KPMG

cutting through complexity

Defined Ambition

ACA Presentation

15 January 2013

Agenda

Reinvigorating workplace pensions: the broad picture

DC Plus

DB Lite

Discussion

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Reinvigorating workplace pensions: the broad picture

DwP Perspective

Objectives

Foundational level of income from the state	→	Single-tier
Increasing numbers saving privately	→	Automatic Enrolment
Saving into high quality schemes	→	Reinvigoration

- Increase the amount people save in pensions;
- Increase the amount people receive for their savings.
- Enable industry innovation and development of new products including those that will give people more certainty about their pensions and encourage more risk-sharing.
- Increase transparency and build trust, confidence and engagement in pension saving as the norm.
- Ensure the sustainability and stability of the UK pension system.

Good DC – key factors and enablers

Key factors:

•Contributions - going beyond 8%

•Charges – monitoring and encouraging self regulation

•Investment strategies – suitable default funds

•Decumulation – supporting decisions and increasing flexibility

Key enablers:

•Governance

•Communications

•Scale?

Where does Defined Ambition fit in?

Consumers value certainty – pure DC does not provide the same level that DB did

Some risk-sharing already exists – can more be encouraged?

Working collaboratively with partners to explore options

Need to consider the incentives, particularly for employers

Fundamentally, it's all about good quality schemes

Defined Ambition Working Group

Chaired by Andrew Vaughan

Supported by joint secretariat from ACA and DwP

Working Groups:

•DC plus

•DB Lite

•Regulatory group

•Scale, CDC

•Consumer perspective group

•DA Co-ordination Group

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DC Plus

Chaired by David Hutchins

Finding the middle ground

….Employers providing DC do not put balance sheet or P&L at risk…

Long list of ideas

Money back guarantees

Income guarantees

New style with profits

Targeted outcome strategies

Employer smoothing fund

Collectivised income provision

Enhanced engagement models

State benefit integration

…………

Reasons for Establishing Short List

Already feasible

No real guarantees or risk sharing –more "a cunning plan"

Ungovernable

Poor value for money – cost of guarantee greater than perceived value

Unsellable

The short list

Retirement Savings Protection Fund (“RSPF”) for qualifying retirement savings products (“QRSP”)

Integration of DC Income with State Benefits

Standardised insurance wrapped guaranteed investments

Standardised retirement income insurance

Passed to Scale / CDC group

Employer smoothing fund

Collectivised income arrangements

RSPF for QRSP

Confidence inspiring low cost money back guarantee, potentially:

- **Member contributions only (subject to cap) with no indexation**
- **tPR responsible for QRSP compliance**

- **Simple cost effective, transferable/flexible, transparent, best execution**
- **Supports improved governance regime for DC**

- **But:**

- **New legislation, scope creep, PPF appetite**
- **Not focused on pension benefit**

Integration of DC Income with State Benefits

In return for contracting to defer an element of State Pension an individual will be allowed to decumulate their entire DC savings in the interim

Individuals get their savings back first

Longevity risk passed from inefficient markets to State

But:

Hard to model risks and costs to State, along with complex administration

At retirement advice model potentially problematic

Standardised Insurance Wrapped Guarantee Investments

Term insurance products purchased on investors behalf by default manager

Standardisation of terms

Regulatory easement on need for daily liquidity for savers

Reduced cost of guarantees and increased investment opportunities

Good ongoing governance of insurance purchase

But:

Insurer appetite and competition issues

Loss of daily liquidity for members

Standardised Retirement Income Insurance

Insurance progressively and collectively purchased from age 50 onwards separate to invested assets that guarantees income in retirement

Guaranteed income grows each year on savers statement

Individual retains full ownership rights of their fund at all times

Alignment with pension benefit

Transparency, flexibility and adaptability

But:

