



Pensions, Actuaries and Convergence

Prepared by Kevin Wesbroom, Senior Partner, Aon Hewitt

Aon Hewitt
Retirement and Investment

AON
Empower Results®

The UK Pensions System – Events, dear boy, events

- **Events, dear boy, events**

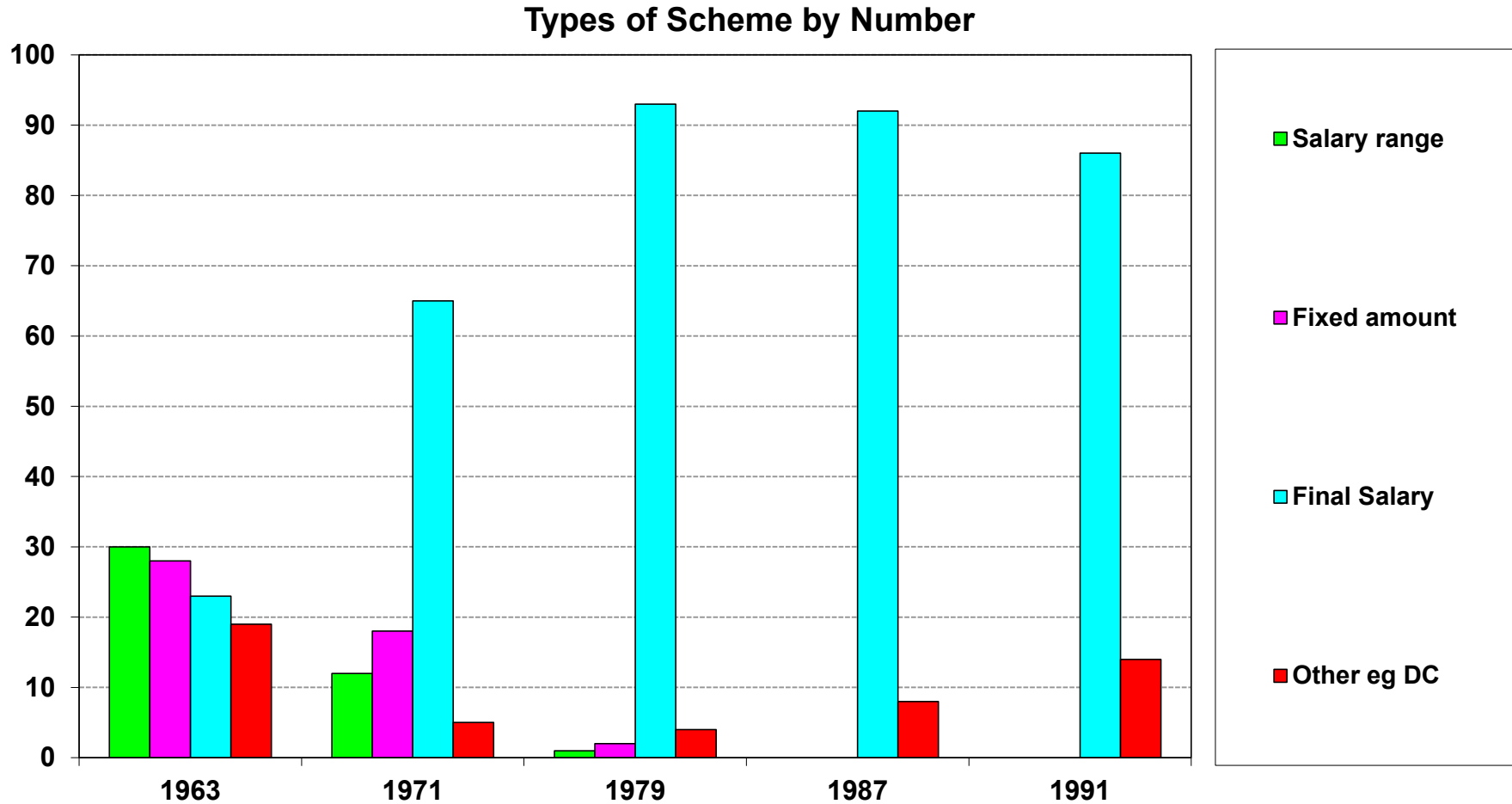
- Response to a journalist when asked what is most likely to blow governments off course.

- **Most of our people have never had it so good**

- But inflation was the country's most important problem of the post-war era.



Changing Pension Designs



Source – UK Government Actuaries Surveys

Never had it so good?

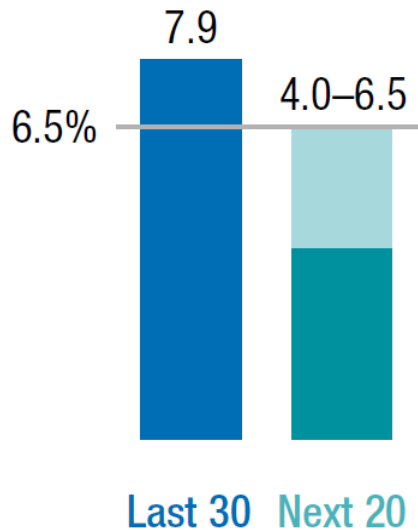
The past 30 years saw returns that exceeded the long-run average

- Historical real returns
- Last 100 years average return

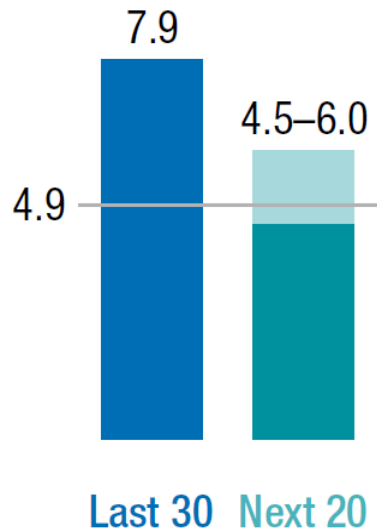
The next 20 years could be more challenging

