ASSOCIATION OF ACA CONSULTING ACTUARIES

Don’t let this crisis go to waste

A simple and affordable way of increasing retirement income

ACA Sessional Meeting

Michael Johnson

Kevin Wesbroom

Introductions

Michael Johnson

- 21 years in investment banking
- Tillinghast
- Secretary to the Conservative Party’s Economic Competitiveness Policy Group

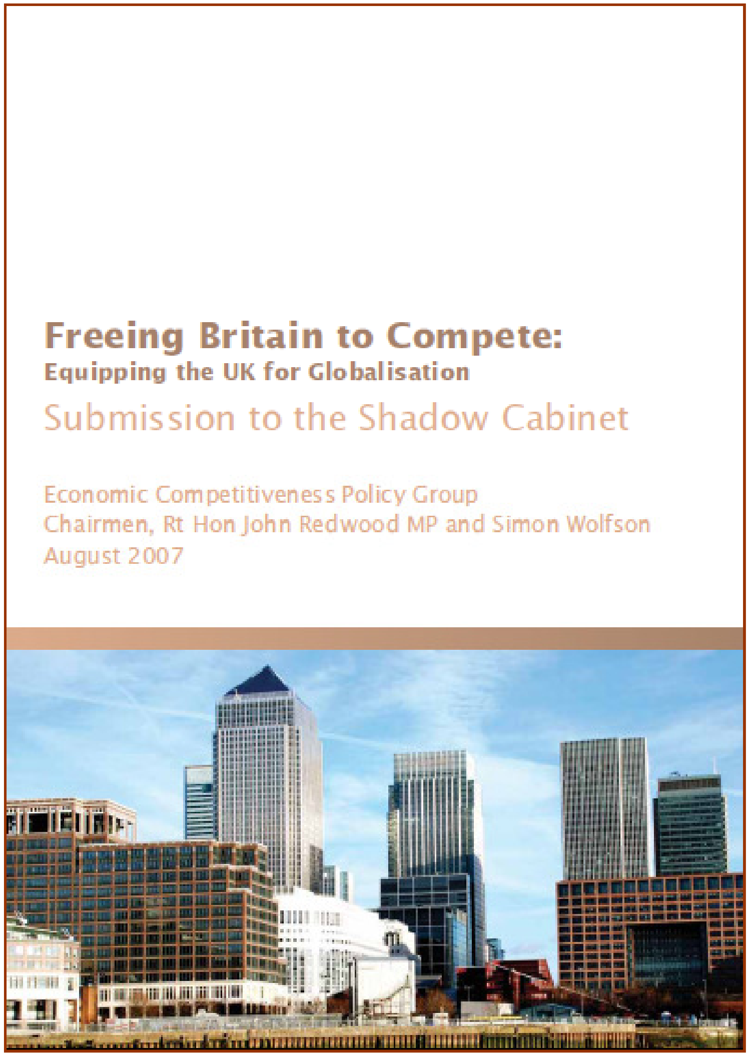
Kevin Wesbroom

- Long term (institutionalised?) consulting actuary
- Bacon & Woodrow and Hewitt
- Invited to join ECPG and met Michael

Policymaker's perspective

- The "P" word
- Big, distant numbers
  - Discount rate, longevity, impact of debt burden….?
- Complex accounting and regulatory environment
- Ethics and identity
- Need to influence behaviour
  - Financial myopia; "spend now"
  - Product complexity
  - Lack of trust breeds resistance
- Political perspective
  - Pensions; politically unpalatable
  - Implementation of legislation; glacial

The Journey …Q1 2006 – Q3 2007



Proposals to overcome 7 barriers to prosperity....including Pensions and Savings

Working Group

- Actuary
- 2 bankers
- IFA services
- Insurance Exec.
- Management consultant
- Former Shadow Chief Secretary to the Treasury

Economic competitiveness and pensions

- Improving longevity, dismal investment returns, rising regulatory burden, low yields, loss of 10p tax credit

