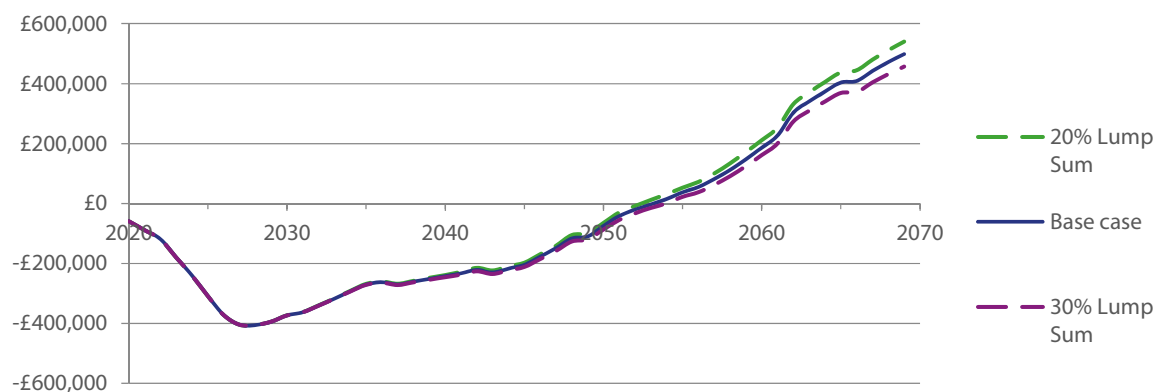
If the opt out rates are lower than assumed then the marginal impact on the government budget will be greater than the base case, while higher opt out rates the impact will have a smaller effect. The lines converge, reflecting the combined effect of the increased income support expenditure on the working age population and a reduced income support expenditure on pension age population.

Figure 79. Marginal impact on income support: sensitivity to investment return



The results are diverging in this scenario, since the assumption on the investment return only impacts on the income support expenditure on the pension age population. If the investment return is higher than assumed, pension incomes will be higher and the pension age population will be less reliant on income support. If the investment return is lower than assumed then the budgetary impact will be greater.

Figure 80. Marginal impact on income support: sensitivity to percentage taken as lump sum



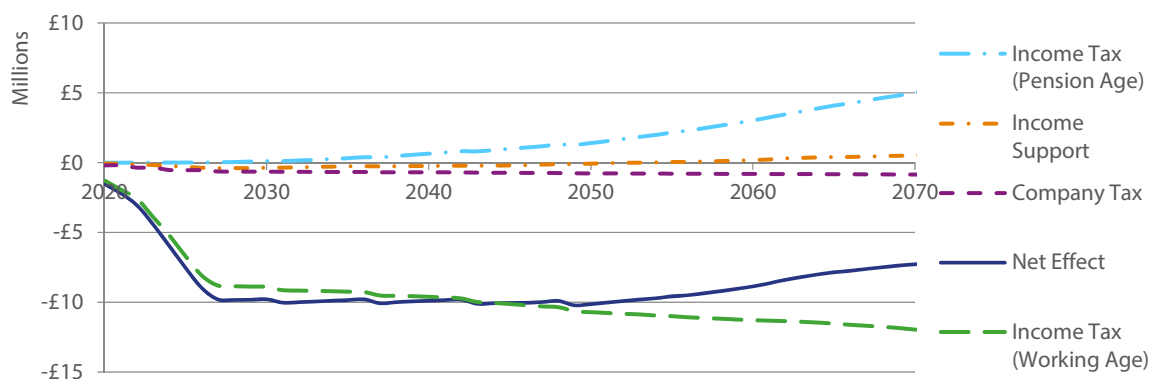
The results are also diverging in this scenario, since the assumption on the amount taken as a lump sum only impacts on the income support paid to the pension age population. The projections are less sensitive to the assumption on the lump sum than they are to the investment return.

7.5 Marginal Impact on Overall Government Budget

This section brings together the projected marginal impact on income tax revenue, company tax revenue and income support and considers the overall impact on the government budget. Figure 81 presents the net effect on the government budget along with its component parts:

- income tax revenue from working age and pension age population
- company tax revenue
- expenditure on income support.

Figure 81. Marginal impact of Secondary Pension Scheme on overall government budget



Over the projection period considered the Secondary Pension Scheme will increase costs for the government. The Secondary Pension Scheme is expected to have a marginal cost of £9.8 million in 2027 when the individual contribution rate reaches the maximum rate of 6.5%. In the short-to medium term, the net effect is dominated by the loss in income tax revenue from the working age population due to the tax relief on pension contributions. By 2069, the marginal cost will have reduced slightly and is projected to be £7.4 million, which includes a loss of £11.8 million in income tax revenue from the working age population.

Over time there will be a gain in income tax revenue from the pension age population, due to the increasing number of pensioners who have participated in the Secondary Pension Scheme. Average pension incomes are also increasing over this period (as they will have contributed for more of their working life). The loss of company tax revenue will be approximately £850,000 by 2069, which is small relative to the loss in income tax revenue. The impact on income support payment is also relatively small. Initially the cost of income support will increase, but the impact is projected to be cost saving by 2054.

7.5.1 Impact on Government Expenditure on Income Support: Sensitivity Analysis

We have considered the sensitivity analysis of the government budget, with respect to the assumptions on real earnings growth, opt out rates, membership of existing occupational pensions, the investment return and the percentage of pension income taken as a lump sum. The results are presented in Figure 82, Figure 83, Figure 84, Figure 85 and Figure 86.

Figure 82. Marginal impact on government budget: sensitivity to the assumption on real earnings growth

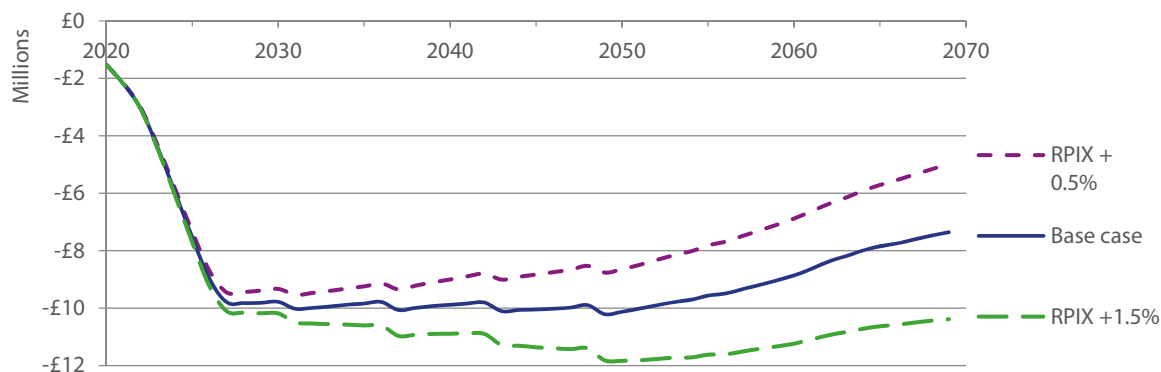


Figure 82 shows how the assumption on real earnings growth impacts on the government budget, with the effect becoming more pronounced over time.

Figure 83. Marginal impact on government budget: sensitivity to opt out rates

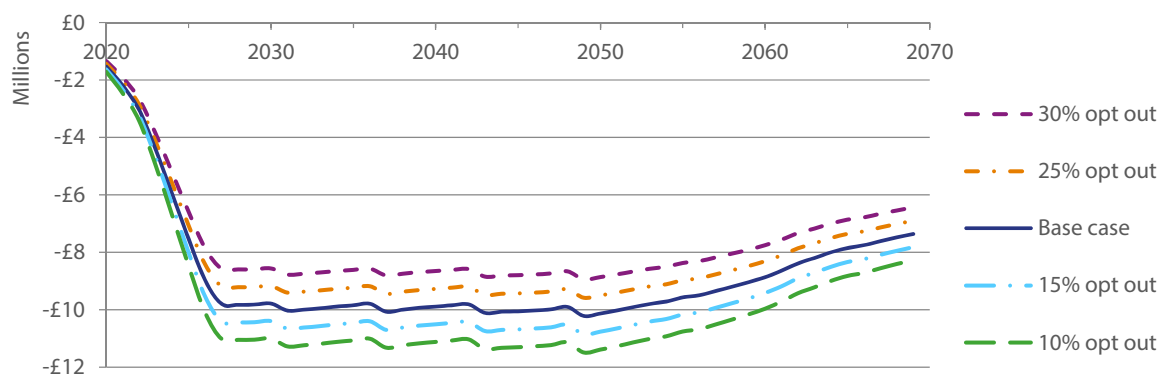


Figure 83 shows how variation in the assumption on the opt out rate will impact on the government budget. The lines appear to converge, and this reflects the combined effect on the working age population (i.e. reduced income tax revenue and higher spend on income support) and the pension age population (i.e. greater income tax revenue and lower spend on income support).