- Growth-recovery scenario
- Slow-growth scenario

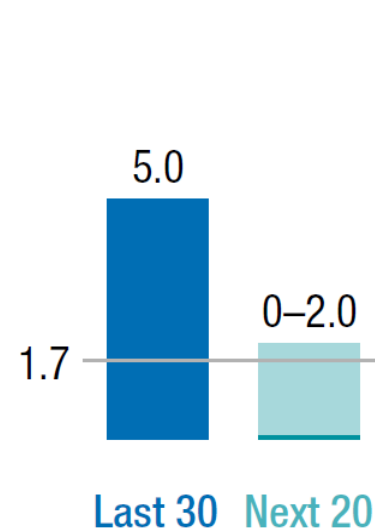
US equities



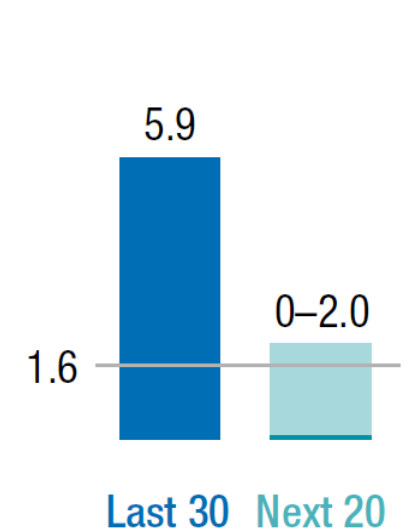
European equities



US bonds

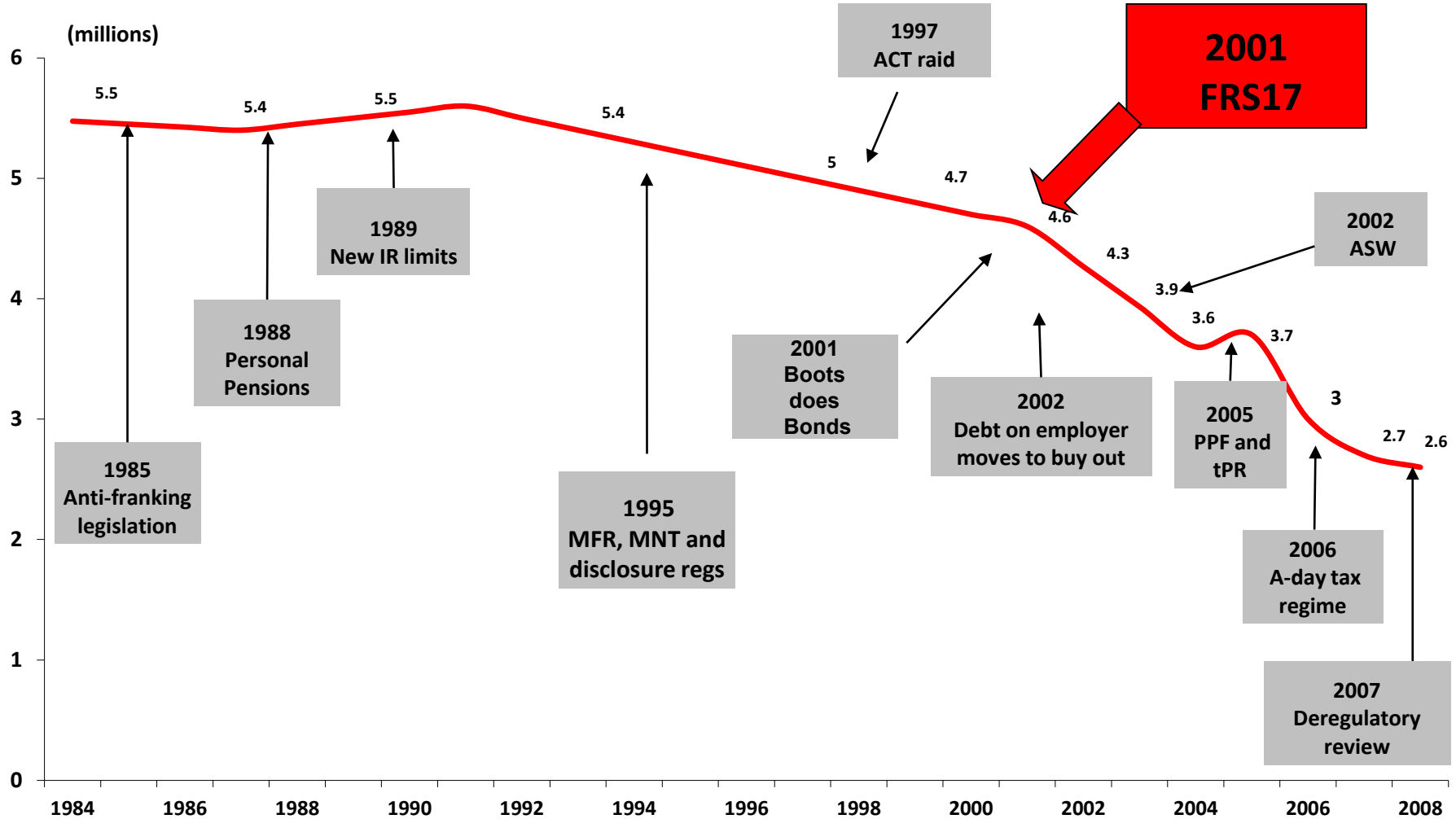


European bonds



Some events and pension changes

Active members of occupational schemes

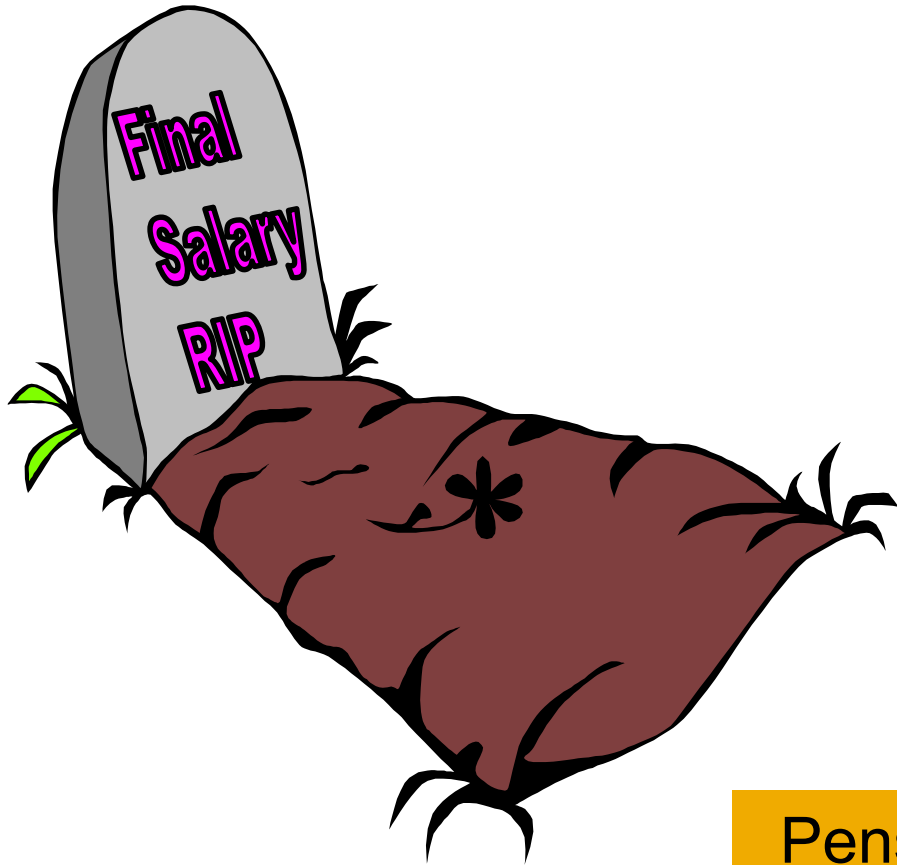


Source: National Association of Pension Funds – now Pensions and Lifetime Savings Association

Accountants



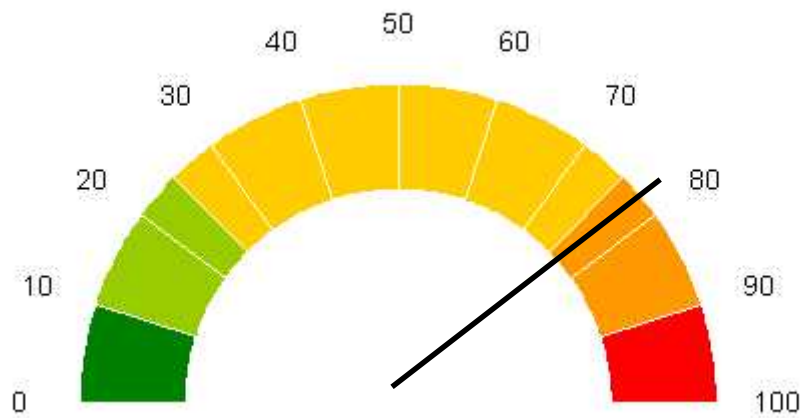
Final Salary Problems



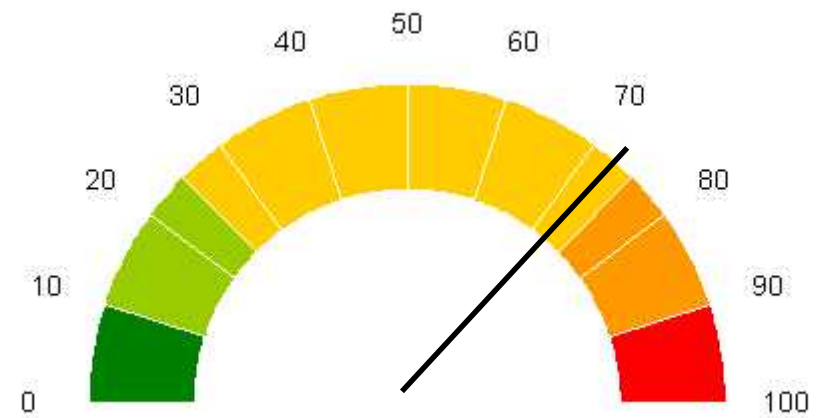
- **Low interest rates**
- **Low investment returns**
- **Pensioners living longer**
- **Tax burden**
- **Compliance costs**
- **Discretions to guarantees**

Pension Risk became the order of the day ...