  ⟶ Diverted cash flow to company pension schemes

  ⟶ Less business investment, R&D

- Can we revive the Final Salary pension scheme? Yes….
  - Encourage amendment of accounting standards to reduce volatility
  - Discount rates to better reflect fund assets; i.e. more equity-related
  - But….no reversal of loss of 10p tax credit
- Savings for Life?
  - No compulsion to buy annuity
  - Some pre-SPA access (ref. 401k)

Subsequently…

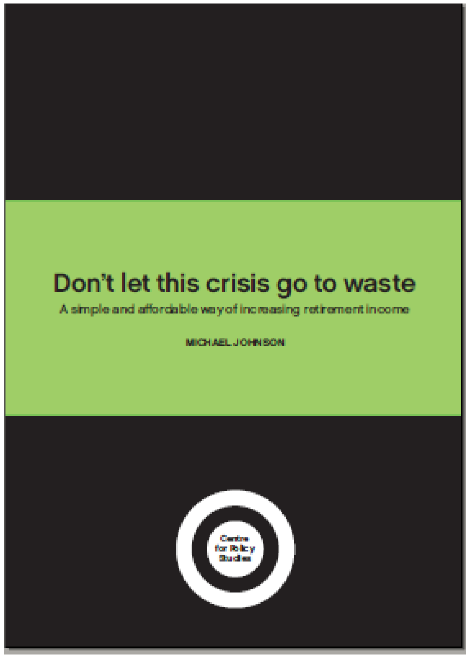
- Mid-2007: political consensus (pre-2007 Act)
- Winds of change

  ⟶ April 2009, working group revitalised
- Guiding principals
  - Protection from poverty in old age
  - Current expectations of a comfortable and lengthy retirement funded by the state are out of date
  - More reliance on personal savings
  - Lasting affordability, fairness and simplification
- Objective: a sustainable income-in-retirement landscape
- Approach: view as a single ecosystem, 4 components:
  - State Pension, OPS, public sector, personal retirement savings

Our Proposals

1. A more generous State Pension for senior citizens
2. End S2P accruals

3. Amend the Personal Account (as FRSA*)
4. Enhance FRSA contributions of those on low earnings
5. FRSA assets to be transferable, on death, free of IHT

