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making financial sense of the future

Conference title Current Issues in Pensions (CIP) 2011
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Auto–enrolment – areas for discussion

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The Pensions Commission – where all this began

- Generally understood that the current combination of state and private pension was unsustainable
- Demographic changes were known – but what were the impacts?
- Defined benefit provision was irreversibly declining
- Government also responding to consumer and Trade Union pressure
- The perceived failure of free market policies
- Need for apolitical answers and cross party support
- Set up in December 2002, final report November 2005

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Pensions Commission first report Oct 2004

- This sets the scene for all future proposals – it is considered orthodoxy now – so no arguments!
- Because of the increasing proportion of the population aged over 65, society has to choose between four options.
  - pensioners will become poorer relative to the rest of society; or
  - taxes/National Insurance contributions devoted to pensions must rise; or
  - savings must rise; or
  - average retirement ages must rise.
- As the first option deemed unacceptable, a combination of the other three is needed as any one of the three in isolation raised problems
- Estimated that about 9million were under saving

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Pensions Commission second report Nov 2005

- Again this sets down perceived political “truth” and forms the basis for all the reform changes
- State Pension support predicted to decline and was originally assumed to be countered in Government planning by an increase in private provision – but reality is different
- Reform of State Pension needed to assist those at the bottom and those with interrupted earnings
- Current provision does not (and cannot) meet needs of under savers and as people will not adequately save without help, auto enrolment is needed
- The 8% banded earnings figure also introduced to give average earners a combined income in retirement of about 45%

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Pensions Commission – key recommendations

- The creation of a low cost, national funded pension savings scheme into which individuals will be automatically enrolled, but with the right to opt out, with a modest level of compulsory matching employer contributions, and delivering the opportunity to save for a pension at a low Annual Management Charge.
- Reforms to make the state system less means-tested and closer to Universal…
- In order to achieve this while maintaining the standard of living of the poorest pensioners it will need to be more generous on average. In the long-term this implies some mix of both an increase in taxes devoted to pensions expenditure and an increase in State Pension Ages."

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Pensions Commission – legislative results

- **2007 Pensions Bill**
  - Introduced changes to State Pension ages, gradually raising it to 68 for both men and women
  - Alters the way that State Second pension accrues, so that over time it will become flat rate rather than earnings related
- **2008 Pensions Bill**
  - Introduced a national pension scheme – now called NEST
  - Introduced auto-enrolment and opting out
  - Imposes liabilities on employers to deduct and pay contributions

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So we thought we understood 2012!

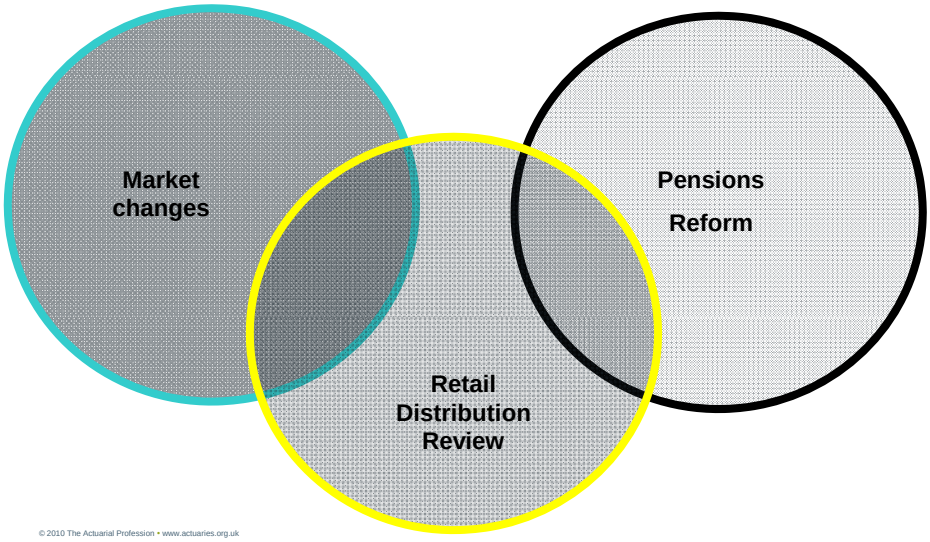


And then – just when we thought it was safe to go out – the Government changed!

- Review of the whole pensions reform initiative announced by the new Coalition government in June 2010
- Reported back October 2010, most things stayed the same, some significant changes - certification and waiting periods
- Changes incorporated into the 2011 Pensions Bill/Act
- Hopefully comes into force October 2011
- Department for Work and Pensions indicating that supporting regulations finalised January 2012

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RDR, Pensions Reform & Market changes: A considerable overlap- but manageable?