Tools to quantify pension risk



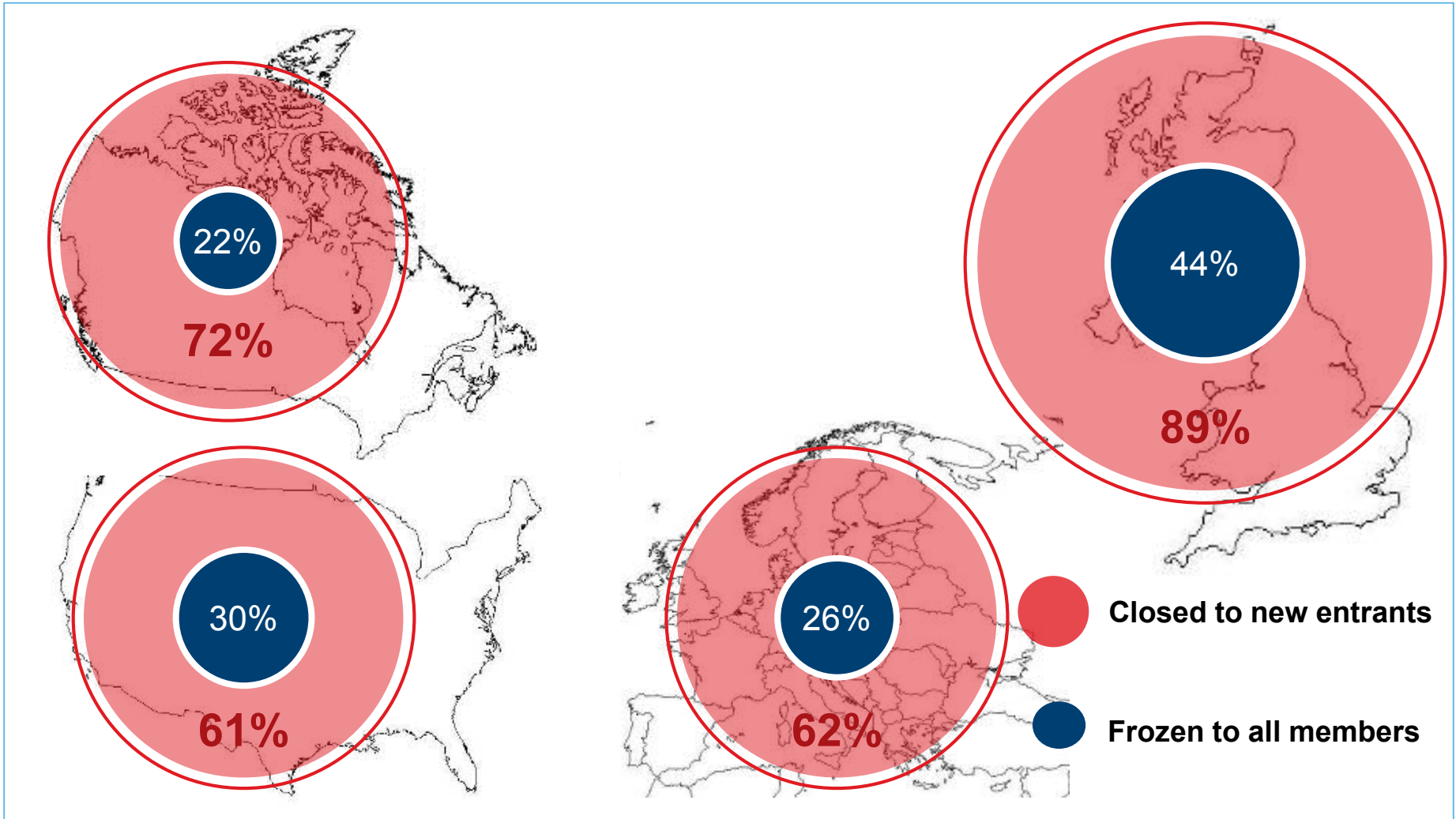
**Balance Sheet
Vulnerability**



Earnings Vulnerability

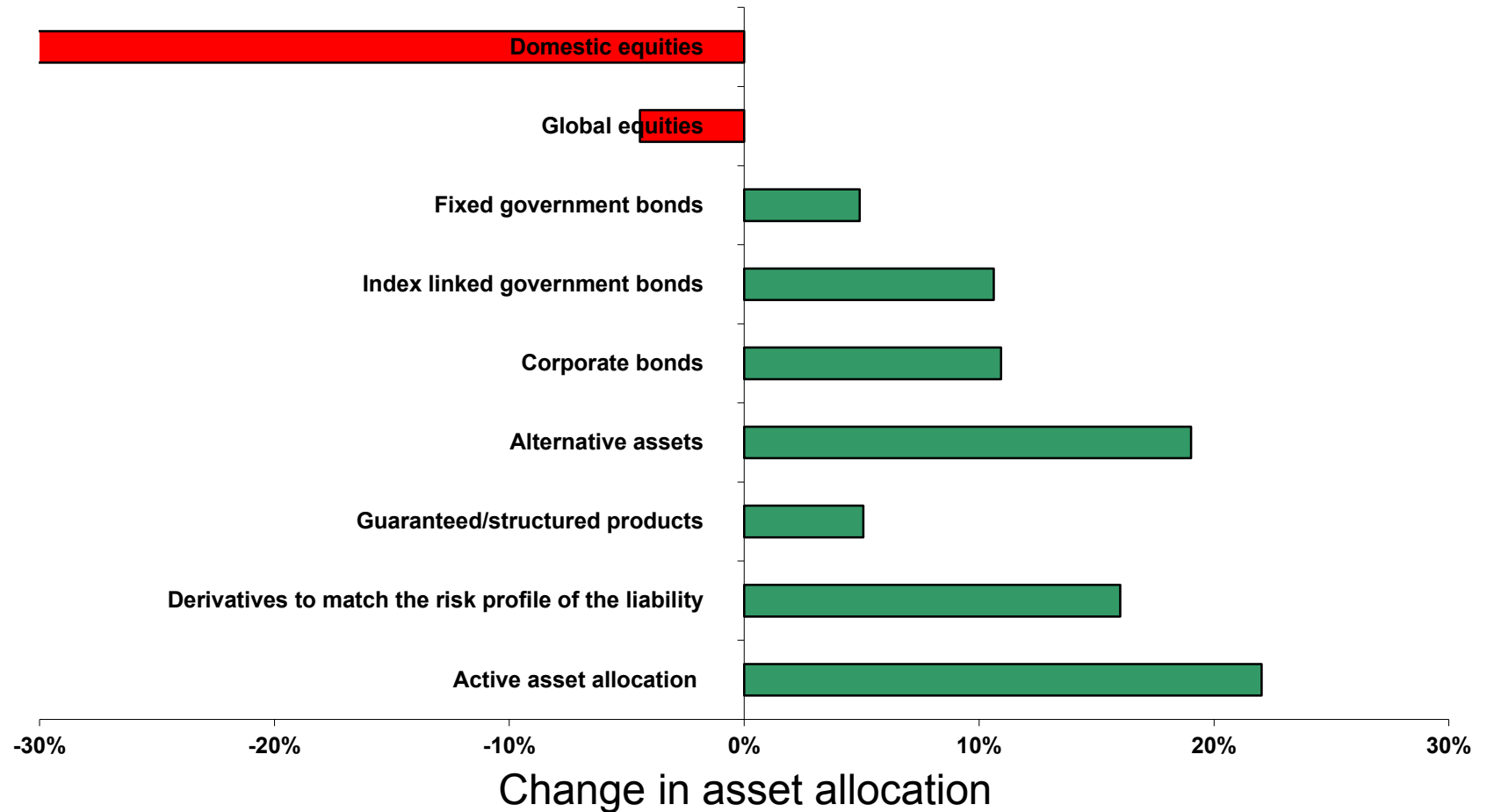
Hewitt launches the Pension Risk Index

UK Quicker to close and freeze

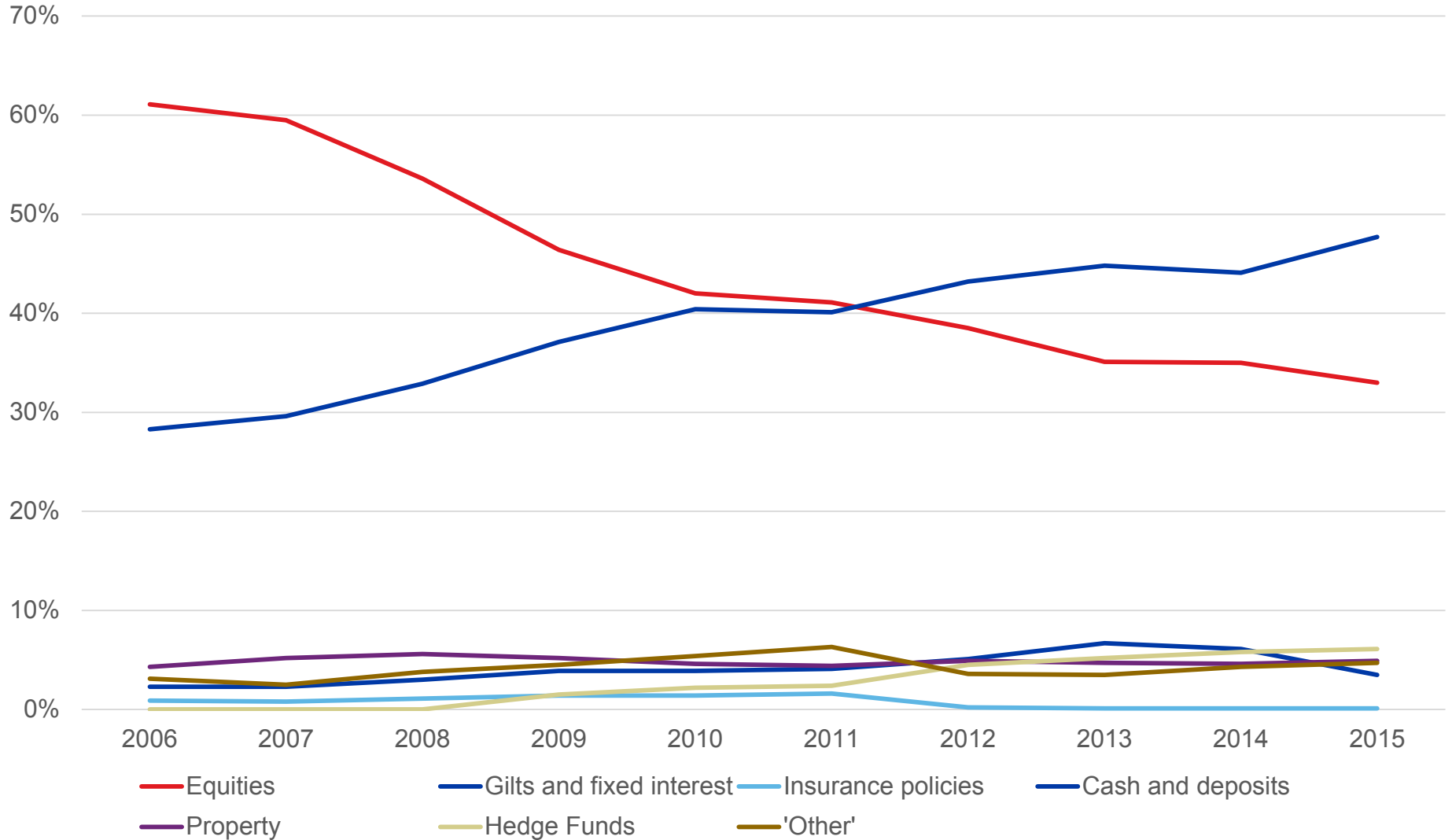


Investment – the Three Ds

De-risking, diversification and dynamism



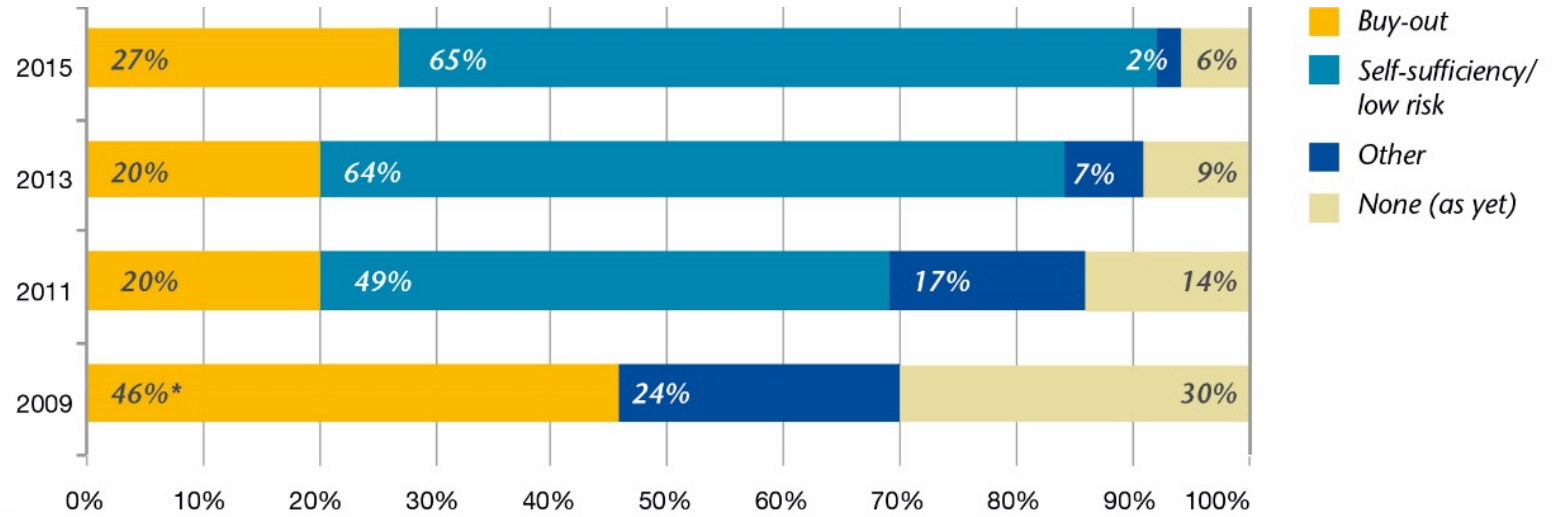
Average UK DB asset allocation



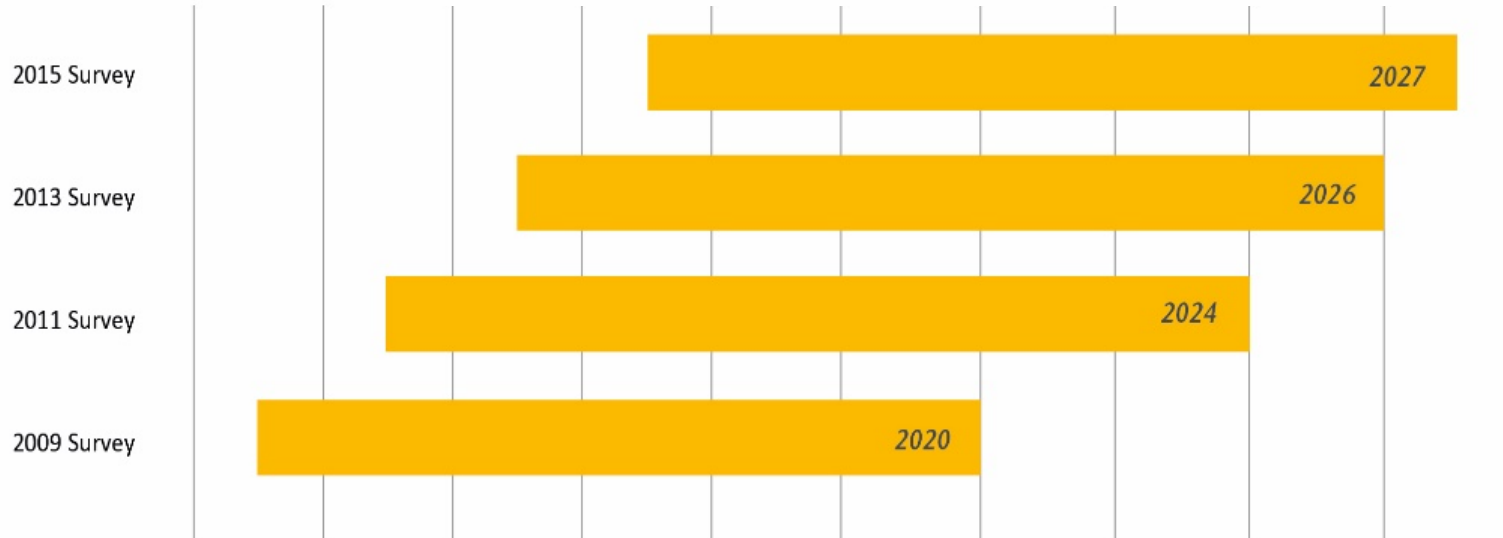