Insurer appetite

Separation of insurance and funds increases costs

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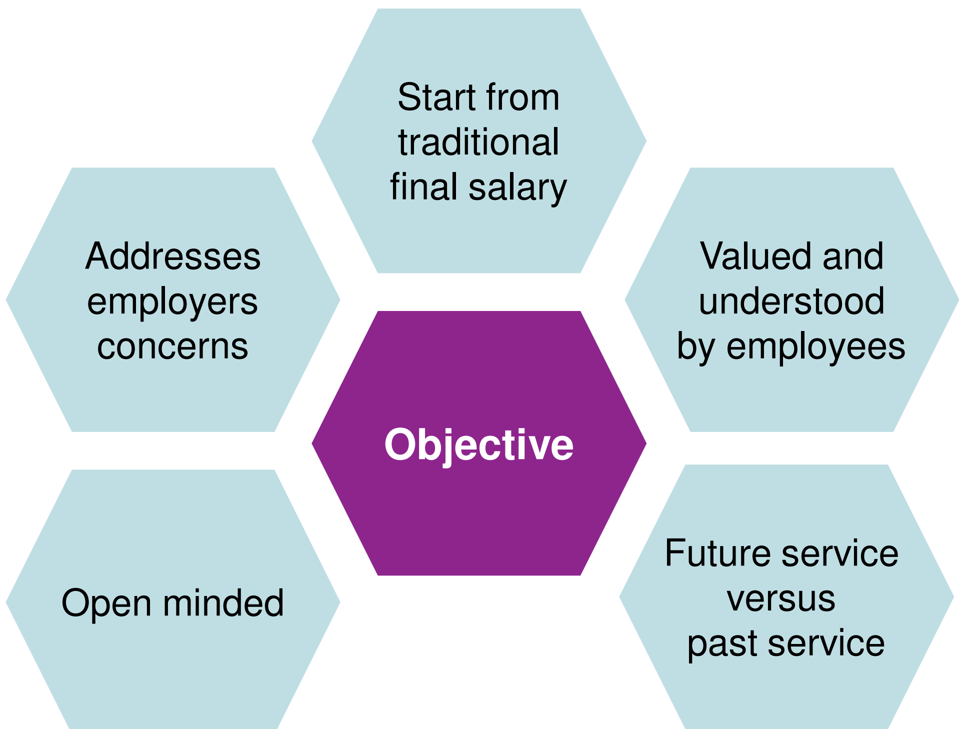
DB lite

Chaired by David Fairs

Introduction to DB lite

“Discussions with a range of employers have indicated that some who want to move away from their current DB pension arrangements are keen to retain some element of DB, but with an element of risk-sharing. They regard this as part of building a long-term relationship with the employee” - DwP



Models already possible

Care

- Winners and losers
- Not reduce risk

Cash balance

- Only pre-retirement risk
- Education?
- Full DB regime

Risk management

- Buy-outs, Buy-ins
- Longevity swaps
- Interest rate/inflation hedging

Longevity risk

John Lewis applies a Life Expectancy Adjustment Factor (LEAF) to service post 1 October 2008

Pension is reduced to take into account improvements in longevity to retirement so employer exposed to less longevity risk post 2008

- Link retirement age to changes in longevity
  - e.g. SPA or independent commission?
- Pass longevity risk to employees…
- …only PRE retirement
- Bring private sector into line with public sector and State
- Consider healthy life expectancy?
- Past and future service?

DB persists only for active service

DB provision which converts to DC on:

- Leaving
- Death
- Retirement

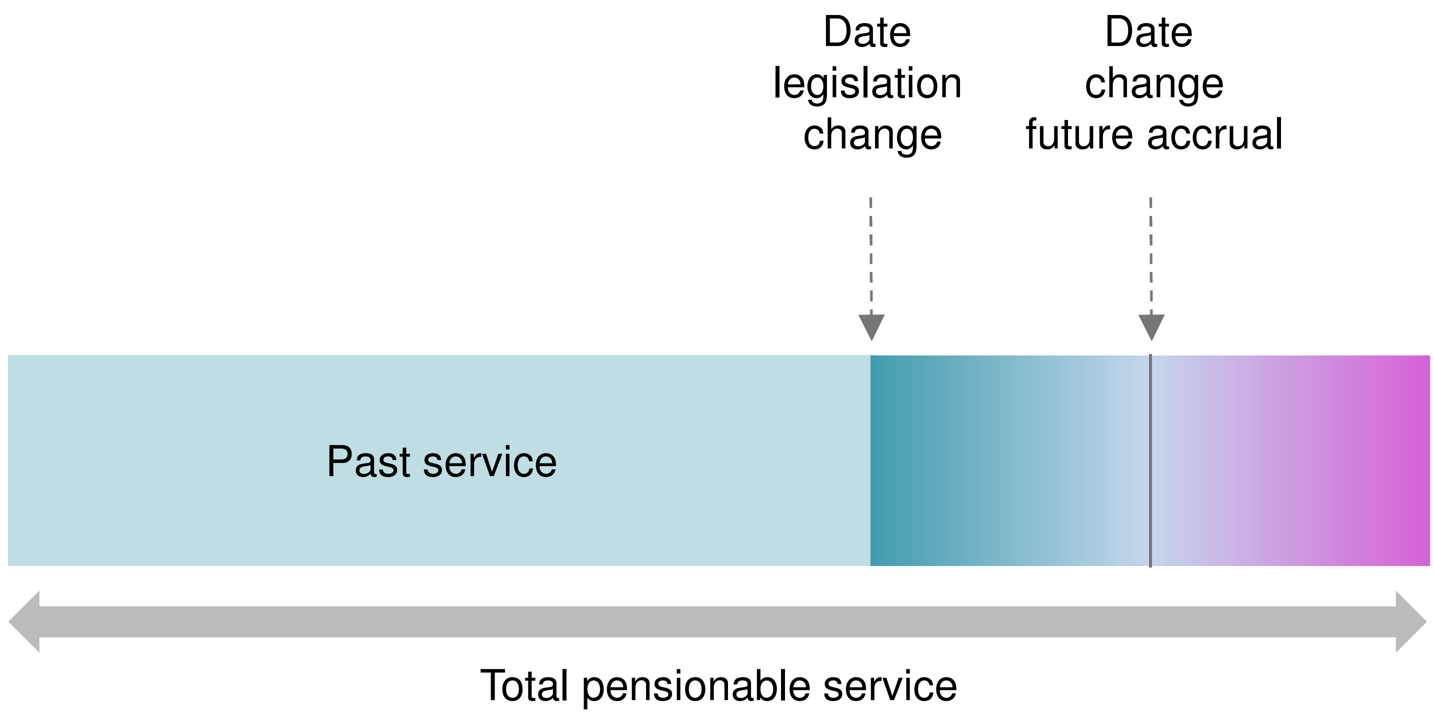
Past and future service?