Figure 84. Marginal impact on government budget: sensitivity to assumption on percentage of employees with existing occupational pension

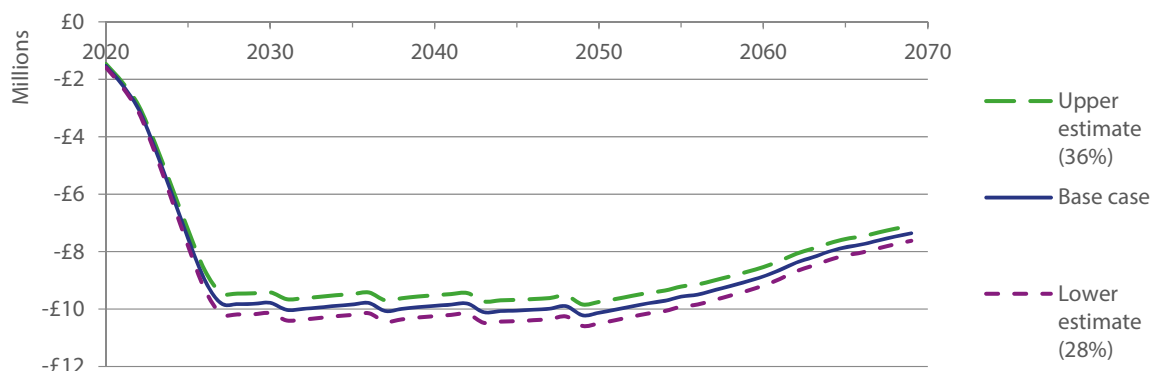
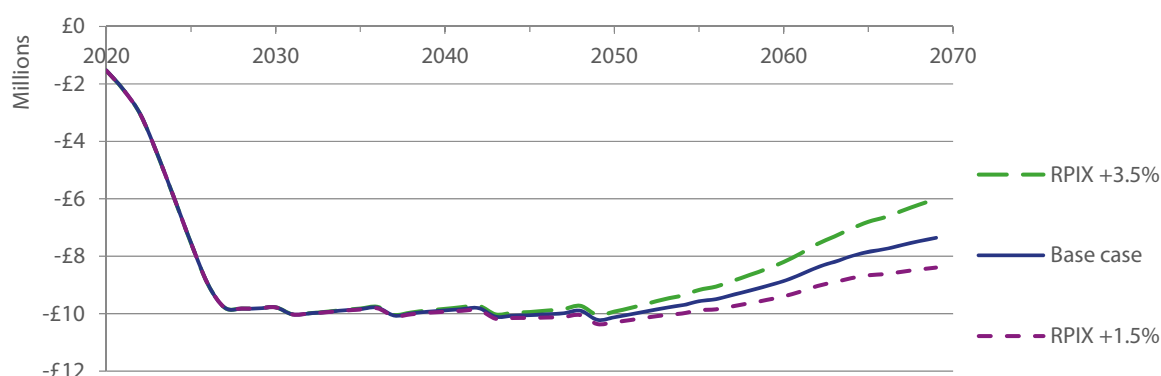


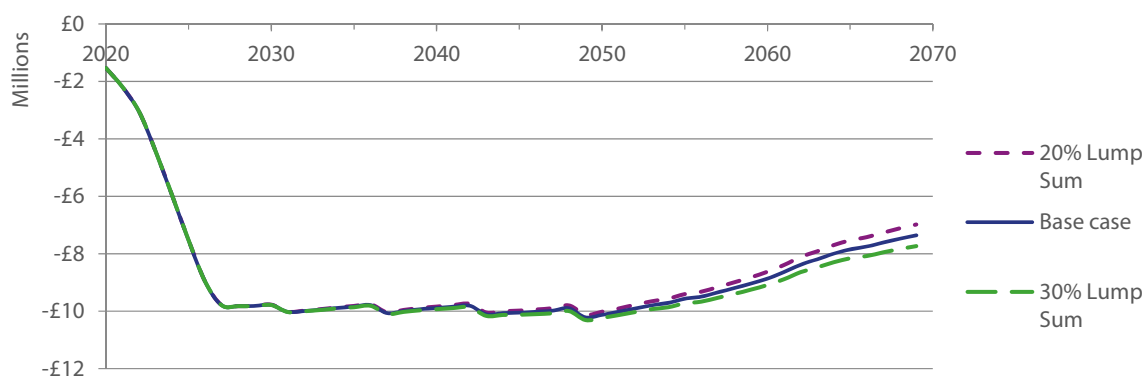
Figure 84 shows the marginal impact on the sensitivity around the assumption about the percentage of individuals who are a member of an existing occupational pension. The variation is smaller than that on the opt-out rates, and as in the last scenario the impact converged because the assumption impacts on both the working age and the pension age populations.

Figure 85. Marginal impact on government budget: sensitivity to investment return



The results are diverging in this scenario, since the assumption on the investment return only impacts on the pension age population. If the investment return is higher than assumed in the base case then the marginal cost to the government would be smaller.

Figure 86. Marginal impact on government budget: sensitivity to percentage taken as lump sum



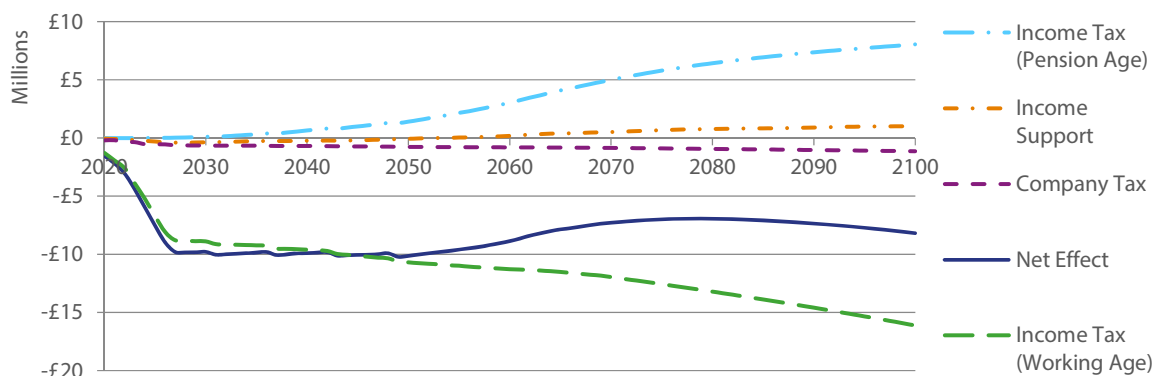
As above, the results are diverging slightly in this scenario, since the assumption on the amount taken as a lump sum only impacts on the income tax revenue from the pension age population. The sensitivity of the projections to the assumption on the lump sum is less than to the investment return.

7.6 Estimating the impact beyond 2069

We have extrapolated to estimate the impact of the Secondary Pension Scheme beyond 2069 to provide an indication of the impact in the very long-term, when all individuals in the population have had the opportunity to participate in the Secondary Pension Scheme, and all pensioners would have been able to contribute to a secondary pension for their working life.

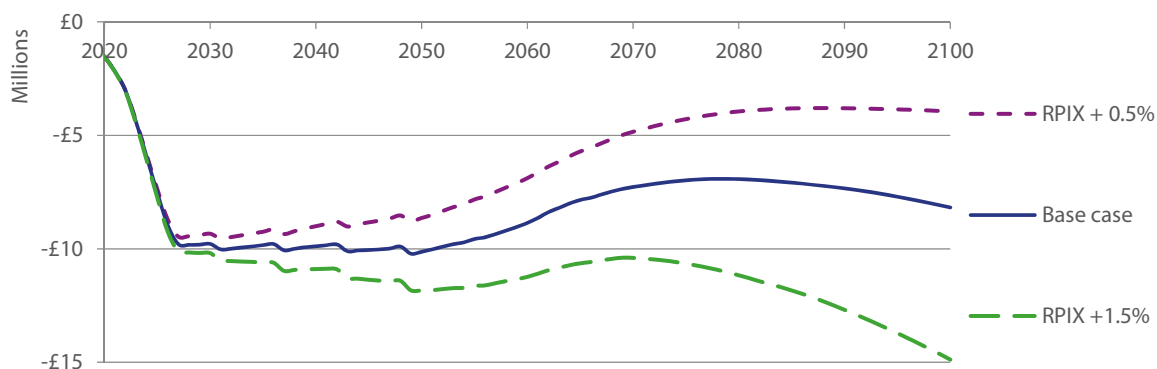
Figure 87 shows the projected marginal impact on the government budget, assuming the population size and age distribution remains stable after 2069.

Figure 87. Marginal impact on overall government budget (2020 to 2100)



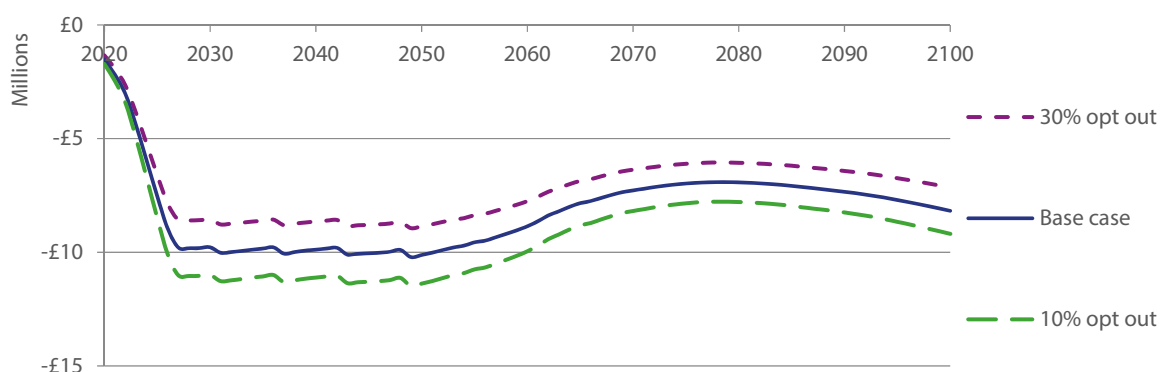
We have considered the sensitivity analysis of the government budget, with respect to the assumptions on real earnings growth, opt out rates and the investment return. The results are presented in Figure 88, Figure 89 and Figure 90.