Source: TPR, The Purple Book

And we all want out from UK DB

The vast majority of UK private sector DB plans want a quiet life



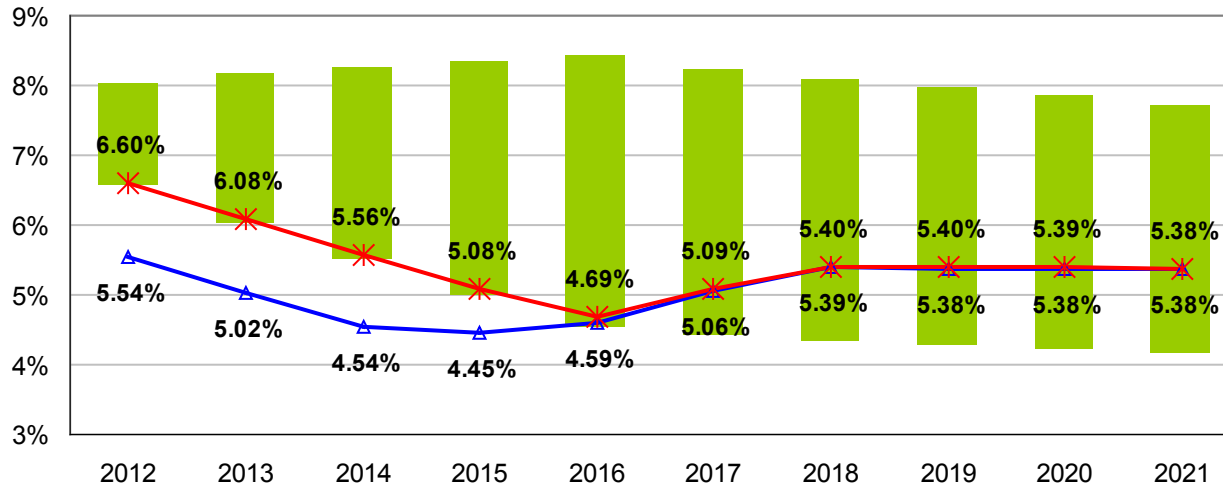
2008 2010



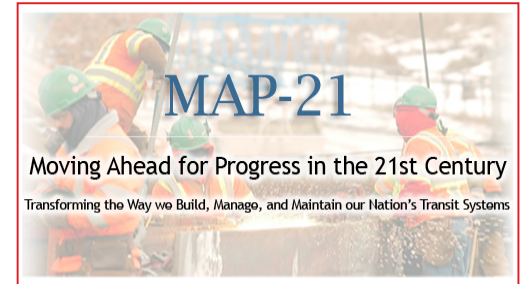
... but the future just keeps getting further away

Source – Aon Hewitt Global Pension Risk Survey – UK 2015

But beware the Changing face of Risk ...



- Corridor for New Interest Rates (based on a 25-year average of interest rates)
