

The Actuarial Profession
making financial sense of the future

Pensions Conference 2012
Anne Jones (Towers Watson)



Old Benefits in a New Light

1 June 2012

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Agenda

- Current retirement processes
- Members' options
- Planning for retirement
- What help can members be given?

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Current focus on DC retirement processes

| | |
|---------------------------|--|
| Pensions Regulator | Schemes need an efficient retirement process |
| | Members will need help and support |
| | It will enforce changes where necessary |
| DWP | Annuity decisions are often ill-informed |
| | Crucial for people to take these decisions on basis of an understanding |
| | Least financially knowledgeable and engaged have most to gain |
| NAPF | Supports efforts to improve the way choices are made |
| | Believes that trustees have a key role to play |
| ABI | Not enough people shop around currently |
| | Consumers should shop around to maximise income from their pension savings |
| | Will introduce a compulsory code of practice binding all ABI members |
| Members | It would have been better to receive it earlier, to give me time to decide |
| | It was only when I approached that date that I realised there were lots of options |
| Claims firms | Targeting pensioners who may not have purchased the most appropriate annuity |
| | One firm piloting 100 cases and it intends to take its findings to Financial Ombudsman Service |
| | Looking at a variety of issues such as entitlement to enhanced/impaired rate, spouses pensions |
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Will DB retirement processes
be in the spotlight next?

Current DB retirement statements

Typical DB retirement statement

Normal Retirement Benefits as at 1 August 2012

Pension payable as at Normal Retirement Date £12,000 pa

OR

Maximum Tax-free Lump Sum at NRD £60,000

Residual Pension payable £9,000 pa

Spouse's pension payable on death after retirement £6,000 pa

- Might have a breakdown by increases
- If PIE is offered, will have details of any exchange offered
- If AVCs, may just have a value as at the statement date

Are these the only options open to DB members?

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Members' options?

- Trustees need to act in the best interests of the beneficiaries
- Employers need to maximise appreciation and value from the scheme
- Are these the only options open to members?
- Do these options best suit all members?
- Will members be allowed to transfer out in the year before NRA?

Members need to consider their options inside and outside the scheme

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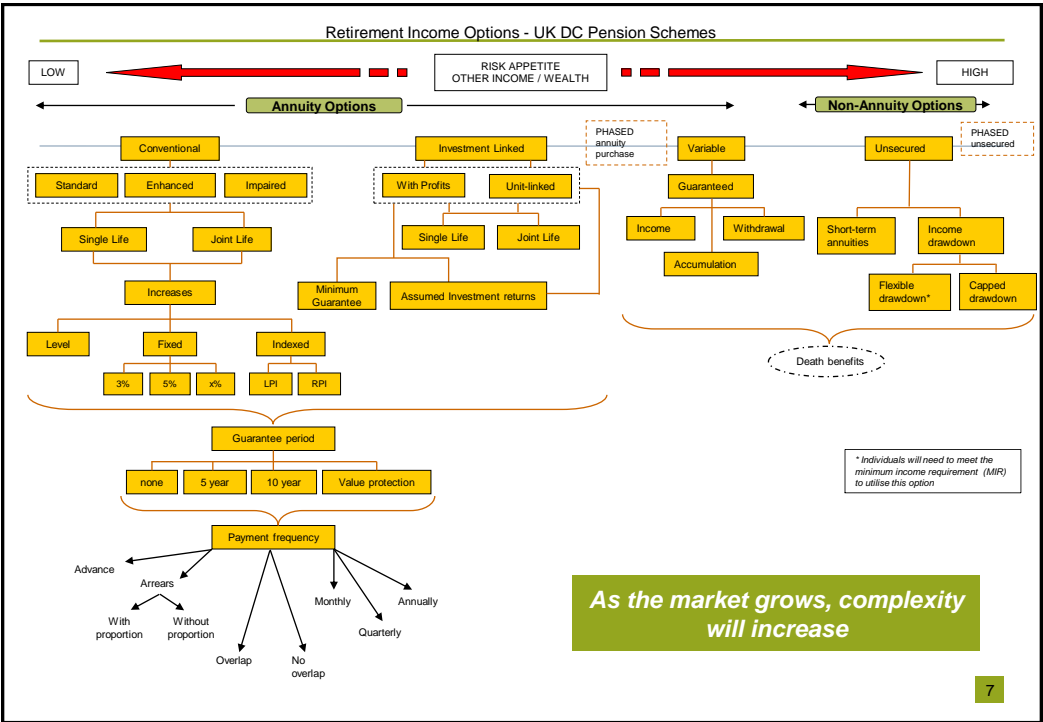
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What are members' options?

| In the scheme | | Outside the scheme |
|---------------|-----------------------------|--------------------|
| ✓ | DB pension | ✗ |
| ✓ | Minimum Pension Guarantees | ✗ |
| ? | Different shape of pension | ✓ |
| ✗ | Impaired life pension | ✓ |
| ✓ | Tax free cash lump sum | ✓ |
| ? | Taxed cash lump sum | ✓ |
| ✗ | Capped income drawdown | ✓ |
| ? | Additional spouse's pension | ✓ |

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Why would members want flexible drawdown?

