The Actuarial Profession
making financial sense of the future

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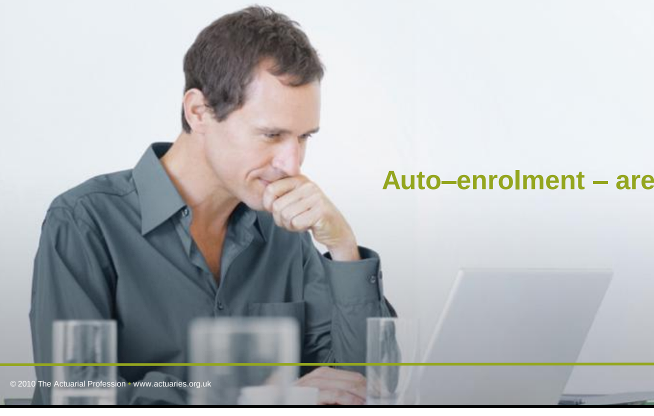


Auto–enrolment – areas for discussion

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

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

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%

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."

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

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

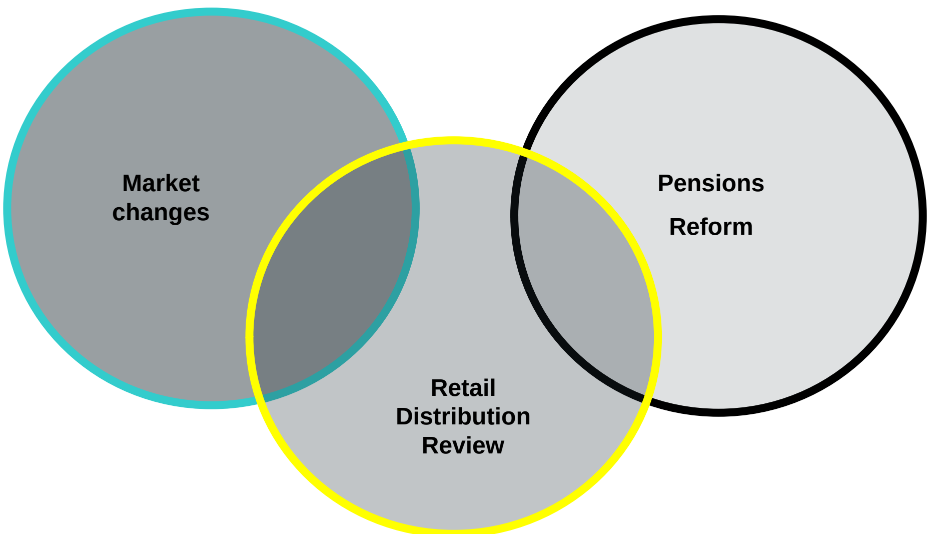
•Reported back October 2010, most things stayed the same, some significant changes - certification and waiting periods

•Changes incorporated into the 2011 Pensions Bill/Act

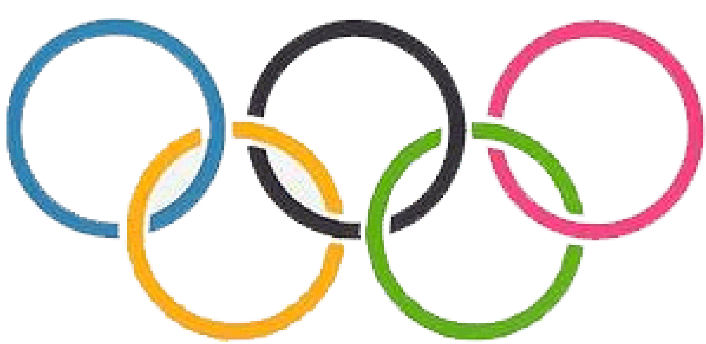
•Hopefully comes into force October 2011

•Department for Work and Pensions indicating that supporting regulations finalised January 2012

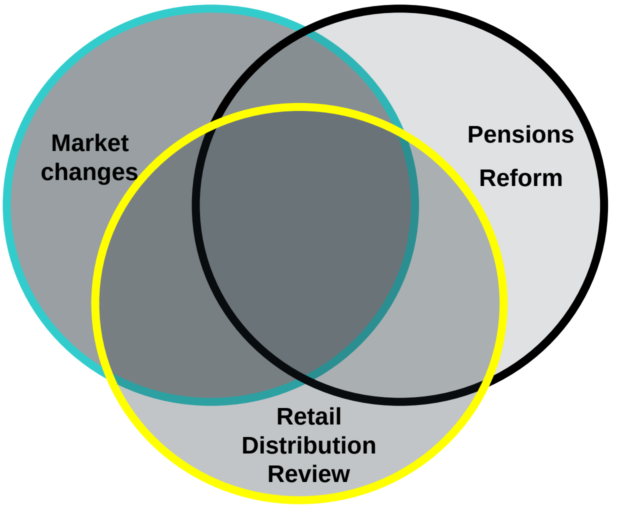
RDR, Pensions Reform & Market changes:
A considerable overlap- but manageable?



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



RDR, Pensions Reform & Market changes: A considerable overlap



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

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.

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

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

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?

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?

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.

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

Tax relief and contributions

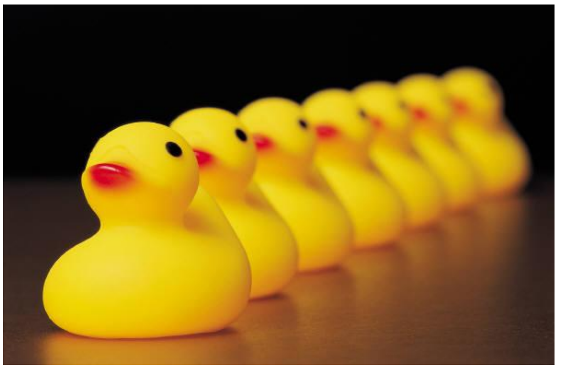
- Just remember
  - It isn’t 3% employer, 4% employee and 1% tax relief
  - It is 8% employer but employee can be asked to pay up to 5% of this
  - Scheme tax basis unaltered
  - Tax relief at marginal rate or basic rate plus ability to reclaim higher rate
- Employee contributions can exceed 5%
- No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

So how big is all this?

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

Any questions or are all your ducks in a row?



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