- Estimated New Law Interest Rates (must be within the corridor)
- Prior Law Interest Rates



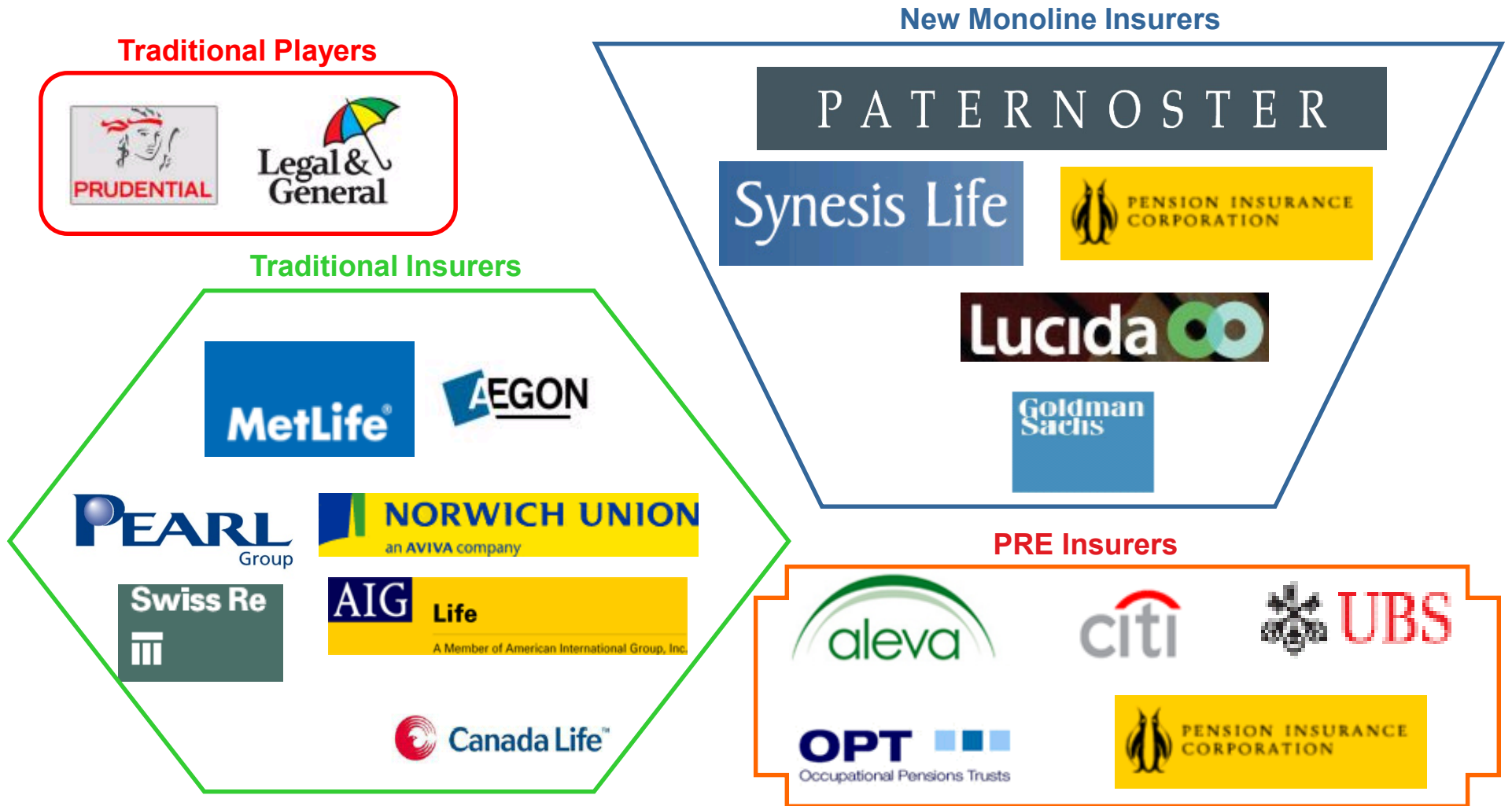
Sweden
Finansinspektionen consults on a "temporary floor" on discount rates

Denmark
Pension funds and insurers use "normal market conditions" of 4.2% UFR

Netherlands
An Ultimate Forward Rate of 4.2% in line with Solvency II

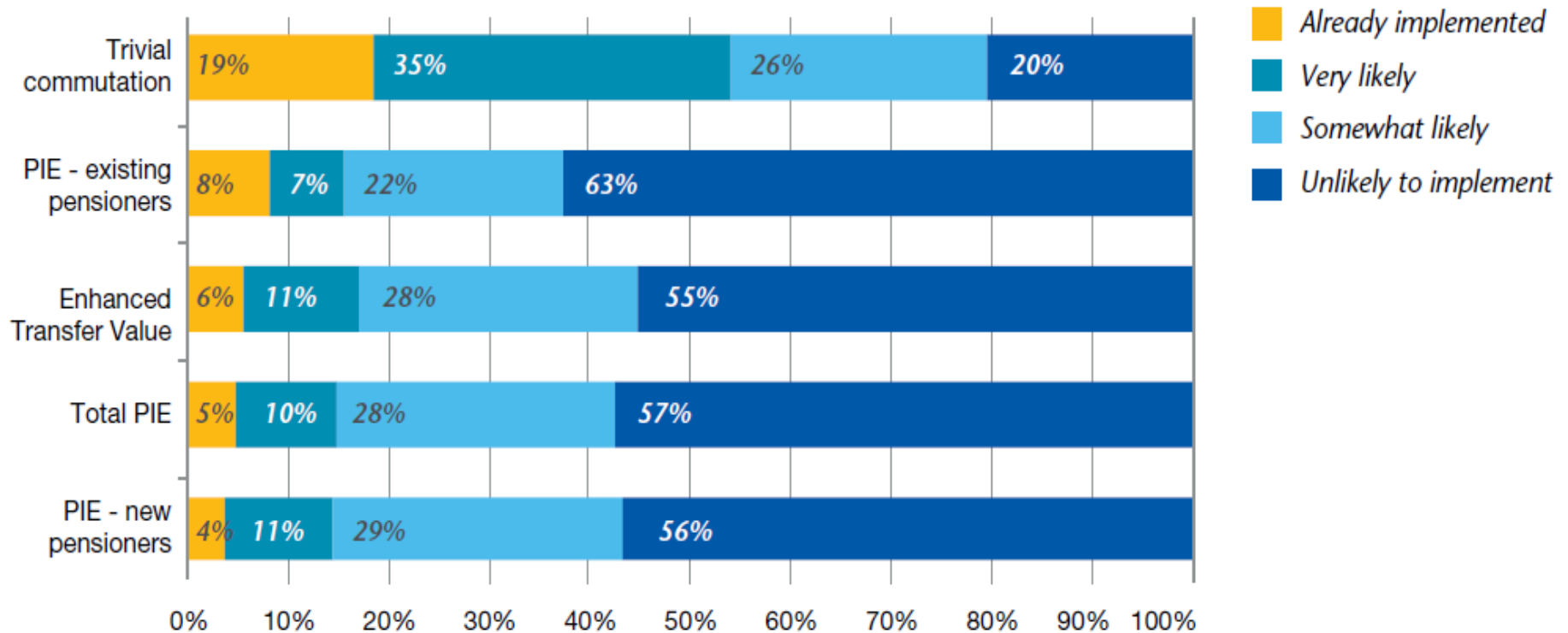
Risk – and the perception of risk – can change
Think – inflation linked government bonds or infrastructure?