Figure 88. Marginal impact on overall government budget (2020 - 2100): sensitivity to the assumption on real earnings growth



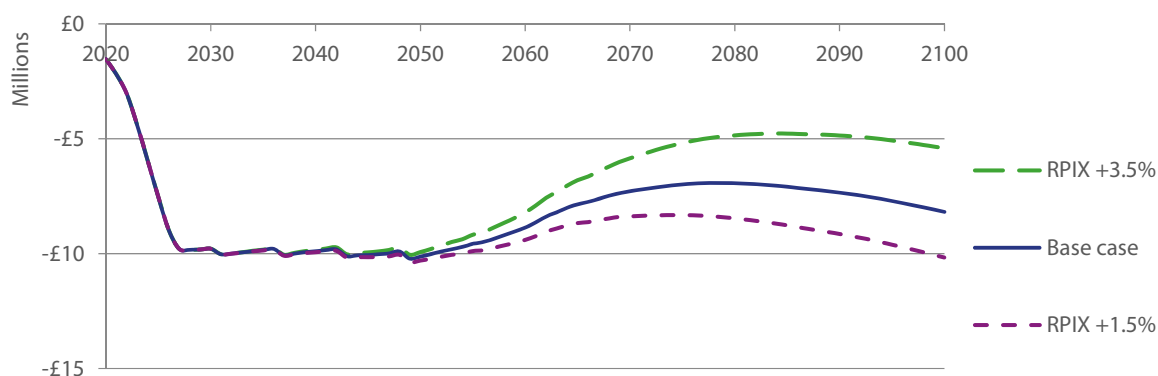
Over the very long term the marginal impact on the government budget is extremely sensitive to the assumption on real earnings growth because it has a compounding effect. However, as discussed in Section 7.1, the assumptions on real earnings growth will also mean total income tax revenue will be increasing over this period.

Figure 89. Marginal impact on overall government budget (2020 - 2100): sensitivity to opt out rates



As Figure 89 shows, the assumption on the opt out rates has relatively minimal impact in the very long-term. The variation is relatively small because the reduction in the income tax revenue from the working age population is largely offset by the increase in income tax revenue from the pension age population.

Figure 90. Marginal impact on overall government budget (2020 - 2100): sensitivity to investment return



The long-term projections are sensitive to the assumption on the investment return. As Figure 90 shows, the difference between the lower and upper estimates on investment return is projected to be of the order of £5 million in current prices. This highlights that the rate of investment return achieved on the Secondary Pension Scheme is central to achieving the policy aims.

7.7 Change of Tax Strategy from EET to TEE

The impact of the Secondary Pension Scheme has been estimated assuming that the tax system remains “Exempt-Exempt-Taxed” (EET). This means secondary pension contributions are exempt from tax, investment income and capital gains are also exempt, but pension income is subject to income tax. TEE is an alternative tax system, in which pension contributions are taxed, but returns and pension income are tax-free.

A change in tax strategy would have a very different impact on the government budget. In the short- to medium-term, the Secondary Pension Scheme would have almost no impact on the government budget as there would be no loss in income tax receipts from the working age population. The downside is in the long-term, as under TEE there would be no income tax revenue generated from the additional pension income.

In theory, both approaches are valid. On first consideration, a change in tax strategy has merit from a fiscal perspective. However, the challenge is switching from one system to the other. The Economist decried the complications involved in such a shift as “mind-boggling” and likened the change to “decreeing that British cars should shift to driving on the right, with the move phased in gradually”.⁵⁵

A key part of the challenge is that the change in tax system would impact on existing pensions. Presumably TEE would only apply to benefits arising from future contributions. If it did not, individuals could transfer their existing pension on which they had received tax relief, to a new one in which they would not have to pay tax on pension income. So this means anyone who already has a pension, would have need to have two schemes going forward, one under EET and the other under TEE.

Opt out rates would be expected to be much higher under TEE. Paying tax on pension contributions would lead to a much larger reduction in disposable income, and incentives for retirement saving would be undermined. In addition, if employee contributions were to be taxed, then individuals already in a pension scheme would effectively receive a reduction in net pay.

Finally, given that population projections show an ageing demographic and a slight reduction in the size of the working population, the fiscal pressures are only likely to increase over time. This suggests that the additional tax revenue from pension income will be critical for the long-term fiscal situation in Guernsey and Alderney.

⁵⁵ The Economist (2015). “EET your TEE, George” from 5 August 2015, <https://www.economist.com/blogs/buttonwood/2015/08/pensions-and-tax>

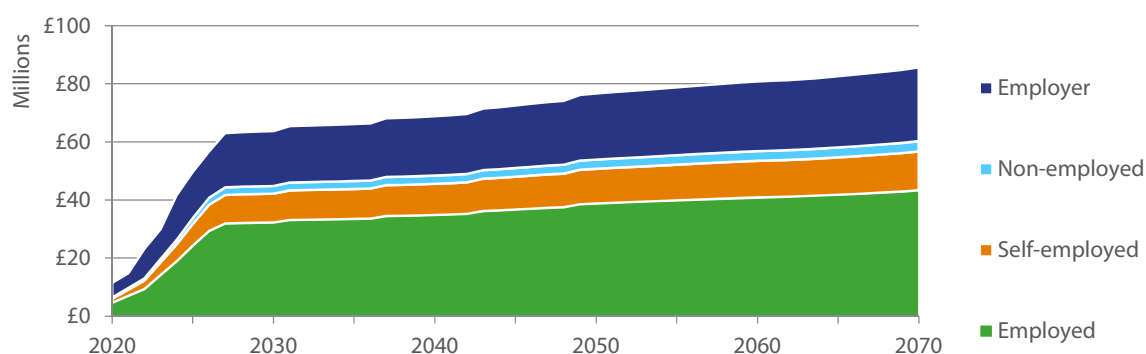
8. Impact on the Economy

The Secondary Pension Scheme will have an impact on the local economy. The overall economic impact will reflect the combined effect on individuals and households, on firms and on the government budget. In this section we discuss the implications of the Secondary Pension Scheme for saving, consumption, the labour market and economic growth.

8.1 Impact on Saving

The Secondary Pension Scheme is expected to increase the amount of pension saving. Figure 91 shows the annual pension contributions into the Secondary Pension Scheme⁵⁶ from new members by type of contributor.

Figure 91. Annual pension contributions in the Secondary Pension Scheme from new members



It is expected that the annual pension contributions from new members will be in the region of £60 million by 2027, with £40 million from individuals and £20 million from employers. From 2027, annual pension contributions increase in line with real earnings growth. However, it is important to acknowledge that not all of the increase in saving will constitute new or additional saving as some people will substitute away from existing savings once they start contributing to a Secondary Pension Scheme. In the UK it was estimated that up to 70% of new savings could be generated by the introduction of auto-enrolment into “Workplace Pensions”.⁵⁷ The features of the Workplace Pension that were designed to encourage new saving included automatic enrolment, mandatory employer contributions, and tax relief on pension contributions. In addition, the scheme was intended to target lower and middle income earners.

⁵⁶ Includes contributions in the States-facilitated scheme and alternative qualifying schemes.

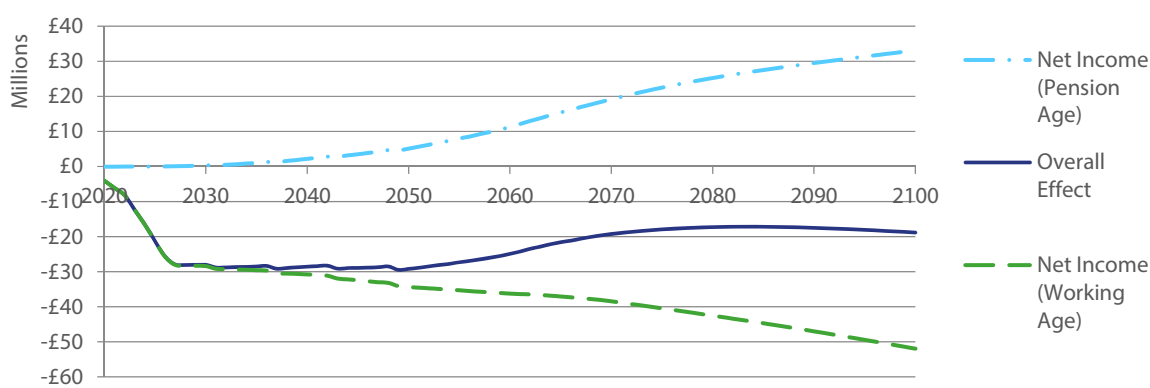
⁵⁷ Department for Work and Pensions (2010). Workplace pension reform regulations. Impact assessment.

8.2 Impact on Consumption

Individuals who pay into a secondary pension will see a reduction in their disposable income. This will lead to a reduction in consumer spending, especially in the short-term. However, in time, consumption will increase as pensioners who have contributed to the Secondary Pension Scheme will have higher incomes in retirement and would be expected to spend at least some of their additional income.