Focus on current active workforce

Member education

Legislative changes

To cover past service…



Simplified/core DB schemes

Removal of spouses' pensions:

Currently required under reference scheme test – contracting out for DB to be abolished

Not required for C/In schemes

Arguably no (or much less) need for today's workforce given both men and women work

Will reduce costs for employer

Will it reduce risk?

Simplified/core DB schemes

Core DB benefits (existing funding regime) with additional benefits on a discretionary basis (light regime)

Conditional indexation

- Future indexation not guaranteed
- Conditional on scheme funding level
- Index targeted but can be withheld

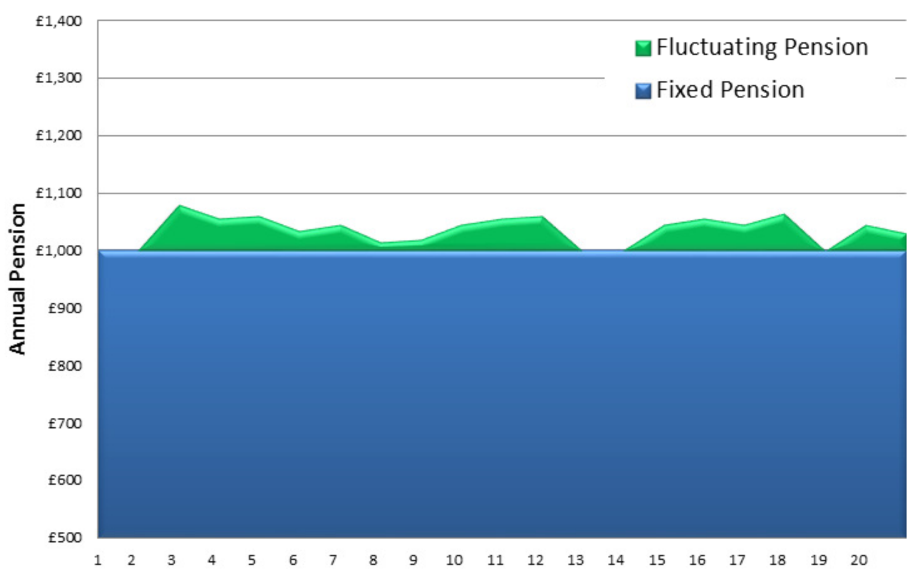
Optional indexation

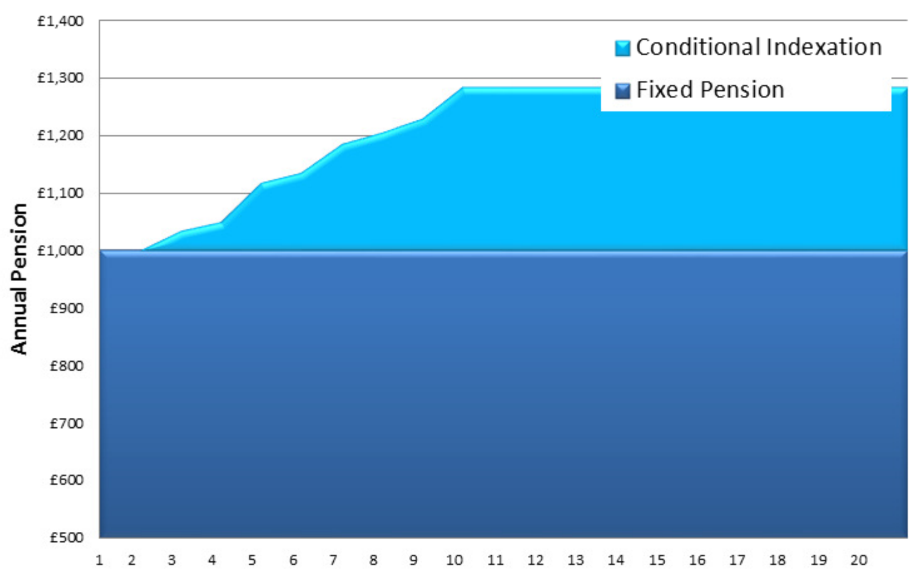
- Remove statutory requirement completely!