Exit planning - convergence with insurance



Exit planning – convergence with individuals??

What is your attitude towards the following strategies over the next 12-24 months?



TLAs rule – PIE, FRO, ETV

Hellish Pension offer you can refuse

Source: Daily Mail, 10 October 2007



Devil is in the detail: firms are offering bribes to former staff

Being fair to members?

INCENTIVE EXERCISES FOR PENSIONS

A CODE OF GOOD PRACTICE

VERSION 2 - JANUARY 2016 (MARK UP)

www.incentiveexercises.org.uk

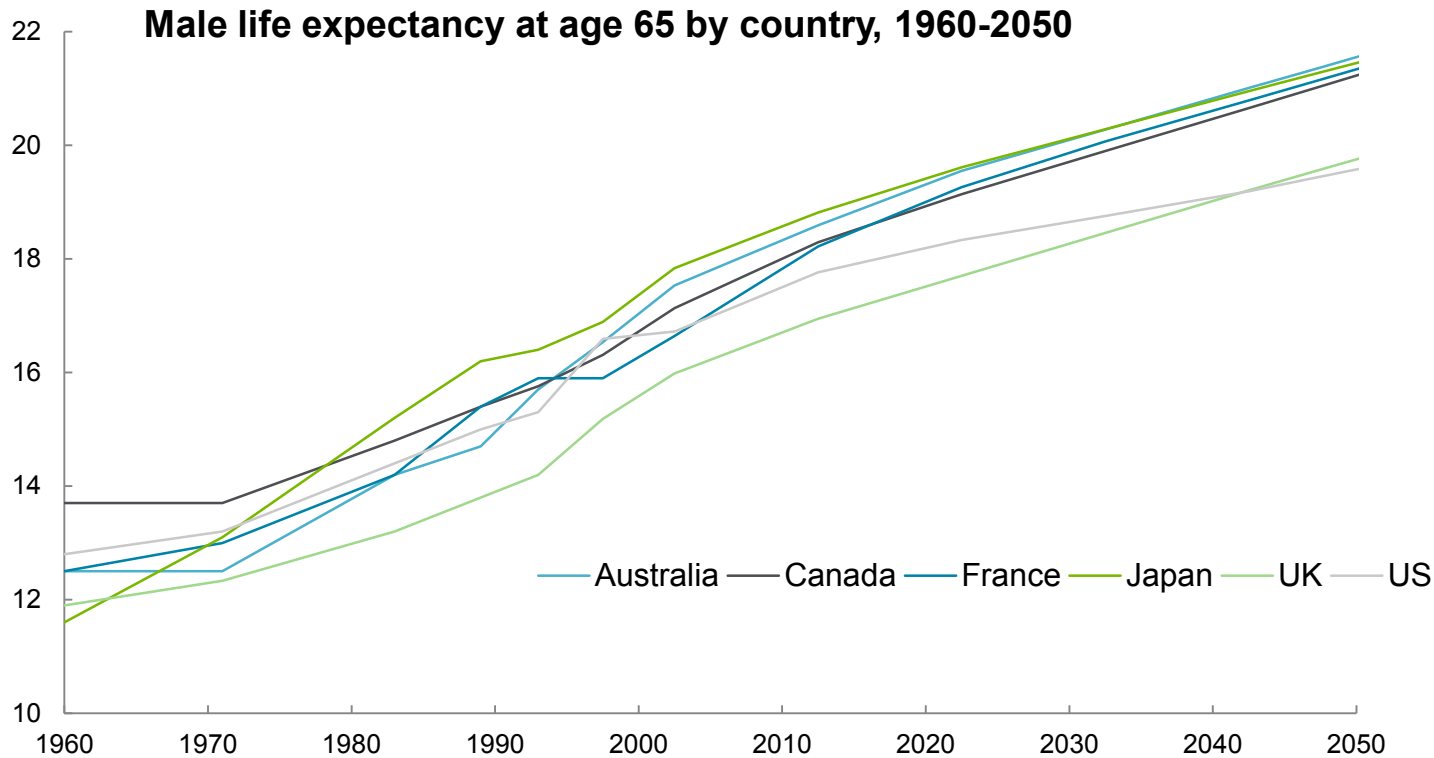
Disclaimer

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Following the Code does not relieve a party of its legal or regulatory obligations and following the Code may not prevent a claim being brought against a party.

- Weeding out the worst practices
 - Cash, cash before Xmas
- But do we know better than members?
 - Personal circumstances – single, poor health
 - UK balanced deal based on interest rates of around 4-6%
 - A Money Advice service report found that 20% of people say they would rather have £200 today than £400 in one month's time?
 - 400,000% per annum – call it hyperbolic!

Behind all of these changes



Source: Historical data on life expectancy OECD Health database 1960-95. Recent data and projections of life expectancy Future based on the United Nations Population Division database, World Population Prospects – The 2008 Revision.



By 2025 the population of China over age 60 will be 288 million. This is more than the population of the US. By 2050 China will have 437 million people over age 60. Old China will have a bigger population than any other country in the world, apart from India

The Toxic Triangle of Pension Compromise

save more



get less

get it later

Personal Life Expectancy – Place the Stone



65

75

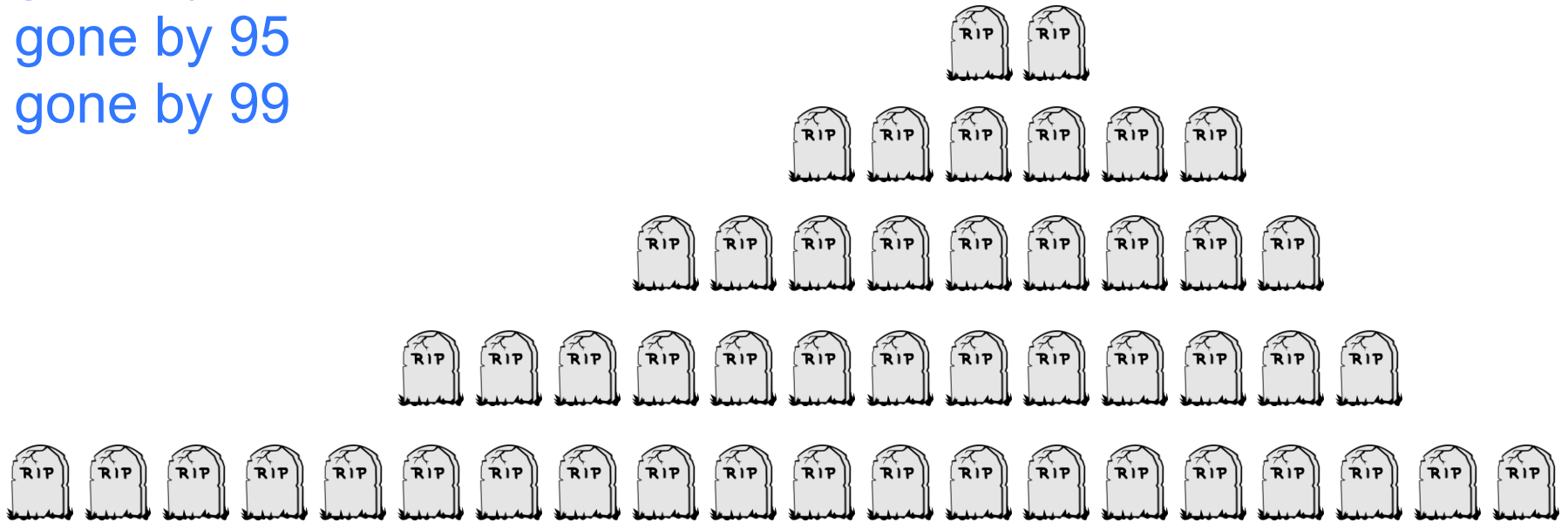
85

95

105

Does this Help ?

