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Pension Reform & Life Insurers

Graham Vidler & Steve Melvin

2007 Life Convention
12 November 2007

Agenda

- Pension Reform – what's it all about? *Graham*
- Personal Accounts – the big decisions *Graham*
- Potential impacts on Life Insurers *Steve*
- Potential responses *Graham*

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Forecasting the future…

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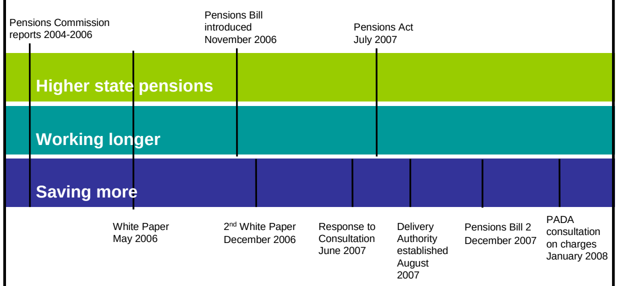
Pension Reform to date



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Pension Reform – key issues

The known…

- Automatic enrolment for eligible employees with freedom to opt out
- Minimum overall level of contribution on earnings between c£5,000 and c£33,500 (uprated in line with earnings)
  - 3% compulsory contribution from employer
  - At least 4% from employee
  - 1% basic tax relief on employee contribution
- Personal Accounts will be an occupational scheme delivered through the centralised "NPSS" approach

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Pension Reform – key issues

…and…

- Maximum contribution of £3,600 pa (uprated in line with earnings)
- Transfers prohibited until at least 2017 review
- *"It is the Government's intention that costs related to the set up and operation of the Personal Accounts scheme will not be subsidised by taxpayers"* [Summary of responses to the consultation, June 2007 p.54]

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Pension Reform – key issues

…and the unknown

- **Charges** – PADA consultation underway: 0.3% AMC remains Government aspiration
- **Exempt schemes** – can employers use GPPs?
- **Reactions** – what will individuals and employers choose to do?

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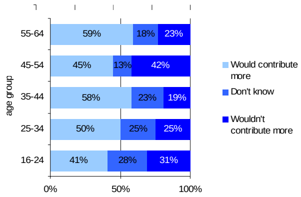
Individual decisions

- pension?
- how much pension?
- which pension?



Employer decisions

NPSS actively sought

Employers cost-conscious

Employers cost-absorbing

NPSS avoided

Employer decisions

NPSS actively sought

- Employers spread the same pension contributions across more members.
- NPSS transfers used as excuse for levelling-down
- Existing pension schemes under cost pressures to compete with NPSS in order to reduce impact of switching
- Overall pension market grows little; NPSS gains significant share

- Employers meet the costs of pension reform but abdicate responsibility for scheme sponsorship
- NPSS perceived as 'good enough' solution
- High contagion and a reduction in new business outside NPSS
- NPSS the big winner in a growing pension market

Employers cost-conscious

Employers cost-absorbing

- Employers spread the same pension contributions across more members
- Existing schemes kept with some reduction in existing contributions
- High differentiation between existing and new members.
- Overall pension market grows little; high volume, low value.

- Employers meet the costs of pension reform and see continued value in scheme sponsorship
- 2 tier workforce with lower-paid enrolled into NPSS, and existing pension arrangements maintained
- Growing pension market spread across NPSS and existing market

NPSS avoided

Scenario development

NPSS actively sought

1. "Maximum Impact"
- 40% of employers close schemes
- 20% of employers close to new members
- 45% of employers level down
- 75% of individual customers switch contributions

2. "NPSS dominated growth"
- 40% of employers close schemes
- 20% of employers close to new members
- 15% of employers level down
- 75% of individual customers switch contributions

Employers cost-conscious | *Employers cost-absorbing*

- 5% of employers close schemes
- 10% of employers close to new members
- 75% of employers level down
- 55% of individual customers switch contributions

3. "Retrenchment & Indifference"

- 5% of employers close schemes
- 10% of employers close to new members
- 15% of employers level down
- 55% of individual customers switch contributions

4. "Minimum change"

NPSS avoided

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Impacts: Glass half full

- 6-7 million new savers
- Cultural shift towards saving
- Transfers into NPSS banned until at least 2017
  - Helps protect embedded value of existing book
- Potential fund management role
- Annuity opportunities

A step-change in UK saving

Impacts: Glass half empty

- No role for insurers as branded providers
- Up to 50% of NPSS contributions simply diverted from other pensions and other savings
- Contribution limit £3,600pa
- Planning blight pre-2012
- Transfers into NPSS could/will start in 2017
- NPSS charges force reduced margins elsewhere

A new and potentially robust competitor

Impact drivers

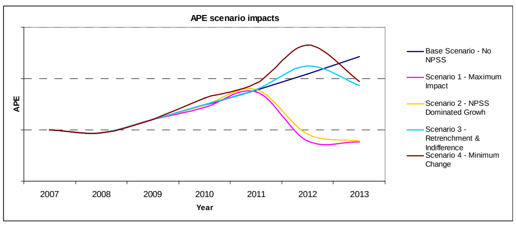
Group business:

- Will employers embrace NPSS or stick with existing (exempt) group pension products?
  - Highly impacted by whether GPPs can allow auto-enrolment and be exempt
- Will employers spend more on contributions as a result of auto-enrolment or level down?

Individual (non-SIPP) business:

- Proportion of self-employed policyholders

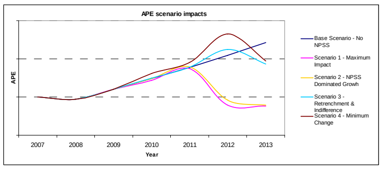
Scenario outcomes: New Business volumes



- 2010-11 Slight rise over base due to auto-enrolment on new schemes in preparation for 2012
- 2012+ Scheme closures to new money and destination of new schemes have big impact
- 2012+ Individual pensions regular premium APE suffers big fall in all scenarios due to the financial incentive to enter NPSS and gain employer contributions (unless self-employed)

Scenario outcomes: New Business Contribution

- If actuarial assumptions remain unchanged then margins will be similar and NBC impact will mirror the APE impact:



- Post 2012, NPSS may give downward pressure on charges, leading to reduced margins and lower NBC

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Scenario outcomes: New Business Contribution

- BUT we know NPSS will have an effect on persistency up to and beyond 2012:

Paid-up rates

- There may also be an impact in 2017+:

Transfers out

- When should these effects be recognised in EV / reporting bases?

- And at what level?

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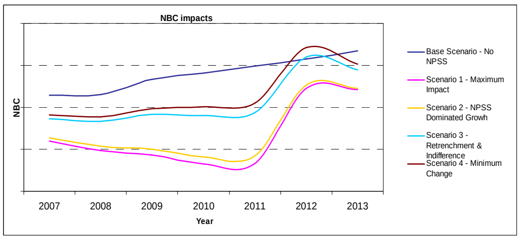
Scenario outcomes: New Business Contribution

Example: Take into account **immediately** the expected impact on PUPs in 2012+, e.g. assume (say) 75% of regular premium individual pensions become paid-up in 2012



- Immediate impact on NBC, now, not in 2012

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Financial Impacts: Summary

New Business Volumes:

- Impact hits in 2012 and beyond, with some (possibly positive) impact 2010-11

New Business Contribution:

- Impact hits when the effect on persistency is reflected in the EV / reporting basis – not in 2012

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Where next for life insurers?

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