The Actuarial Profession
making financial sense of the future

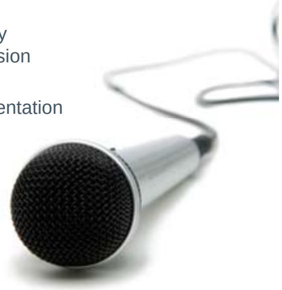
Current issues in Pensions
Paul Enderby

2012 and all that

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



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Pensions Reform 2012

Pension Reform 2012: Background

- Pensions Commission December 2002
- First report – October 2004
  - 10m people not saving enough for their retirement

  Second report - November 2005
  - **Nat**ional **P**ensi**o**ns **S**avings **S**cheme
- Pensions Act 2007
  - Personal Accounts Delivery Authority (PADA)
- Pensions Act 2008
  - Automatic enrolment
  - Personal Accounts
- Consultation papers / responses during 2009
- January 2010 – **National Employment Savings Trust**

Pensions Reform 2012

The Details

The basic position

- Employers must auto-enrol "all" employees
- Into a "Good" or "Qualifying" pension scheme…..
- Which can be the employer's existing scheme or a new arrangement
- NEST is just one option

Who must be auto-enrolled?

- Employees aged between 22 & SPA
- Earning over £5,035

- Employee opt-outs
  - Inducements to opt-out will be strictly prohibited
  - Opt out forms must be available from the employer
- Re-enrolment
  - Must take place exactly 3 years after auto-enrolment started (1 month window allowed)
  - Employers don't have to re-enrol within 12 months of opting-out

Auto-enrolment

- Temporary and Contract workers must be included
- Agency workers too, if employed by the sponsor
- Waiting periods may be allowed if the Qualifying Scheme provides a suitable level of contributions
- Contributions must be paid by the end of the 2nd month following auto-enrolment

Auto-enrolment: the timetable

- Employers with at least 120,000 employees from 1 Oct 2012
- All employers with at least 500 E'ees subject to duties by Nov 2013
- Every employer will be subject to duties by Sept 2016
- Smaller employers divided using payroll numbers – somewhat random?
- The specific date will be notified to employers
  - Employers can bring these dates forward if desired – but not the largest employers

Implications

- Larger retailers employing many temps will be hit by this timescale
- They will be required to auto-enrol in the run-up to Christmas
- And explain to temps why they have been put into a pension scheme they didn't asked to join and had contributions deducted from their pay?
- And then need to process opt-outs during November and December
- Employees may not notice deductions from their pay during this period, so squabbles may ensue
- Do the same issues apply to the leisure sector over the summer months?

Conditions for Qualifying DC Schemes

- Employer minimum equivalent contribution of 3%
- Employees meet the balance to 8% (inc. tax relief)
- Contributions are being phased in over 5 years

	E'er		E'ee
– **October 2012 - October 2016**	**1%**	**+**	**1%**
– **October 2016 - October 2017**	**2%**	**+**	**3%**
– **October 2017 -**	**3%**	**+**	**5%**

  - **Based on "qualifying earnings"**
    - all gross earnings
    - £5,035 to £33,540
    - National Average Earnings linked
- Scheme certification requirements are still unknown – many schemes will be worth more for most people, most of the time……

Conditions for Qualifying DB Schemes

- Contracted out

  or
- Provide benefits at age 65 of at least n/120ths of average qualifying earnings in the last 3 tax years
- Scheme based test, may need to be certified by Scheme Actuary – DWP to publish Regs
- Government has suggested that passing the "test scheme standard" is a one-off, up front, determination with no requirement to carry out any sort of retrospective check

Conditions for Qualifying Scheme (Hybrids)

- Combination of DB and DC tests
- CARE
  - Must provide revaluation.
  - Where discretionary, revaluation of minimum 2.5% LPI must be included in funding plans and SFPs
- Cash balance schemes
  - Benefits accrue at 16% of "salary" p.a. or
  - 8% of "salary" p.a. with 3.5% minimum returns

NEST – Key Features

National Employment Savings Trust

- Trust based occupational scheme
- Development overseen by Personal Accounts Delivery Authority (PADA)
- Run by "NEST Corporation"
- Established July 2010
  - Chairman Lawrence Churchill
  - His stated aim is "to help NEST facilitate pension saving among a population not previously engaged in retirement planning"

Who's in charge?

PADA → Nest Corporation

PADA

- Initial remit – to get NEST running
- It is 'selling' NEST hard
- Minimising:
  - adverse effects on other pension schemes….
  - employer workload….
  - running costs…..