25 gone by 89
40 gone by 95
45 gone by 99



65

75

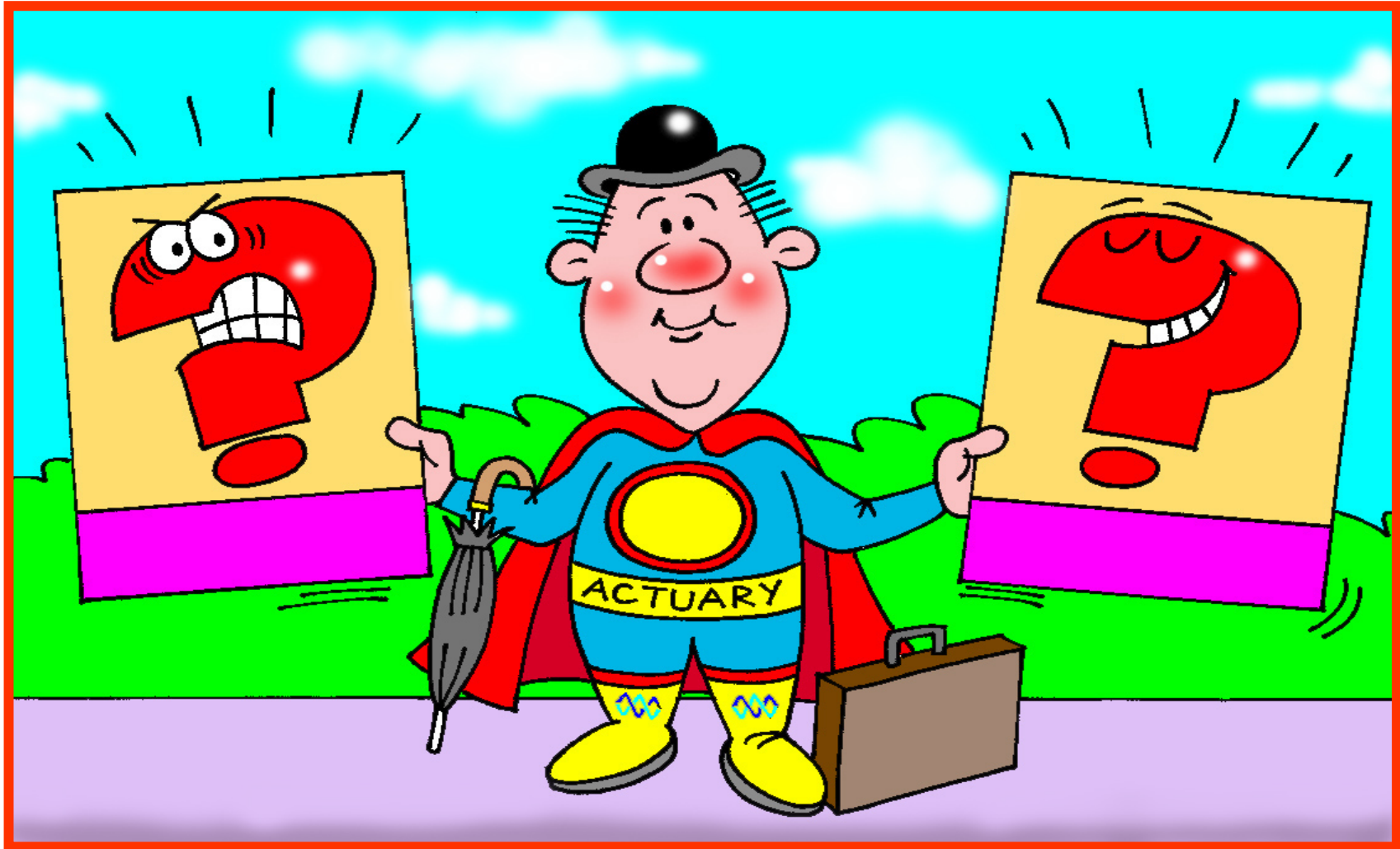
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105

Assumptions: S2PMA – CMI 2013 M YOB 1950 1.5 long term improvement

DC - Threat or Opportunity?



The Changing Role of Actuaries in a DC World ...

Skill Sets

The move from DB to DC will inevitably change the skills required by a pensions actuary. One would expect the changes to be **evolutionary rather than revolutionary**

How do individuals invest?

Behavioural Finance - psychology applied to finance. Gives rise to the new paradigm for DC investment - prospect theory, regret, illusion of control, overconfidence

Threats & Opportunities - Other professions

Professions other than the actuarial profession are also able to advise on many of the needs associated with DC schemes. **The challenge to the actuarial profession will be to demonstrate the unique added value that actuaries can bring to the process**

Threat & Opportunity - Clarity & Simplicity

Actuaries should be seen to champion the public interest by seeking clarity & simplification

Behavioural Finance and Actuaries

The field of behavioural finance looks at how a variety of mental biases and decision making errors affect financial decisions. It relates to the psychology that underlies and drives financial decision making behaviour.

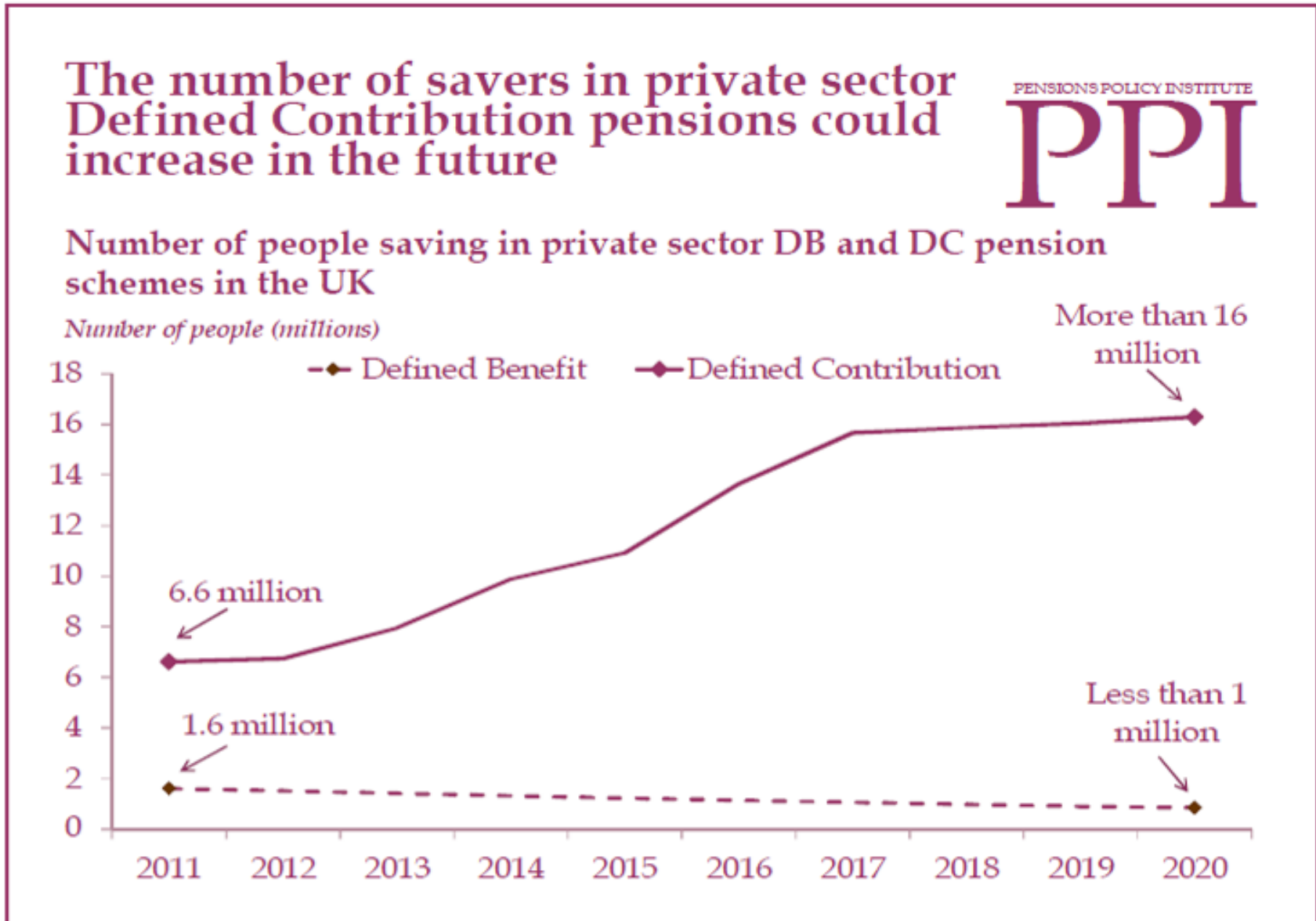
- Institute of Actuaries examiners report 2012

A veritable host of new ideas and concepts

- Heuristics and Bias
- Prospect Theory and Loss Aversion
- Representativeness
- Availability
- Overconfidence
- Status Quo Bias
- Hindsight Bias
- Framing
- Anchoring

A simple example, of anchoring – fold a piece of paper in half ...