The impact of the Secondary Pension Scheme on consumption can be estimated from the projected change in net income for the population as a whole. In the base case, it is assumed that the average marginal propensity to consume is 0.8, which means that 80% of additional income would be spent. Other economic conditions are presumed to remain stable. Figure 92 shows the marginal impact of the Secondary Pension Scheme on consumption for the period 2020 to 2100 for the entire population, and also disaggregated for the working age and pension age populations.

Figure 92. Marginal impact of Secondary Pension Scheme on annual consumption



The pattern is a familiar one. At the population level, consumption is projected to reduce in the short-term. The reduction in consumption is estimated to be close to £30 million by 2027, when contribution rates reach their maximum levels. This reduction in consumption is sustained until 2050. Thereafter the impact then begins to reduce because there will be an increasing number of pensioners benefiting from additional pension income.

It should be noted that these estimates are from a partial equilibrium analysis, and therefore focus only on the first-round effects. In other words, the estimates do not take into account interaction with other economic variables, or any second-round effects, that may result from the initial change in consumption. In addition, the impact on consumption has been estimated from the change in saving among individuals. It does not take into account any changes in consumption that may arise from the employers' pension contribution.⁵⁸ Nevertheless, the simple modelling helps to give some indication of the magnitude of the impact.

The projected changes in consumption is small relative to GDP, which was estimated to be £2,355 million in 2015. This means that the change in consumption is equivalent to a loss of approximately 1% of GDP in the short-term; it is likely to be less than 1% of GDP in the long-term. The impact on the local economy will also depend on the extent to which it changes consumer spending within Guernsey and Alderney. At least some

⁵⁸ For example, it does not take into account the impact of the SPS on pay awards and bonuses. If salary increases and bonuses are lower, consumer spending is also expected to fall. The economic impact of the employers' contribution on wages, the labour market and investment rates are discussed in Sections 8.3 and 8.4.

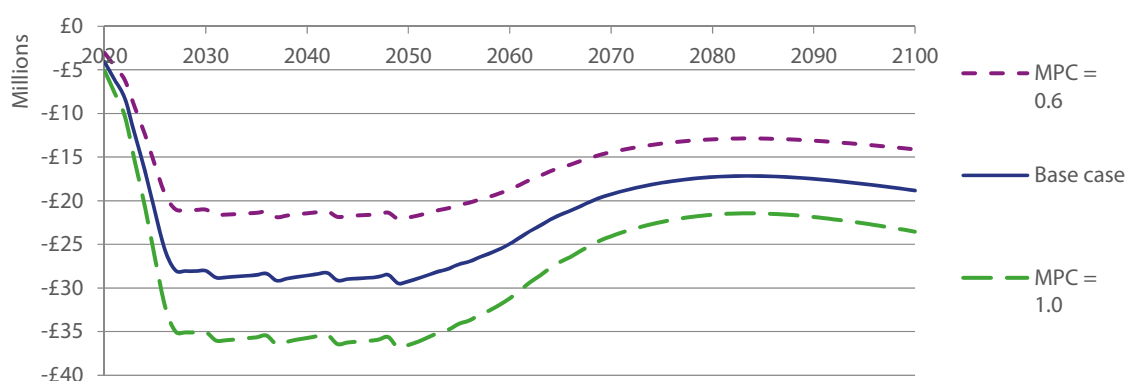
of the change in consumption is likely to impact on spending on goods or services from elsewhere (including goods directly imported from UK suppliers).

Research undertaken in the UK prior to the introduction of the Workplace Pensions, which used a general equilibrium model, concluded that the reduced consumption would have a minimal impact on economic output. In the short-term they estimated that the impact would not exceed -0.15% of GDP, and that in the medium- to long-term the economy would adjust to the new level of savings and gradually revert back to the original growth path.⁵⁹

8.2.1 Impact on Consumption: Sensitivity Analysis

We have considered the sensitivity of consumption to the assumption on the average marginal propensity to consume (MPC), real earnings growth and the investment return. The results are presented in Figure 93, Figure 94 and Figure 95 respectively.

Figure 93. Marginal impact on annual consumption: sensitivity to marginal propensity to consume (MPC)

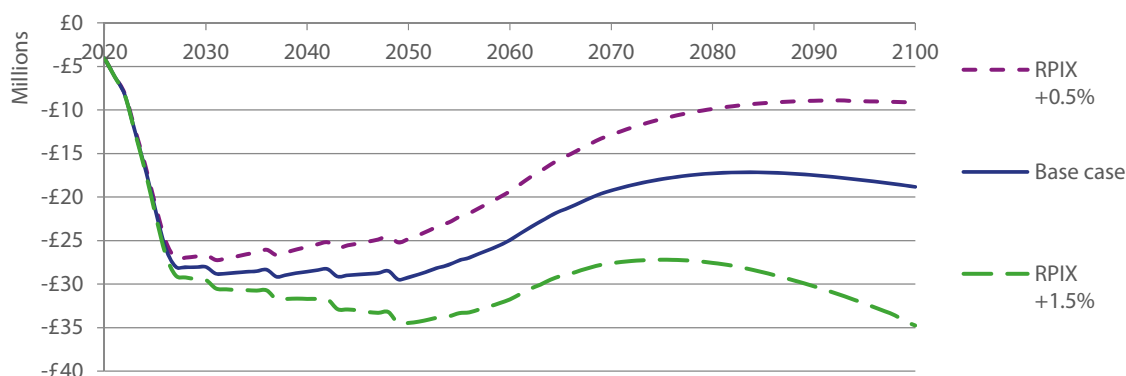


The base case assumed that a 1% change in income would lead to a 0.8% change in consumption. If individuals adjusted their spending so that it was 100% responsive to changes in income (i.e. the MPC was 1.0), then the impact in consumption would amount to a reduction of annual consumption of approximately £32 million in the short-term.⁶⁰ Conversely, a MPC of 0.6 would have a smaller impact on consumption, and the reduction of annual consumption would be approximately £20 million.

⁵⁹ Van de Coevering et al. (2006). Estimating economic and social welfare impacts of pension reform. DWP Pensions Technical Working Paper.

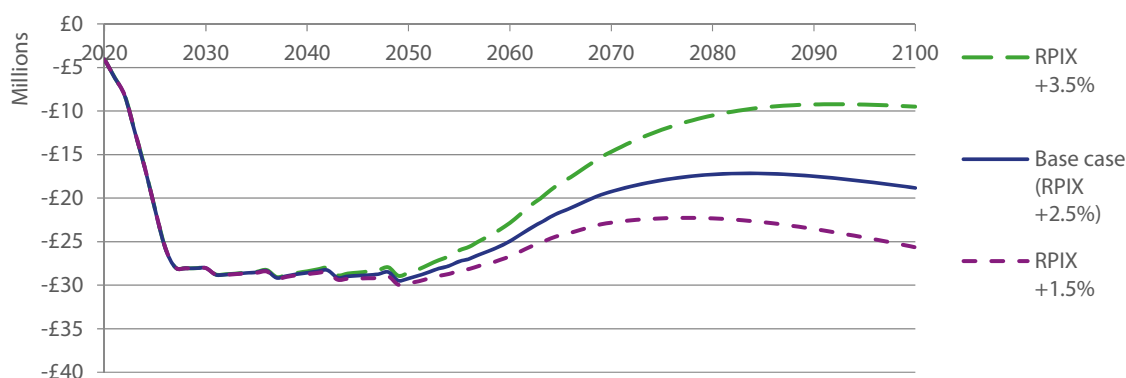
⁶⁰ With an MPC of 1.0, the change in income, and therefore the change consumption is approximately 80% of the individual pension contributions (sum of employed, self-employed and non-employed contributions in Figure 93). The remaining 20% is the total amount that individuals saved in income tax.

Figure 94. Marginal impact on annual consumption: sensitivity to the assumption on real earnings growth



As the impact of Secondary Pension Scheme was sensitive to real earnings growth, we also consider how this would impact on annual consumption. As Figure 94 shows, the real earnings growth will impact on consumption in the long-term.

Figure 95. Marginal impact on annual consumption: sensitivity to investment return



As the impact of the Secondary Pension Scheme was sensitive to the investment return, we also consider how this would impact on annual consumption. As Figure 95 shows, the investment return impacts on consumption in the long-term.

8.3 Impact on the Labour Market

In Section 6 we described how the Secondary Pension Scheme is expected to impact on employers. We now build on these findings and consider the likely implications on the labour market.

The Secondary Pension Scheme is unlikely to impact on labour participation rates since individuals who were concerned that paying into a secondary pension would reduce their take-home pay can choose to opt out. The policy is also unlikely to impact on the ability of Guernsey and Alderney to attract migrant workers.

The Secondary Pension Scheme will, however, impact on wages and employment. The pension contributions firms are required to make increase their payroll. Firms may look to recover some additional costs using one or more of the following strategies. Otherwise, the Secondary Pension Scheme will impact on company profits and dividends.

- Increase consumer prices
- Increase productivity
- Reduce the number of hours worked or overtime available
- Reduce the number of people employed, freeze recruitment or make redundancies
- Defer or reduce future pay rewards and bonuses
- Cut costs in other areas

The extent to which employers are able to deploy these strategies depends on the extent to which their goods and services can be substituted by imports, and the extent to which local firms need to offer attractive remuneration package to recruit and retain staff.