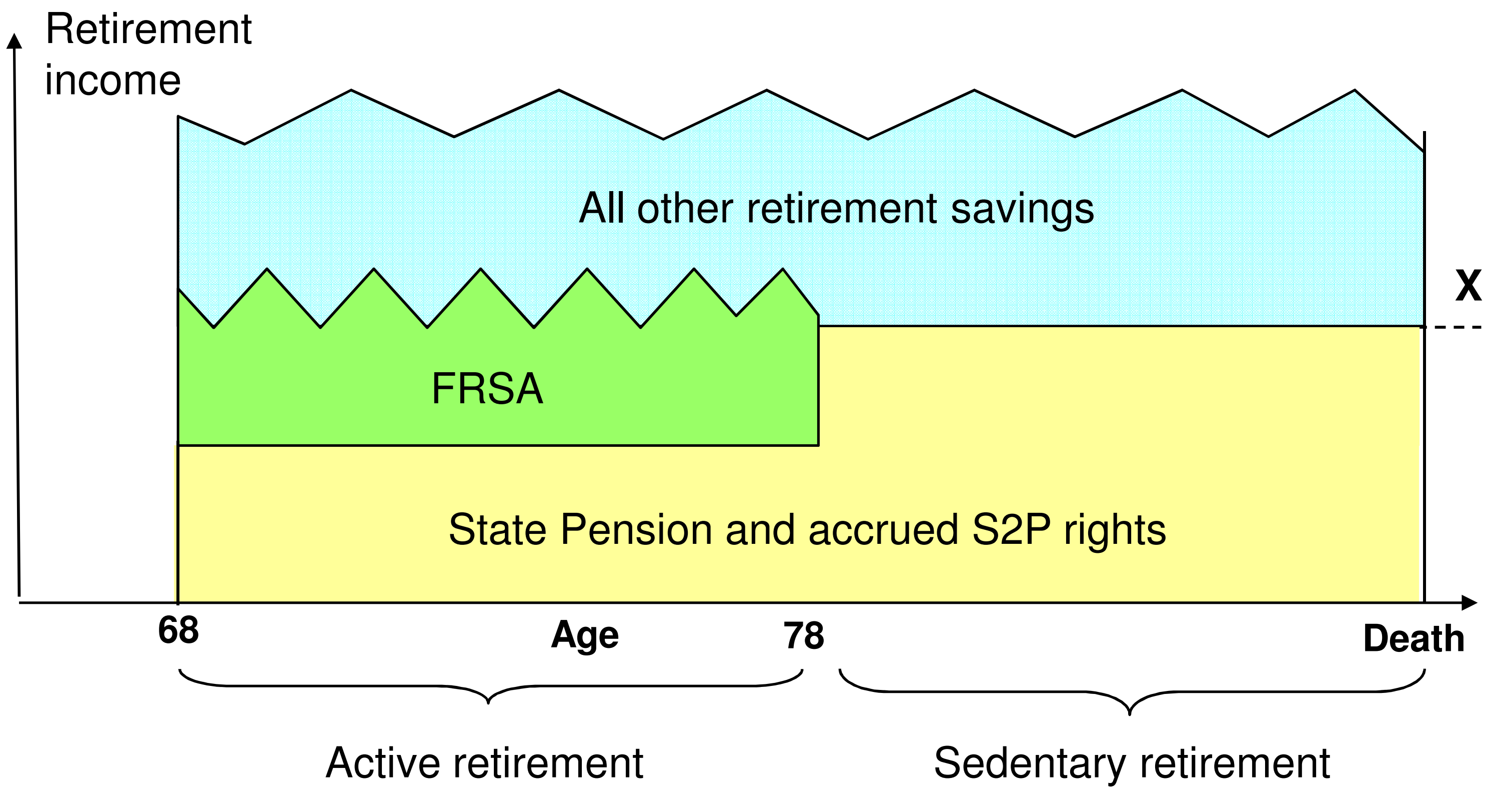


6. Public sector (PS) pensions to be cashflow self-sufficient
7. Compulsory FRSA participation for PS employees
8. Clarity on future PS pension liabilities

** Flexible Retirement Savings Account*

New architecture

- State Pension increased c.40% at SPA+10
- S2P accruals cease
- Flexible FRSA drawdown



X is set above full Guarantee Credit

FRSA: details

- Contributions
  - 7% of gross earnings as 3% ‘ee, 3% ‘er, 1% tax credit
    - “Pay £3 and get £1 free”
    - Similar to NEST
- Top-ups to 3% of median earnings (say) (effectively pre-funding MTB)
- Self-employed; contribute as ‘ee and ‘er + tax rebate
- Some pre-SPA access to encourage participation
- Simplify the administration; PADA role?

FRSA: details, cont.

- Assets transferable, upon death, free of IHT, to other FRSAs
  - “Cascading of (pensions) wealth down the generations”
  - Reinforces sense of personal ownership of FRSA assets

- Drawdown flexibility; no lifetime annuity
  - E.g. focus on first ten years after SPA
    - Gives decent income!
  - Scope for lifestyle choices
    - e.g. work or FRSA drawdown?