Invest how they want

Pass to dependants free of Inheritance Tax

Take out what they want...

...when they want

- Mr Smith:
 - Aged 65 in May 2012
 - DB pension entitlement of £35,000 pa from the Scheme
 - State pension of £5,000 pa
 - Commutation factor 15:1

He's traded £10,000 p.a. gross for:
 £75,000 net if he pays 50% tax and takes it all up-front
 £120,000 net if he pays 20% tax over a longer period

- Retirement income:

Post commutation pension (including State)

Pension Commencement Lump Sum

Taxable cash lump-sum

| | Current regime | MIR regime |
|--|----------------|------------|
| Post commutation pension (including State) | £30,000 | £20,000 |
| Pension Commencement Lump Sum | £150,000 | £150,000 |
| Taxable cash lump-sum | Nil | £150,000 |

Members who could get enhanced annuities could get an even higher taxed cash lump sum

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Flexible drawdown – what do Trustees need to do?

Trustees need to decide:

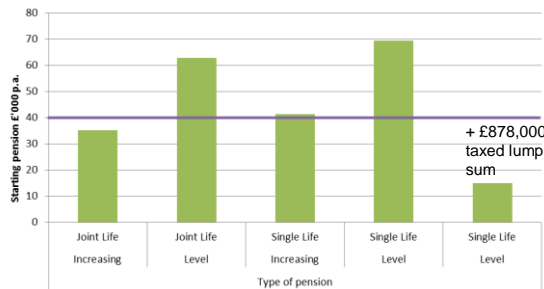
- Will they offer the ability to take a taxed-lump sum from the scheme?
- Will members be allowed to reshape their benefits in the scheme?
- If not, will they allow partial transfers out?
 - If so, any restrictions?
- If not, will they allow full transfers out in the last year before retirement?
- Will they allow members to transfer their AVCs out of the scheme?

Need to come up with policies and tell members

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What could Mr Baker get on the open market?

- Let's assume Mr Baker has reached 65
- Mr Baker has a pension of £40,000 within the Scheme
 - Increases in line with inflation and 50% spouse's pension
- Equates to a transfer value of £1,120,000
- On the open market this could buy:



Source: Annuities from Money Advice Service

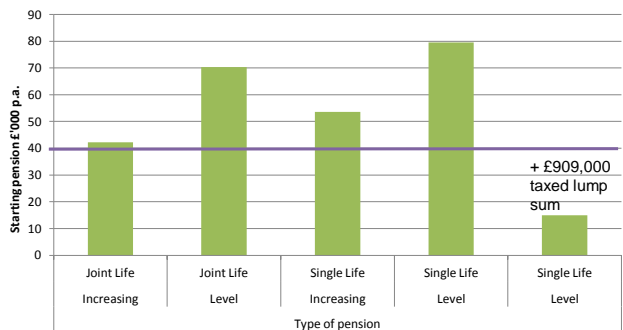
Mr Baker's tax free cash could also increase on transferring out from £196,000 to £280,000

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What about if Mr Baker is a smoker?

- Mr Baker still has a transfer value of £1,120,000
- On the open market this could buy:



Source: Annuities from Money Advice Service

Markets suggest that around 50% of the population could be entitled to an enhanced/impaired life annuity

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Planning for retirement

- More and more members will be retiring with DB *and* DC pensions
- Some will have other savings
- Need to help them to understand what their retirement could look like

Desired replacement ratios at retirement

| Earnings | Replacement Ratio (% of earnings at retirement) |
|--------------------|--|
| < £10,000 | 86% |
| £10,000 - £30,000 | 67% |
| £30,000 - £50,000 | 61% |
| £50,000 - £100,000 | 59% |
| > £100,000 | 55% |

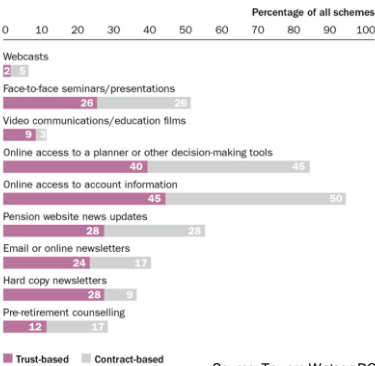
Source: Watson Wyatt Pension Research Forum – The future of UK retirement savings (2008). Taken from a random sample of 2,000 employees in medium and large private sector companies in the UK.

- Many realise that they may not need as much as they desire

Help members to understand what they need vs what they desire
and
how they might get there

What help do DC members get?

- HAVE to be told about Open Market Option
- Guides that highlights members' options
- Links to Money Advice Service
- Access to annuity brokers
- Retirement Counselling
- Warm up communications, often from age 55
- Retirement budget planners



Source: Towers Watson DC FTSE 100 Survey 2012

DC still isn't perfect, but it is improving

What help could DB members get?

- Guide which highlights what is available
 - Including links to Money Advice Service
- Tell members whether or not a TV is available in the final year
 - Possibly provide a TV as part of the retirement statement
- Warm up communications
- Retirement budget planners
- Possibly retirement counselling or access to an annuity broker
- Can force advice if TV in the final year

DB retirement support is a long way behind DC

Questions or comments?

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