Firms that primarily sell their goods and services to the local market, and cannot be easily substituted by imported products, will be better able to recover some of the additional costs through increased consumer prices. For example, some local retailers may be able to increase the price of their goods without incurring a large reduction in demand and preserve their profitability. However, other firms who face competition from international firms, or from online providers, would be unlikely to find this an effective strategy. The ability of firms to pass on costs to the consumers is also likely to be impeded by the lower levels of disposable income in the short- to medium-term.

Some firms may look to increase productivity. This would be particularly effective if labour can be replaced by capital, such as new technology. However, this is likely to be challenging to achieve and evidence from the UK shows persistently low levels of productivity growth.⁶¹

Strategies that target the wage bill are likely to be more effective. It is expected that firms would look to offset their pension contributions by limiting pay awards and bonuses. This means we can expect lower wage growth during the implementation period; median earnings may even fall in real terms. Having said that, given the limited labour supply and low unemployment rates, firms that want to recruit and retain high quality staff will need to offer an attractive remuneration package. Thus, while firms may want to adjust their wage bill through lower salary increases, there will also be some limits on their ability to do so.

Another strategy for reducing the wage bill is to reduce the number of hours worked, or people employed. For instance, there may be fewer opportunities for earn overtime, or a freeze on additional recruitment. Firms

⁶¹ Office for National Statistics. (2017). Labour productivity: April to June 2017. Statistical Bulletin

could also change the composition of their workforce. This could involve making more use of workers who would not be automatically enrolled, such as using part-time workers whose annual earnings would fall below the lower earnings limit, or employing staff who are over the States pension age. It is also possible that some firms may seek to limit their wage bill by using self-employed contractors, or encouraging workers into the informal sector.

Finally, there is also the possibility that some firms will incur redundancies or be forced to close because they cannot afford the higher wage bill. In practice, this seems less likely as the employer contribution rate is increased gradually over seven years; this should allow firms the opportunity to look for cost savings in other areas. Overall, we would not expect significant increases in unemployment rates following the introduction of the Secondary Pension Scheme. In the UK, unemployment rates have fallen in the period since the introduction of Workplace Pensions, and this implies that automatic enrolment has a relative small influence on labour market when compared to other factors.

8.4 Impact on Economic Growth

In considering the impact of the Secondary Pension Scheme on Gross Domestic Product (GDP) and economic growth we bring together the range of effects that have been previously discussed along with impact on trade, investment and international competitiveness.

Consumption is the largest single contributor to GDP. As explained earlier, consumption is likely to be reduced particularly in the short-term, as more individuals contribute to a secondary pension and working age individuals will incur a reduction in their net income. Over time, the impact on consumption will reduce as individuals benefit from additional pension income in retirement, and are expected to have higher levels of consumer spending. In the very long-term, the marginal impact of the Secondary Pension Scheme is sensitive to the assumptions on the marginal propensity to consume, real earnings growth and the investment return.

Public sector spending contributes to GDP. In the short- to medium-term the States will see an annual reduction in government revenue, which is expected to be around £10 million in the short- to medium-term. There is also expected to be some additional spending on income support in this period. The impact on economic growth will depend on how the States looks to fund the shortfall in the government budget. Reductions in government spending may reduce the level of economic output. However, the cost of the Secondary Pension Scheme will be small relative to the projected increases in revenue that result from the real earnings growth of 1% per annum.

Investment and international trade can also contribute to GDP. Local firms will face additional costs as they will be required to contribute to the Secondary Pension Scheme. This is likely to limit the scope for local investment. It is possible the Secondary Pension Scheme could act as a disincentive for inward investment or adversely impact on international trade as firms operating in Guernsey and Alderney would incur higher employment costs than they would have done before. However, in practice, the effect is likely to be minimal. Financial services are the largest economic sector, and a major source of exports. Many firms in this sector already offer occupational pensions, which means the impact of the policy will be limited. Moreover, investment decisions would be expected to take into account a wide range of factors, such as the tax regime and the regulatory environment.

In the long-term, the marginal cost of the Secondary Pension Scheme is likely to be small given the States' assumption on real earnings growth, which will be associated with higher levels of economic growth. In the short-term the Secondary Pension Scheme will put pressure on economic growth, primarily reflecting the reduction in disposable income and consumer spending. The magnitude of the impact is likely to be relatively limited, and the risks will be small compared to other economic challenges, such as the impact of Brexit.

Finally, some may argue wider economic uncertainties may bring into question the merits of the Secondary Pension Scheme or the timing for its implementation. However, it may be worth noting that the case for pension reform in the UK was advanced at a time of economic and fiscal austerity. Research commissioned by the UK Department for Work and Pensions assessed whether it remained appropriate to promote private retirement saving in the wake of the 2008-09 global financial crisis.⁶² It was concluded that although the recession may reduce people's willingness to save in pensions, and there may be preferences for savings vehicles that offered greater liquidity, on balance, the workplace pension reforms remained appropriate despite the economic downturn.

⁶² Department for Work and Pensions (2010). Workplace pension reform regulations. Impact assessment.

9. Conclusions

This report sets out the results of the actuarial modelling of the projected growth in the States-facilitated Secondary Pension Scheme. The central results have been generated from a “base case” set of assumptions. In addition we have illustrated the sensitivity of the projections to changes in the assumptions. The assumptions used were derived in conjunction with the Committee for Employment & Social Security. The results shown in this report are projections and do not necessarily reflect what will happen in practice. The sensitivities considered do not necessarily represent the extremes of the outcomes. However, they are useful in quantifying the relative effect of different assumptions.

The economic impact assessment illustrates how the introduction of the Secondary Pension Scheme could potentially have implications for individuals and households, employers, the government, and on the economy. The economic projections are also estimated using the base case assumptions, and sensitivity analyses have been undertaken.

In the long-term, the introduction of a Secondary Pension Scheme is expected to cumulate in an increase in economic activity among pensioners by increasing the income of households in retirement. It will also enable people to distribute their income more evenly across their lifespan. However, to achieve this increase in the savings rate, there would be a loss of disposable income among the working age population, with reductions in income tax revenue, aggregate consumption and a possible suppression of economic growth. These effects would be due to part of the disposable income of households being diverted into long-term saving which will defer some consumption.

10. Useful References

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11. Appendix: Derivation of Assumptions

This appendix sets out the derivation of the base case assumptions which have been agreed with the Committee for Employment & Social Security.

11.1 Employee opt out rate

11.1.1 Key Assumption

The opt out rate assumption is one of the principal assumptions; the outcome of the Secondary Pension Scheme projections and analysis will be highly sensitive to this assumption. In order to consider the central assumption in a Guernsey context, it is helpful to consider the data that has been published so far on the opt out rates experienced in the UK.

11.1.2 UK Experience

The UK has been phasing in auto-enrolment since 2012, starting with the largest employers (120,000 or more employees) first. The phasing in process has been spread over around 5 years, and so it was not until 2015 that employers with fewer than 30 employees began to introduce auto enrolment.

Prior to the introduction of auto enrolment in the UK, opt out rates had been estimated. At that time it was anticipated that the opt out rate could be in the range 15%-30%. However, it transpired that the actual opt out rates observed initially were lower than expected, at around 10% amongst employees of the largest employers.

There is some evidence that the opt out rate has increased as smaller employers introduce auto enrolment. In particular, data from the Employers' Pension Provision Survey 2015⁶³ indicates that employers with between 1 and 19 employees experienced a much higher opt out rate of 17%, compared to an average across all employers of 9%. Data for 2016 does not appear to have yet been published at the time of preparing this paper.

11.1.3 Guernsey-specific considerations

How the opt out rate may change in future in the UK is unknown. However, we would expect the long-term opt out rate in the UK to increase as the employees' contribution rate increases to 5%.

The average opt out rate in Guernsey may be higher than that experienced in the UK for a number of reasons:

- Most Guernsey employers would be considered "small" in UK terms
- Guernsey's employees' proposed long-term contribution rate under the Secondary Pension Scheme is 6.5%, compared to 5% in the UK
- The minimum age of auto enrolment in the UK is 22, compared with 16 proposed for the Secondary Pension Scheme

11.1.4 Assumption

Considering the UK evidence so far for small employers, and the higher long-term contribution rate in the Secondary Pension Scheme, we would expect that a long-term realistic opt out rate could be around 20%. However, we recognise that this assumption is difficult to predict accurately and therefore we have illustrated sensitivity of the output to this assumption.

⁶³ Department of Work and Pensions (2016). Employers' pension provision survey 2015. (www.gov.uk/government/publications/employers-pension-provision-survey-2015)

11.2 Membership of existing occupational pension schemes

11.2.1 Key Assumption

The percentage of employees who are existing active members of an occupational pension is an important assumption for estimating the economic impact of the Secondary Pension Scheme.

The number of individuals who join an occupational pension scheme as a result of the Secondary Pension Scheme is estimated to be the number of individuals who would become eligible, less the number of employees who are existing members of an occupational pension scheme.

11.2.2 Evidence

We have estimated this percentage using income tax data on contributions to occupational pension schemes and on an assumption about the percentage of occupational schemes that are non-contributory.

Anonymised individual level data from the Electronic Census for 2014 were provided containing Income Tax and Social Security records. Raw data were cleaned following the steps set out in the Guernsey Household Income Report and advice from the States Data and Analysis Unit. The cleaned dataset contained 58,010 records, of whom 28,253 were individuals of working age and who were classified as employed. Complete tax records were available for 23,444 working age employees and showed that 28% of working age employees contributed to an occupational pension.