Unfunded public sector pensions

- PAYG meaning? ⟶ Unsustainable funding gap

£ billion	**2005-06**	**2006-07**	**2007-08**	**2008-09***	**2009-10****	**2010-11****
Contributions	£17.4	£17.9	£19.1	£19.5	£20.0	£20.7
pensions in payment	-£17.6	-£19.1	-£21.4	-£22.6	-£24.2	-£25.3
= Shortfall	**-£0.2**	**-£1.2**	**-£2.3**	**-£3.1**	**-£4.2**	**-£4.6**

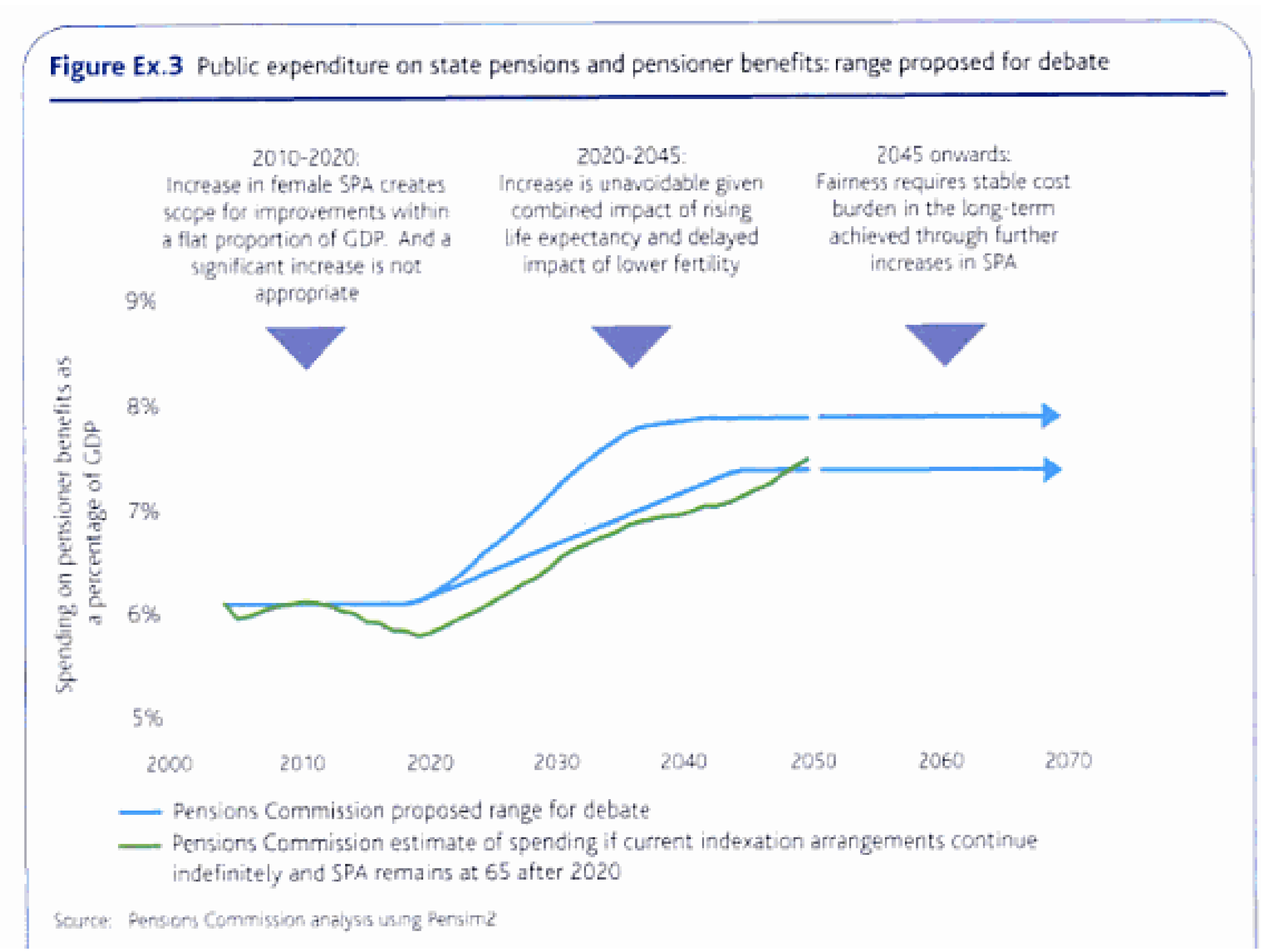
** Estimated outturn* ***Planned, as at May 2009*