Simplified/core DB schemes

Fluctuating pensions

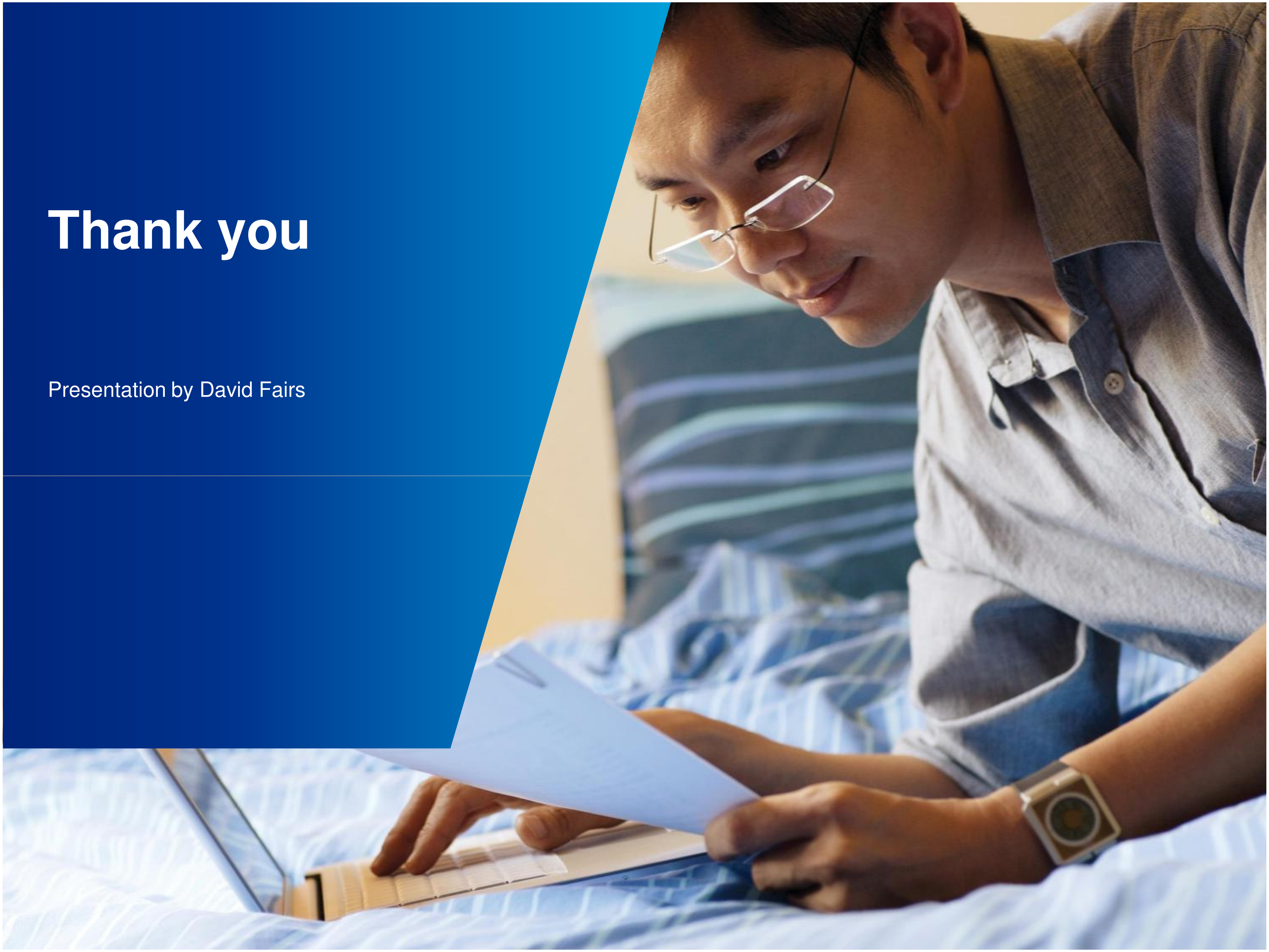
- Indexation not ‘building’ on itself
- Lighter regime





Thank you

Presentation by David Fairs



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