Contribution rates to an occupational pension vary by employment sector. According to income tax records, 85% of individuals in public administration⁶⁴ pay into an occupational pension. The percentage is also relatively high for those working in energy and communications.⁶⁵ It is estimated that 18% of all employees have access to the public sector pension scheme.

The remaining 82% of employees work in the private sector. Income tax records showed that 16% of private sector employees pay into an occupational pension. This could be an underestimate, as the 2012 Pensions Survey found that approximately 20% of occupational pension schemes in the private sector were non-contributory schemes.⁶⁶ Based on the assumption that 20% of occupational pension schemes were non-contributory for the employees, then it can be inferred that 20% of individuals working in the private sector are active members of an occupational pension scheme.⁶⁷

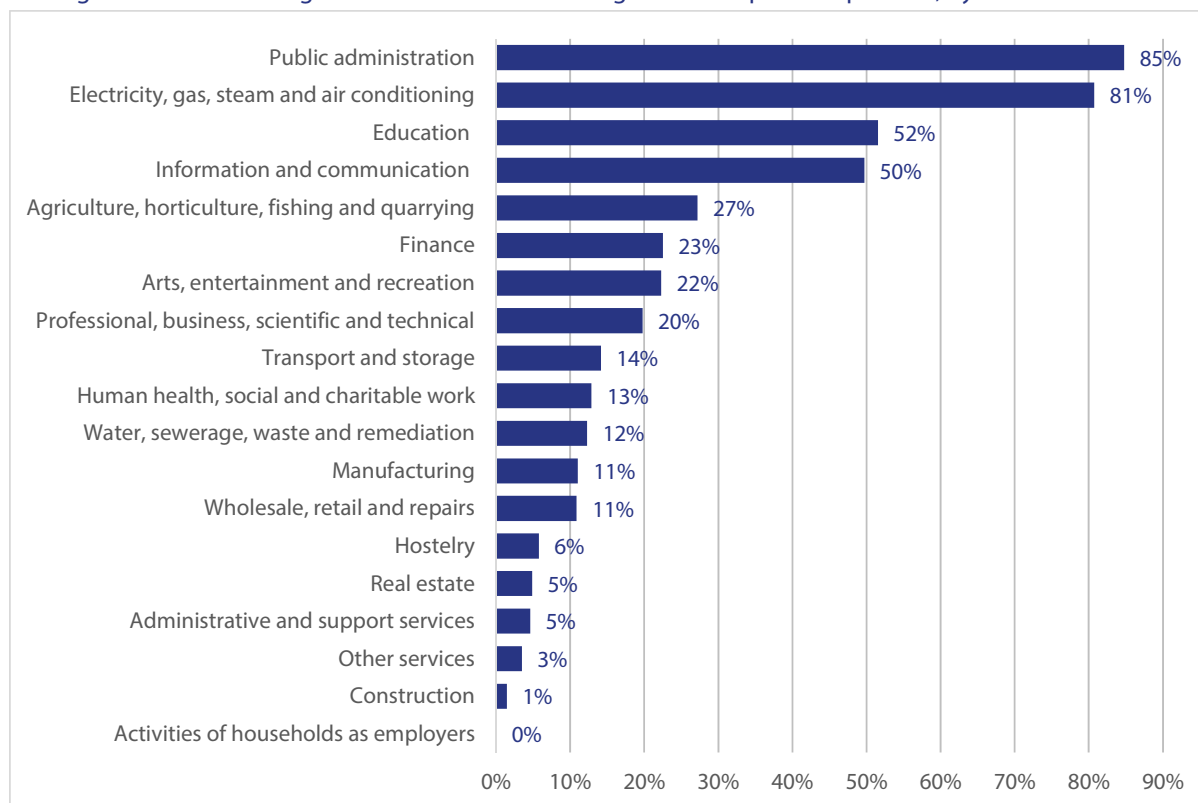
⁶⁴ Including medical and teaching staff who are employed by the States of Guernsey.

⁶⁵ Includes employees of Guernsey Electricity and Guernsey Post who also have access to the public sector scheme Billet d'Etat

⁶⁶ States of Guernsey Policy Council, Pensions survey 2012.

⁶⁷ This is lower than was reported in the 2012 Pensions Survey, which surveyed residents working in the private sector and found 27% of respondents were in active occupational pension scheme members and 45% of respondents were actively saving in a private sector pension scheme.

Figure 96. Percentage of individuals contributing to an occupational pension, by economic sector



Note: Used E-Census data from 23,444 individuals who are of working age and have SI classified as employed for whom the employment sector and whether they paid into an occupational pension was known. Uses first employment category if work in more than one industry.

Combining evidence from the employment data and assumptions about membership of occupational pension schemes in the public and private sector, it is estimated that, on average, 32% of all working age employees are existing active members of an occupational pension scheme. This is based on the following calculation:

% of employees who are existing active members = $(18\% \times 85\%) + (82\% \times (16\% + X\%))$.

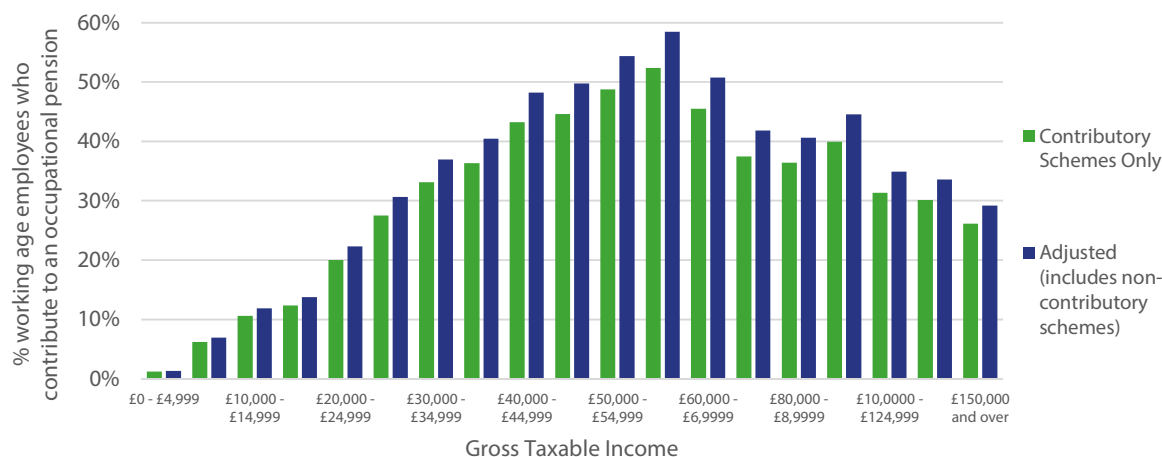
Where:

- 18% of employees work in the public sector. 85% of these employees have an occupational pension.
- 82% of employees work in the private sector. 16% of these employees are an active member of a contributory scheme and the % of whom are an active member of a non-contributory scheme is unknown (X).
- X can be inferred if we assume that 20% of all private sector occupational pensions are non-contributory (as reported in the 2012 Pensions Survey). If the 16% of private sector who are active members of contributory scheme represent 80% of all private sector occupational pensions, then there must be a further 4% of private sector employees who are active members of a non-contributory schemes.

Furthermore, the economic model assumes existing membership of occupational pension scheme depends on an individual's gross taxable income. Figure 97 shows the percentage of working age employees who are existing active members of an occupational pension by gross taxable income band.

Income tax records show that membership of occupational pension schemes is associated with gross taxable income, and those with a higher gross taxable income are more likely to contribute to an occupational pension. To allow for non-contributory schemes an adjustment has been made in which the percentage of employees who are active members in each income band has been increased by 1.142 (i.e. 32% / 28%).⁶⁸

Figure 97. Percentage of working age employees who pay into an occupational pension



Source: E-Census data containing income tax records from 2014.

⁶⁸ Where 32% is the estimated % of employees who are active member of any (contributory and non-contributory) occupational pension scheme and 28% is the % of individuals who are active members of contributory occupational pension scheme. No data are available on the relationship between membership in a non-contributory scheme and gross taxable income, so we apply the simplifying assumption that the distribution of non-contributory schemes by income band is the same as the distribution of contributory scheme by income band.

11.2.3 Assumption

The assumption of the percentage of employees who contribute to an occupational pension in each gross taxable income band is shown Table 10.

Table 10. Percentage of employees who are active members of an occupational pension

| Gross Taxable Income | Base Case | Base Case scaled down by 10% | Base Case scaled up by 10% |
|----------------------|-----------|------------------------------|----------------------------|
| £0 - £4,999 | 1% | 1% | 1% |
| £5,000 - £9,999 | 7% | 6% | 8% |
| £10,000 - £14,999 | 12% | 11% | 13% |
| £15,000 - £19,999 | 14% | 12% | 15% |
| £20,000 - £24,999 | 22% | 20% | 25% |
| £25,000 - £29,999 | 31% | 28% | 34% |
| £30,000 - £34,999 | 37% | 33% | 41% |
| £35,000 - £39,999 | 40% | 36% | 45% |
| £40,000 - £44,999 | 48% | 43% | 53% |
| £45,000 - £49,999 | 50% | 45% | 55% |
| £50,000 - £54,999 | 54% | 49% | 60% |
| £55,000 - £59,999 | 58% | 53% | 64% |
| £60,000 - £69,999 | 51% | 46% | 56% |
| £70,000 - £79,999 | 42% | 38% | 46% |
| £80,000 - £89,999 | 41% | 37% | 45% |
| £90,000 - £99,999 | 45% | 40% | 49% |
| £100,000 - £124,999 | 35% | 31% | 38% |
| £125,000 - £149,999 | 34% | 30% | 37% |
| £150,000 and over | 29% | 26% | 32% |
| All incomes | 32% | 28% | 35% |

11.3 Employers offering an occupational pension

11.3.1 Key Assumption

The percentage of employers who currently offer an occupational pension is an important assumption for estimating the economic impact of the Secondary Pension Scheme.