- Require cash flow "self-sufficiency"
  - End Treasury's open-ended exposure
  - Government sets the principle
  - Implementation responsibility lies with employers
- Compulsory FRSA participation for all PS employees; ≥3% of gross earnings
  - Employer contributions by negotiation, subject to self-sufficiency
- Transparency

Affordability

- Savings
  - Phase out S2P ⟶ contracting out ends
    - More people paying full rate NICs
    - Rebates end
  - Means testing bill will fall (largely disappears for those > SPA+10)
    - Top-ups and compressed FRSA realisation ⟶ more income
    - Higher State Pension at SPA +10
  - Treasury savings from Public Sector pensions
  - Cash flow advantages
    - NICs rise today
    - State Pension (i.e. re-engineered S2P) rises at SPA + 10
- The challenge concerns transition

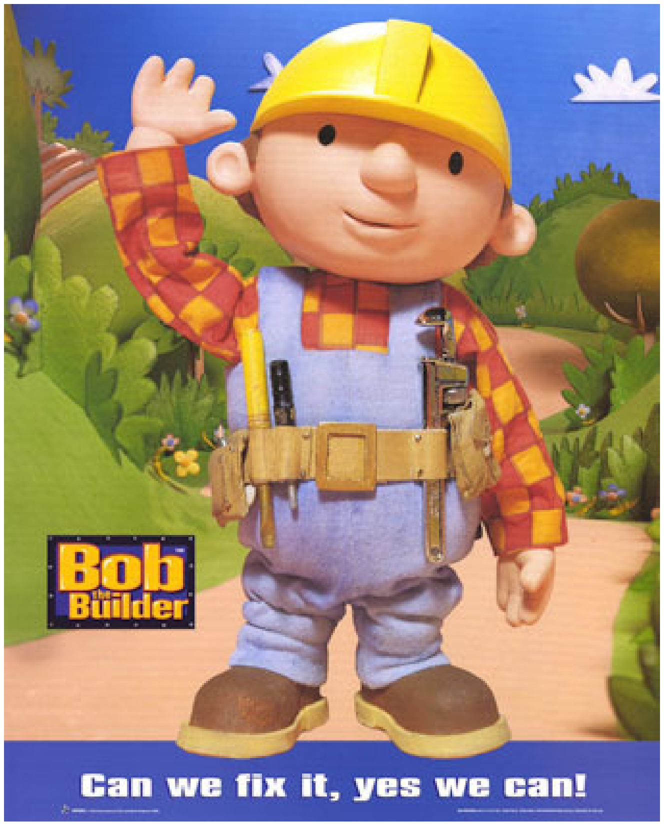
Costing pension changes – as Adair Turner did

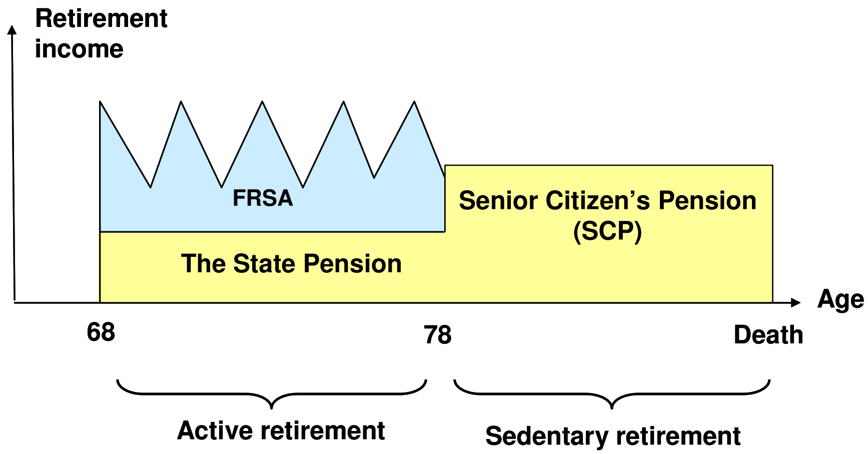


Practical problems with costing and transition

- What does affordable mean?
- Access to data
  - Parliamentary Questions
  - PenSim
- Dealing with means testing
  - Knowledge and data
  - Impact of changes on take up
  - PPI only trustworthy body?
- Access to money !