Nest Corporation

- Narrower remit than PADA
- Consultation: employer and employee panels

Contributions to NEST

- As per a qualifying DC scheme
- Maximum annual contribution £3,600
  - Can reject or refund certain 'excess' contributions
- General ban on transfers in and out prior to retirement
  - Pension credits on divorce allowable in some cases
  - There will be a future review
- Collection system
  - no final decision yet
  - won't be PAYE → which is putting employers off….
- **Administration**
  - Down to one potential provider → which represents a risk

NEST Benefits

- No opportunity to apply a waiting period
- Limited refunds
  - For those with less than 30 days service
- Full disclosure
- Retirement
  - as other UK registered schemes
- No trustee discretion in relation to payment of death benefits
- Limited annuity 'broking' service proposed

Investment

- PADA has undertaken much of the preparatory work
  - Consultation underway on:
    - design of the default fund
    - governance
    - wider investment choices, e.g. SRI
- NEST Corporation
  - responsible for investment decisions
  - review PADA's proposals
  - takes final decisions

NEST Investment

- The Pensions Institute has warned that the "administrative nightmare" of auto-enrolment will divert necessary attention from NEST's investment strategy.
- It is possibly no surprise that PADA has been talking about using Target Date funds.
- These are very much out of line with UK practice, where most DC schemes opt for the much more flexible approach of lifecycle strategies.
- Post establishment of NEST, will its trustees be spending much of their governance 'budget' on ensuring that effective administration is delivered, rather than on developing and managing the investment strategy?

Charging and financing of NEST

- Low cost:
  - long term aim was 0.3%
  - informally talking about "0.5%"?
  - "same level for same service"
- Structure of charge:
  - Consultation suggested:
    - AMC; or
    - contribution charge plus AMC
- Further details awaited

A lot more still to do…

More Regulations and consultation still to come?

- Who will be the administration provider?
- What will be the auto-enrolment practicalities?
- Requirements for Qualifying Scheme certification?
- Clarification of the requirement for Hybrid schemes

Pensions Reform 2012: Implications and Actions

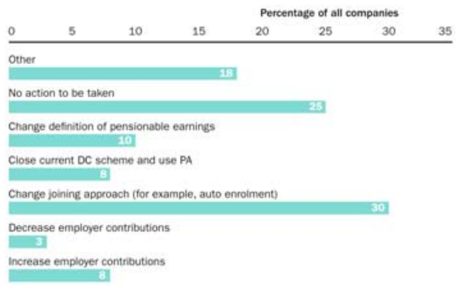
Employers' strategic options

- Continue their existing scheme for all employees?
- Level down their existing scheme to NEST standard?
- Use NEST as their main vehicle?
- NEST for some employees, or top up for others?
- Will they go for the cheapest option?

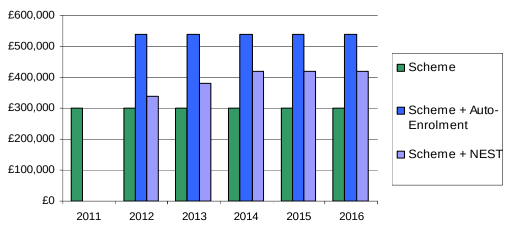
Potential impact of the changes

- 84% of FTSE 100 companies have considered the impact of the changes but few have made definitive strategy decisions
- 30% may change their member joining approach
- 10% may change their pensionable earnings definition
- 85% currently define pensionable earnings as basic salary

Employers' stated likely reactions



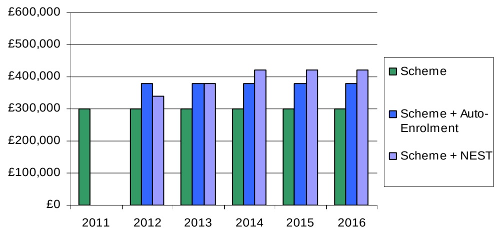
Cost of Auto-enrolment



Why it's not that easy

- Definition of "job holder"
- Definition of earnings
- Effect of waiting periods
- Uncertainty of take-up rates / opt-outs
- Effect of early leavers / refunds

Effect of refunds etc?



Reactions to auto-enrolment

- Increased pension cost
  - Increase prices
  - Lower profits
  - Reduce other benefit costs
- Review existing plan design
- Salary sacrifice
- Review delivery mechanism and costs – trust v contract, sharing costs with members etc
- Other benefits (PHI, healthcare, death benefits)
- Big issue as average DC take up is c50%

Possible areas for action

- Administration – how robust is it, can payroll & HR cope with auto-enrolment to your scheme?
- Contributions – how will they be payable to NEST, can payroll cope with another system?
- Investment
- Charges
- Communications

What about a change of government?

- Conservative 'policy':
  - 'Quick and dirty' review of NEST pensions
    - Reconsider if costs are greater than 0.5% p.a.
  - Bring forward auto-enrolment
    - Separate from NEST
    - How?
  - Remove age 75 restriction on annuities
    - Relevant for small funds?
    - How appropriate will it really be?

Summary

- Strategic planning should be underway now
- Employers should be ahead of the game
- They will need to retain flexibility
- 2012 is not that long away