11.3.2 Evidence

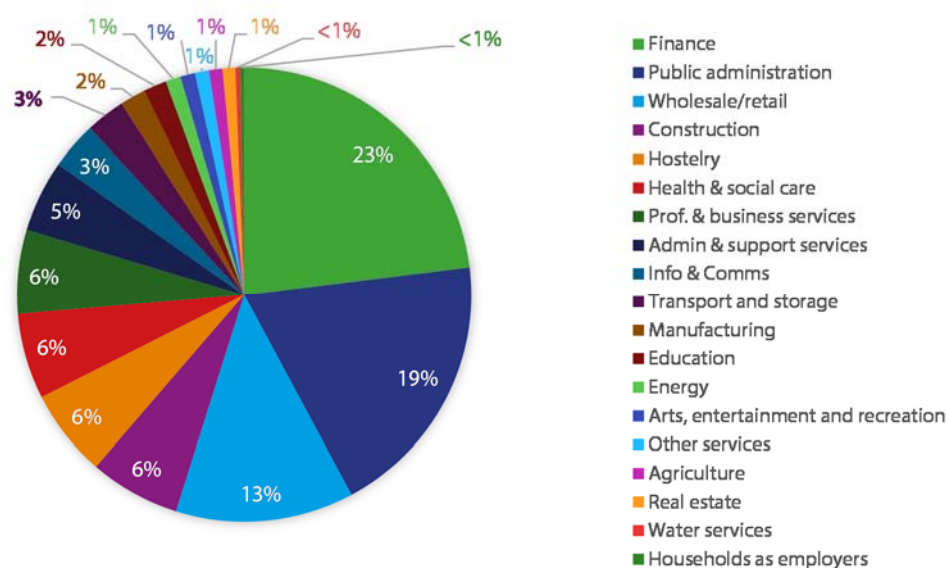
There do not appear to be any reliable data on the percentage of employers who currently offer an occupational pension. Income tax records showed that the percentage of employees who contributed to an occupational pension varies considerably by economic sector. However, the available data do not show how this varies by employer size. The policy documents cite a BWCI survey from 2010, but no general assumptions can be made, as the respondents were predominately employers in the finance sector.

The economic model requires an assumption that the percentage of employers who currently offer an occupational pension varies by sector and size. The assumption is based on an extrapolation of employment data. Income tax data were used to validate the assumptions.

11.3.3 Approach

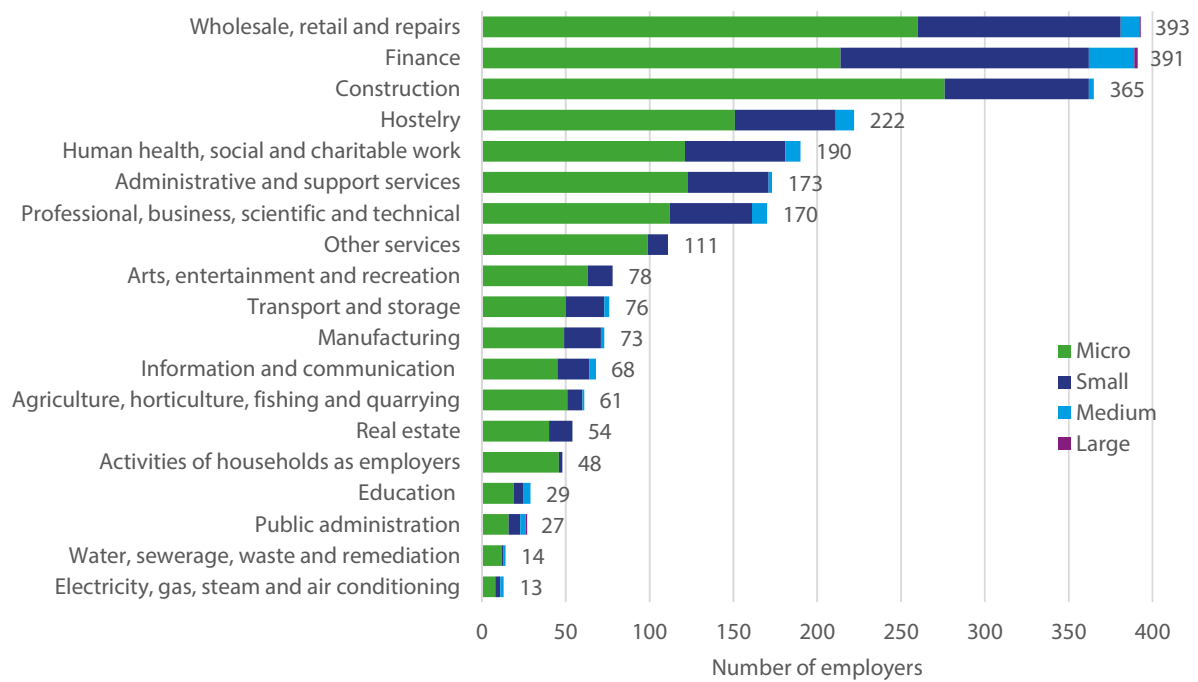
The first step was to estimate the number of employees per economic sector and employer size. The number of employees by sector is available; the number of employers by sector and size is known (Figure 98 and Figure 99).

Figure 98. Distribution of employees by economic sector



Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017; States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

Figure 99. Number of employer, by size and economic sector



Source: States of Guernsey (2017). Guernsey Quarterly Population, Employment and Earnings Bulletin. Issue Date 4 August 2017; States of Alderney (2017). Alderney Electronic Census Report 31 March 2016. Population snapshots and trends. Issued on 21 April 2017.

The number of employees per sector and size was estimated by selecting median values for employer size category (Table 11).

Table 11. Estimated number of employers by employer size and sector

| | Estimated Number of Employers per Size | | | | | | | | | | Number of employees |
|--|--|--------|---------|----------|----------|-----------|------------|-------------|-----------|--------|---------------------|
| | 1 | 2 to 5 | 6 to 10 | 11 to 25 | 26 to 50 | 51 to 100 | 101 to 250 | 251 to 1000 | Over 1000 | Total | |
| Agriculture, horticulture, fishing and quarrying | 21 | 105 | 56 | 15 | 35 | 65 | 0 | 0 | 0 | 297 | 282 |
| Manufacturing | 22 | 95 | 72 | 180 | 35 | 130 | 0 | 0 | 0 | 534 | 534 |
| Electricity, gas, steam and air conditioning | 5 | 11 | 16 | 0 | 35 | 65 | 150 | 0 | 0 | 282 | 316 |
| Water, sewerage, waste and remediation | 5 | 25 | 0 | 15 | 0 | 65 | 0 | 0 | 0 | 110 | 100 |
| Construction | 131 | 508 | 376 | 510 | 175 | 65 | 300 | 0 | 0 | 2065 | 1,892 |
| Wholesale, retail and repairs | 102 | 553 | 536 | 510 | 700 | 455 | 600 | 300 | 0 | 3756 | 3,724 |
| Hostelry | 71 | 280 | 248 | 360 | 175 | 715 | 0 | 0 | 0 | 1849 | 1,823 |
| Transport and storage | 28 | 77 | 80 | 135 | 140 | 130 | 150 | 0 | 0 | 740 | 821 |
| Information and communication | 25 | 70 | 56 | 120 | 140 | 130 | 300 | 0 | 0 | 841 | 986 |
| Finance | 110 | 364 | 424 | 900 | 1,225 | 910 | 1,950 | 600 | 0 | 6483 | 6,758 |
| Real estate | 22 | 63 | 40 | 120 | 35 | 0 | 0 | 0 | 0 | 280 | 263 |
| Professional, business, scientific and technical | 59 | 186 | 184 | 315 | 175 | 260 | 750 | 0 | 0 | 1929 | 1,763 |
| Administrative and support services | 60 | 221 | 144 | 225 | 525 | 0 | 300 | 0 | 0 | 1475 | 1,496 |
| Public administration | 7 | 32 | 8 | 75 | 35 | 0 | 450 | 0 | 5,000 | 5607 | 5,612 |
| Education | 10 | 32 | 8 | 60 | 35 | 195 | 150 | 0 | 0 | 490 | 484 |
| Human health, social and charitable work | 57 | 224 | 272 | 225 | 385 | 520 | 150 | 0 | 0 | 1833 | 1,797 |
| Arts, entertainment and recreation | 33 | 105 | 56 | 105 | 35 | 0 | 0 | 0 | 0 | 334 | 306 |
| Other services | 62 | 130 | 88 | 0 | 35 | 0 | 0 | 0 | 0 | 315 | 294 |
| Activities of households as employers | 32 | 49 | 16 | 0 | 0 | 0 | 0 | 0 | 0 | 97 | 84 |
| TOTAL | 862 | 3,126 | 2,680 | 3,870 | 3,920 | 3,705 | 5,250 | 900 | 5,000 | 29,313 | 29,335 |

The next step was to select assumptions for the percentage of employers that offer an occupational pension scheme that are plausible given income tax data. The expected percentage of employees with an occupational pension by sector are similar to the income tax data, with the exception of Finance, which is intentionally higher to reflect the prevalence of non-contributory schemes in the finance sector.⁶⁹

⁶⁹ States of Guernsey Policy Council, Pensions Survey 2012.