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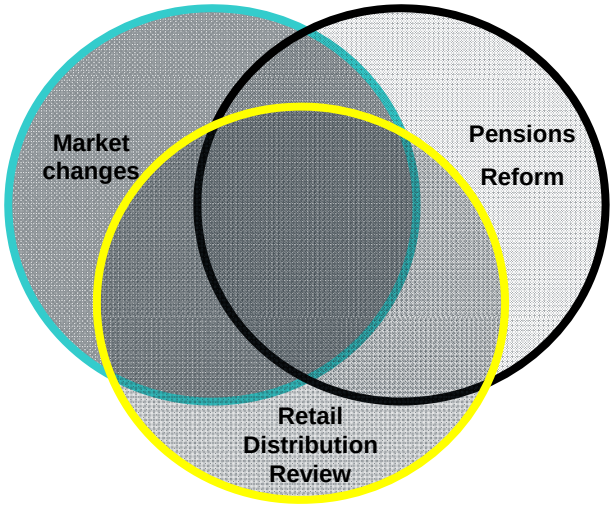
Something else for 2012 – but with more rings on and only a couple of weeks of disruption



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RDR, Pensions Reform & Market changes: A considerable overlap



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Market context and Retail Distribution Review

- Current providers to withdraw from pensions?
- How many new providers will enter market?
- Impact of NEST on charges and service
- NEST as a benchmark for advice on other products
- RDR drives need to settle in for the long haul by 2013
- Potential need to show added value

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So what are the background areas for discussion?

- Defined benefit and hybrid schemes
- Who is an employee?
- Staging dates
- Non-banded versus banded earnings – liabilities for employers
- Default funds
- Treatment of variable earners
- Salary sacrifice
- Non-UK employees
- Tax relief and contributions



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Defined benefit and hybrid schemes

- If open to new entrants – no action until Oct 2016
- But then use auto-enrolment process for all
- Could use nursery scheme and move employees after “waiting” period

- If only further accrual for existing members then is it qualifying?
- Even if not could scheme become a hybrid?

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Who is an employee?

- Not as simple as it sounds
- Anyone on the payroll could be an employee, including “self employed” contractors
- May depend on whether employer rate NI is paid and who pays
- Directors and other office holders may not be employees
- Zero hour employees count for staging purposes
- Agencies may, or may not, be employers
- Legal advice may be needed.

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Staging dates

- Starts from October 2012, existing employers split into 36 groups
- Employer “staging dates” October 2012 to February 2016, date dependent on employer size and/or PAYE reference.
- Large employers (>50,000 employees) can elect to go earlier (from July 2012).
- Other employers can elect to bring forward their staging dates (e.g. to align to payroll dates) but not before October 2012
- Makes communication a real issue

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Non-banded versus banded earnings – liabilities for employers

- Everyone thinks that employers are only liable for earnings over the contribution threshold
- True – if your scheme is on a banded earnings basis
- Not true – if your contributions are based from £1?
- Depends on how the employer communicates contributions
- Think in particular about people whose earnings drop

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Default funds

- Not needed for DB
- Must be lifestyled or target dated (legacy products?)
- Think of stakeholder default funds
- Must be suitable for the employees
- How many defaults are needed for an employer?
- Who is responsible for them?
- What about charges?
- What is a suitable investment strategy and where is the market likely to settle?

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Treatment of variable earners

- DWP are removing “Person A” in the consultation draft
- Trigger for auto-enrolment based on weekly or monthly earnings – no overview from employer
- Deferral periods still operate – look at pay at the end
- Possibly works for schemes based on £1 of earnings
- But what about banded earnings?

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Salary sacrifice

- Works until auto-enrolment starts with no issues
- But salary sacrifice is voluntary
- Auto-enrolment is involuntary
- There are alternatives
  - Side by side joining
  - Contract of employment changes
  - Reduce pay for all
  - Post joining salary sacrifice.

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Non-UK employees

- All UK jobholders meant to be covered
- Ordinarily working in the UK
- May not be resident in the UK or a UK taxpayer
- NEST will exclude permanent residents of another EU Member State
- Otherwise have issues with cross border schemes and/or tax relief and/or social and labour law breaches

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Tax relief and contributions

- Just remember
  - It isn't 3% employer, 4% employee and 1% tax relief
  - It is 8% employer but employee can be asked to pay up to 5% of this
  - Scheme tax basis unaltered
  - Tax relief at marginal rate or basic rate plus ability to reclaim higher rate
- Employee contributions can exceed 5%
- No idea what is safe – but encouraging opting out is unacceptable.

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So how big is all this?



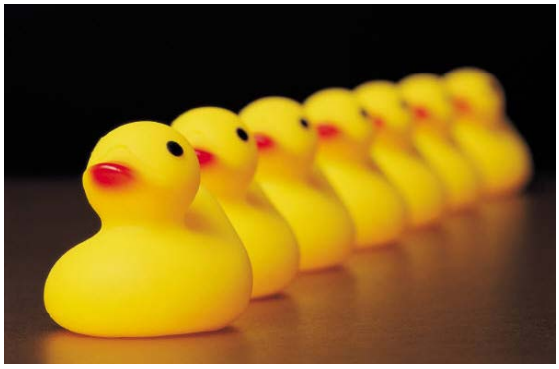
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Conclusions

- An awful lot to get your head around
- All this on top of the other changes happening in 2012
  - RDR – brings forward decisions on auto-enrolment
  - New entrants bring fresh challenges
  - Peripheral impacts of Solvency II
  - Longer term changes to IORP
- .Huge risks and huge opportunities
- Lets keep talking to minimise impacts to our customers

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Any questions or are all your ducks in a row?



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