Our approach to costing: control levers





- The size of SCP
- Age for introduction of SCP
- Age for BSP !
- Indexation
- Phasing of introduction of FRSA
- Level of top-ups
- Phasing of top-ups

Cracks in the NEST egg …

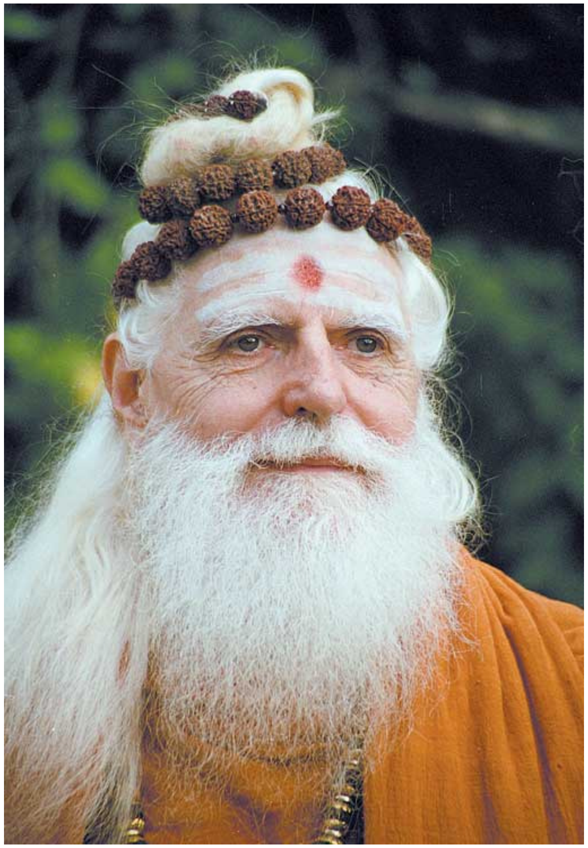
- Laudable objective…but flawed structure
  - Does not accommodate future lifestyles (“U”)
    - Decumulation rules unchanged (annuity by 75)
  - Derisory income for many
    - Sacrifices whilst working not worthwhile
    - Penalises those who die early
  - Problematic interaction with Means Tested Benefits

- Tattered process
  - Pre Budget Report (Nov 2009)
    - delays employer contributions to save money
  - Administrator; only Tata CS remains

Politics - appeal to the masses

- Low paid
  - Meaningful saving incentives (FRSA top-ups)
  - Scrapping annuity by 75 favours those with shorter life expectancy
- Older pensioners
  - Larger basic pension → means testing almost disappears
- Inter-generational transfer, pre-SPA access and post-SPA flexibility reinforces personal ownership
- More income than NEST
  - Benefits those with shorter life expectancy, typically low earners
  - Pays to save in 40s and 50s
- Tackles public sector pensions without direct diktat
  - Employers' given discretion as to how to achieve self-sufficiency
- IFAs have a role…..as distributors

Conclusions



- State Pension and FRSA complement each other
  - S2P re-engineered to be more useful
    - Simplification
  - Greater certainty of income post-SPA+10
    - Scope for lifestyle choice
- FRSA; a “suitable” product (relative to NEST)
  - Risk of mis-selling scandal diminished
  - No need for compulsion
  - the FRSA stands up on its own merits
- Emphasise “savings” rather than “pensions”
- Consistent with the “Built to Last” and “Responsibility Revolution” ethos
  - With nudges
- But….what customer need does the NEST contributions cap serve?