11.3.4 Assumption

The following assumptions have been used to model the percentage of employers who currently offer an occupational pension, by sector and employer size.

Table 12. Assumption on percentage of employers who currently offer an occupational pension

| Employer Size | Micro | | Small | | | Medium | | Large | |
|--|-------|--------|---------|----------|----------|-----------|------------|-------------|-----------|
| Number of employees | 1 | 2 to 5 | 6 to 10 | 11 to 25 | 26 to 50 | 51 to 100 | 101 to 250 | 251 to 1000 | Over 1000 |
| Public administration | 100% | 100% | 100% | 100% | 100% | . | 100% | . | 100% |
| Electricity, gas, steam and air conditioning | 0% | 0% | 20% | 30% | 30% | 100% | 100% | . | . |
| Information and communication | 0% | 0% | 20% | 30% | 30% | 100% | 100% | . | . |
| Agriculture, horticulture, fishing and quarrying | 0% | 0% | 20% | 30% | 30% | 100% | . | . | . |
| Arts, entertainment and recreation | 0% | 0% | 20% | 30% | 30% | . | . | . | . |
| Finance | 0% | 0% | 20% | 30% | 30% | 50% | 75% | 100% | . |
| Education | 0% | 0% | 20% | 30% | 30% | 50% | 75% | . | . |
| Human health, social and charitable work | 0% | 0% | 10% | 20% | 20% | 30% | 30% | . | . |
| Transport and storage | 0% | 0% | 10% | 20% | 20% | 30% | 30% | . | . |
| Professional, business, scientific and technical | 0% | 0% | 10% | 20% | 20% | 30% | 30% | . | . |
| Manufacturing | 0% | 0% | 10% | 20% | 20% | 30% | . | . | . |
| Administrative and support services | 0% | 0% | 0% | 10% | 10% | . | 20% | . | . |
| Real estate | 0% | 0% | 0% | 10% | 10% | . | . | . | . |
| Water, sewerage, waste and remediation | 0% | 0% | . | 10% | . | 20% | . | . | . |
| Wholesale, retail and repairs | 0% | 0% | 0% | 0% | 0% | 20% | 20% | 100% | . |
| Construction | 0% | 0% | 0% | 0% | 0% | 20% | 20% | . | . |
| Hostelry | 0% | 0% | 0% | 0% | 0% | 20% | . | . | . |
| Other services | 0% | 0% | 0% | . | 0% | . | . | . | . |
| Activities of households as employers | 0% | 0% | 0% | . | . | . | . | . | . |

Note: "." where there are no employers in Guernsey and Alderney of that sector and size.

11.4 Expected rate of return on Secondary Pension Scheme contributions

11.4.1 Key Assumption

The investment return assumption models the expected rate of return on the contributions invested in the States-facilitated Secondary Pension Scheme. This is a key assumption which will affect the size and expected rate of increase in the Secondary Pension Scheme funds. In addition, it will affect the size of each individual's pension account and so ultimately their retirement income from the Secondary Pension Scheme.

11.4.2 Investment Expenses

The assumption is net of any investment management expenses or charges, to eliminate the need for an explicit allowance for expenses.

11.4.3 Investment Strategy

While the actual rate of return achieved each year will fluctuate with market conditions, a key driver for the expected investment returns will be the long-term strategy adopted. While this strategy is not known at this stage, the February 2016 Billet states that *"the Secondary Pensions Scheme would be required to offer a range of investment choices, including an option to invest in a fund mirroring the investment strategy of some of the capital funds currently administered by the States."*

There are three main States investment funds as follows:

| Fund | Target Investment Objective |
|------------------------------|-----------------------------|
| Long-term Fund | UK RPI +4% |
| Medium-term Fund & Cash Pool | UK RPI + 3.5% |
| Common Investment Fund | Guernsey RPIX + 3.5% |

These are aspirational target returns and it would be more prudent to assume a slightly lower long-term average rate of return for projection purposes. The initial projections included within the February 2016 Billet, to illustrate possible benefit levels provided by the Secondary Pension Scheme, assumed a real rate of return of 3% pa (i.e. 3% pa in excess of price inflation). These initial projections also assumed an annual management charge on funds under management of 0.5% pa. Combining these two assumptions leads to an assumption of 2.5% pa in excess of inflation.

11.4.4 Lifestyle Strategy

It has been assumed that, over the 10 years prior to retirement, there would be a gradual reduction in the level of return-seeking assets in an individual member's pension account, in order to move to a more matched position for purchasing an annuity at retirement.

11.4.5 Assumptions

In view of the target investment return on the Common Investment Fund and the assumption made in the February 2016 Billet, a central investment return of RPIX + 2.5% pa has been used, reducing to RPIX over the 10 year period prior to retirement. We illustrate the sensitivity of the output to this assumption.

11.5 Administrative costs for employers

11.5.1 Key Assumption

Employers will be legally required to automatically enrol eligible employees into a Secondary Pension Scheme. As well as the costs to employers arising from the pension contributions they will be required to make, employers are also expected to incur some administrative costs. These costs will predominately be additional HR and payroll costs. However, some employers may also seek professional advice on how best to comply with the requirements in their particular circumstances.

11.5.2 UK Evidence

An impact assessment was undertaken prior to the launch of the UK workplace pension.⁷⁰ This assumed that the administrative cost would depend on firm size, and they reported both the cost per firm and the equivalent cost per employee. The projected costs are shown Table 13 and expressed in GBP at 2009/10 prices.

Table 13. Assumptions on administrative cost of participation in UK workplace pension, by firm size

| Firm Size | | Cost per firm | | Equivalent cost per employee | |
|-----------|------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| | | Cost in First Year of Scheme | Ongoing cost in future years | Cost in First Year of Scheme | Ongoing cost in future years |
| Micro | 1-4 employees | 200 | 100 | £130 | £50 |
| Small | 5-49 employees | 400 | 100 | £50 | £15 |
| Medium | 50-249 employees | 1,800 | 400 | £30 | £6 |
| Large | 250 employees | 12,000 | 1,900 | £20 | £3 |

There is also UK evidence from employers on the costs incurred to implement a workplace pension. A 2015 survey of employers showed the median implementation cost varied by firm size.⁷¹ As expected, the reported costs were higher if they sought independent advice. Several employers reported they had incurred no costs. The results are presented in Table 14.

Table 14. Median implementation costs reported by Staged Employers in UK in 2015

| Firm size | Cost per firm | Equivalent cost per employee |
|-------------------|---------------|------------------------------|
| 1-19 employees | £200 | £25 |
| 20-49 employees | £1,000 | £30 |
| 50-99 employees | £1,000 | £16 |
| 100-249 employees | £2,500 | £16 |
| 250-499 employees | £5,000 | £13 |
| 500-999 employees | £5,000 | £6 |
| 1000+ employees* | £20,000 | £8 |

* There are no private sector employers in Guernsey and Alderney with more than 1000 employees.

11.5.3 Assumption

It is assumed that employers will incur a fixed cost of £500 per employer in the first year and £200 in subsequent years, together with a variable cost of £25 per employee in the first year and £10 per employee in subsequent years. In the first year the fixed component reflects the time and/or advice required to understand their responsibilities under the Secondary Pension Scheme and make system-wide changes to human resource or payroll systems. In subsequent years the fixed costs reflects the time and/or advice required to

⁷⁰ Department for Work and Pensions. Workplace Pension Reform Regulations Impact Assessment, 2010.

⁷¹ Department for Work and Pensions. Employers' Pension Provision Survey 2015. Published 2016.

monitor policy changes (such as increases to the contribution rate). The variable cost reflects the staff time required to enrol each employee.

These assumptions are conservative compared to the UK evidence, which are shown in Table 15. Sensitivity analysis is undertaken in which these costs are varied by $\pm 50\%$.

Table 15. Assumption on administrative cost per firm and per employee

| Firm Size | Number of firms in Guernsey | Cost per firm | | Equivalent cost per employee* | |
|-------------|--------------------------------|---------------|--------------|-------------------------------|--------------|
| | | 2020 | 2021 onwards | 2020 | 2021 onwards |
| 1 | 810 | £525 | £210 | £525 | £210 |
| 2 to 5 | 858 | £588 | £235 | £168 | £67 |
| 6 to 10 | 328 | £700 | £280 | £88 | £35 |
| 11 to 25 | 251 | £875 | £350 | £58 | £23 |
| 26 to 50 | 109 | £1,375 | £550 | £39 | £16 |
| 51 to 100 | 56 | £2,125 | £850 | £33 | £13 |
| 101 to 250 | 34 | £4,250 | £1,700 | £28 | £11 |
| 251 to 1000 | 3 | £8,000 | £3,200 | £27 | £11 |

* assumes mid-point values for each range of 1, 3.5, 8, 15, 35, 65, 150, and 300 respectively