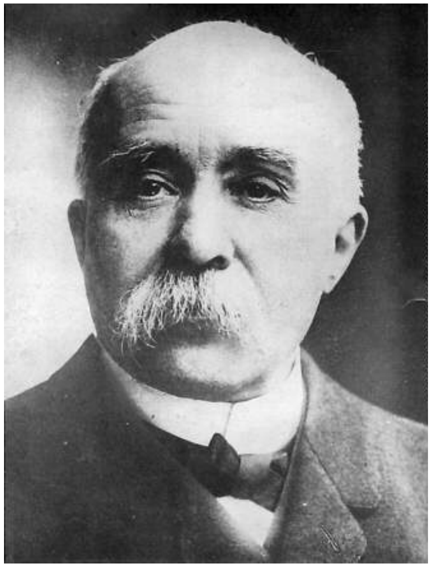
Next steps

- CPS paper got attention; DWP, LibDems, Tories
- House of Lords
- Second paper underway; in search of the retirement income Holy Grail (?)
  - Objective
    - to encourage more people to save more for the long term
  - Radical simplification required
    - Merger of ISA and pension worlds
    - Single unified tax treatment; TEE

    Lifetime savings platform
- Teaser:
  - Tax relief; a social engineering tool
    - Intended purpose?
    - Effectiveness of spend?

Comment from a potential Pensions Minister

- **Waterson – not Clemenceau**



- ***Signed up to the post-Turner consensus***
- ***But consensus – deferral of NEST contributions***
- ***But is NEST the right model?***
- ***Still issues with means testing***
- ***Immediate fast review of process***
- ***Avoid primary legislation – plenty of other things***
- ***Early adoption of auto-enrolment before NEST?***

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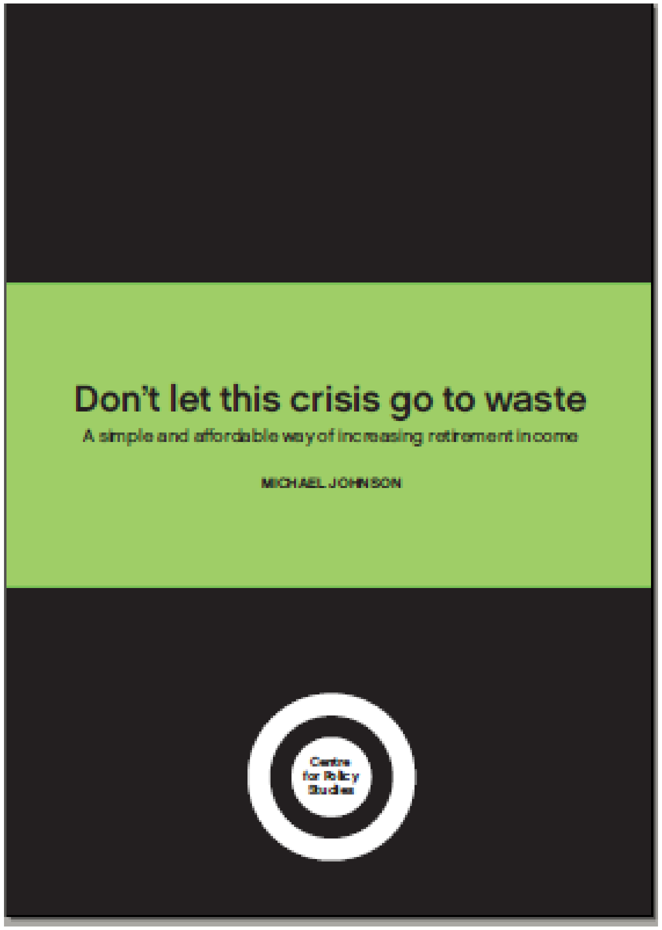

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