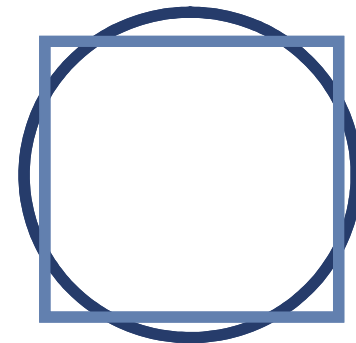
The UK (private sector) future is now firmly DC ...



But did the UK miss a trick with Defined Ambition ??

- Ten Years too Early or Ten Years too Late?
- Legislation on the Statute books – but not enacted
- We could have opted for DB style benefits
 - Target Pension Plan
 - Collective Defined Contribution plan
- The employer pays a fixed contribution rate
- The member gets a Defined Ambition (DB like) Pension
 - Think 1% CARE from State Pension Age
- We square the circle because the DA Pension is conditional
 - Indexation is not guaranteed but targeted (CPI)
 - Even the basic pension is not guaranteed
 - Adjusted to ensure cost stays constant
 - Including benefit cuts

Pension Schemes Bill	
PART 3	
COLLECTIVE BENEFITS	
<i>Introduction</i>	
19	Introduction [j220]
20	Duty to set targets for collective benefits [j223]
<i>Contributions</i>	
21	Payment schedule [j219]
22	Overdue contributions and other payments [j219A]
<i>Investment</i>	
23	Statement of investment strategy [j211]
24	Choosing investments [j211A]
25	Investment performance reports [j212]
<i>Valuation</i>	
26	Valuation reports [j213]
27	Valuation process [j225]
<i>Dealing with deficits and surpluses</i>	
28	Policy for dealing with a deficit or surplus [j214]
29	Deficits attributable to an offence or the imposition of a levy [j224]



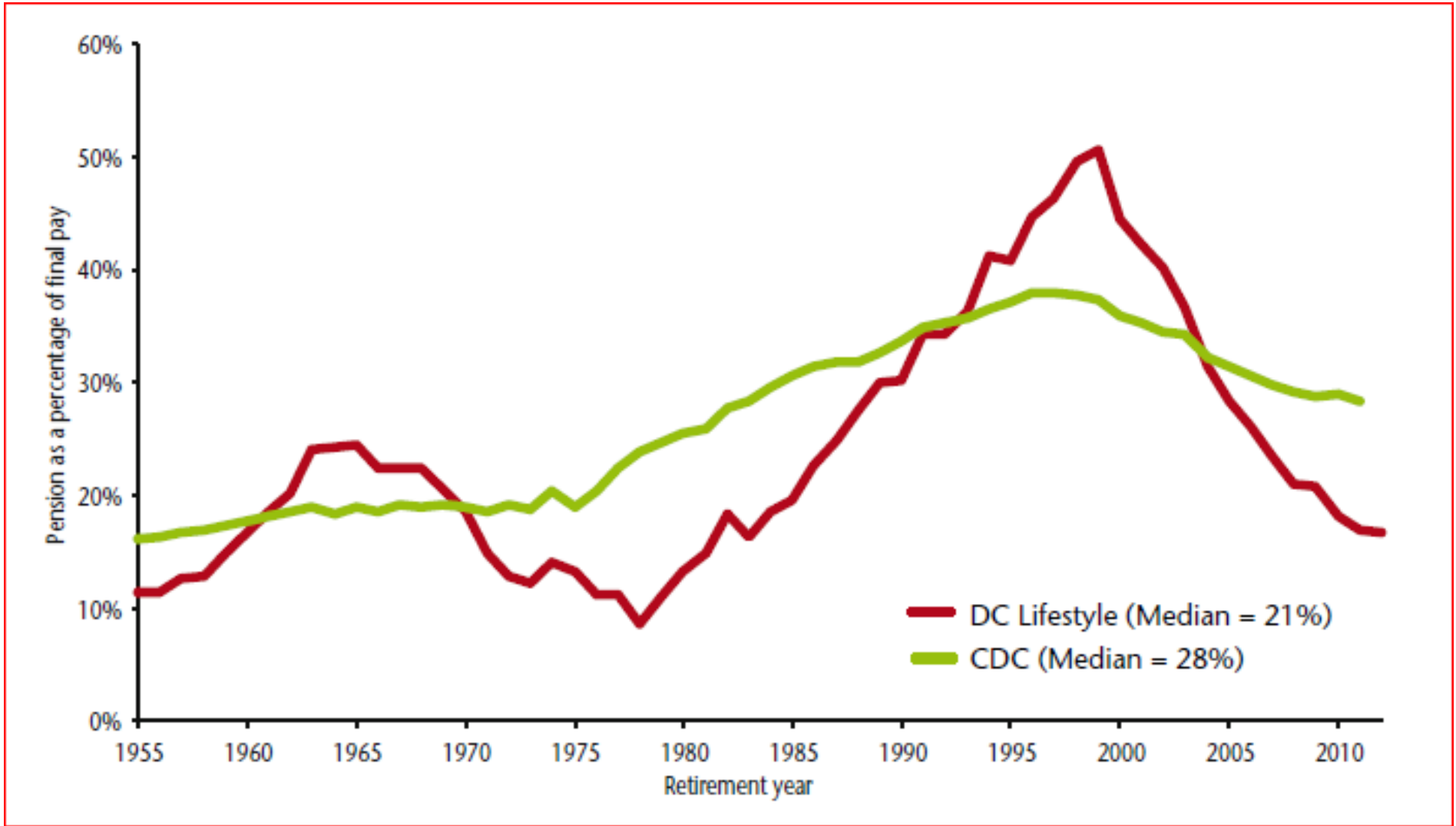
What does DA offer??

- Economies of scale
 - Economies of thinking
 - Benefits of longevity pooling
 - Benefits of timescale
 - Addressing the decumulation issue
 - Addressing account blindness
 - Eliminating the weak link – the member !!!
-
- And it offers ...
 - No guarantees!
 - Intergenerational solidarity (??)
 - Sharing (??)



Defined Ambition – better member outcomes?

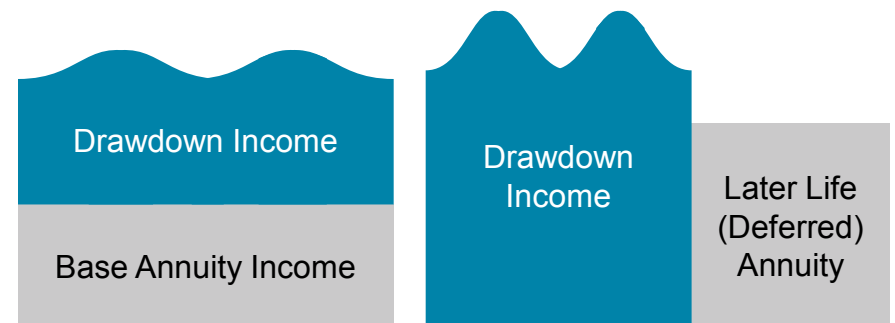
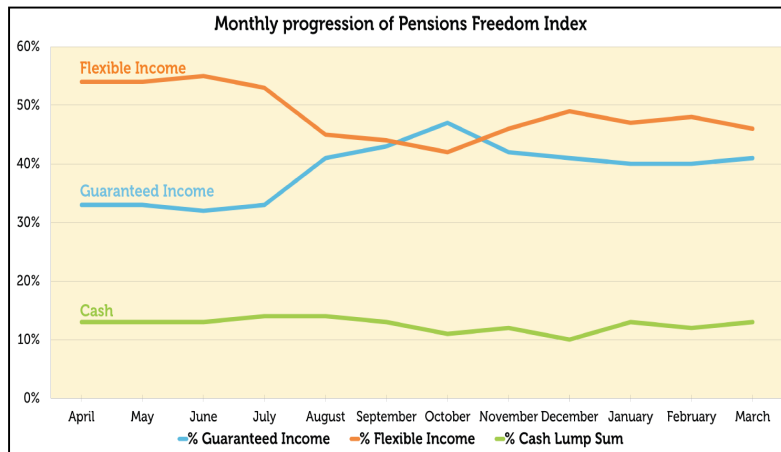
Pension on retirement after 25 years' contributions of 10% of pay to a plan invested in the way shown



George Osborne – pensions surprise merchant



- 100 years of “compulsory” annuity purchase blown away at a stroke
- “Let them buy Lamborghinis”
- Give them 40 minutes of guidance (not advice)



Combined drawdown and annuity strategies may offer optimal at retirement options

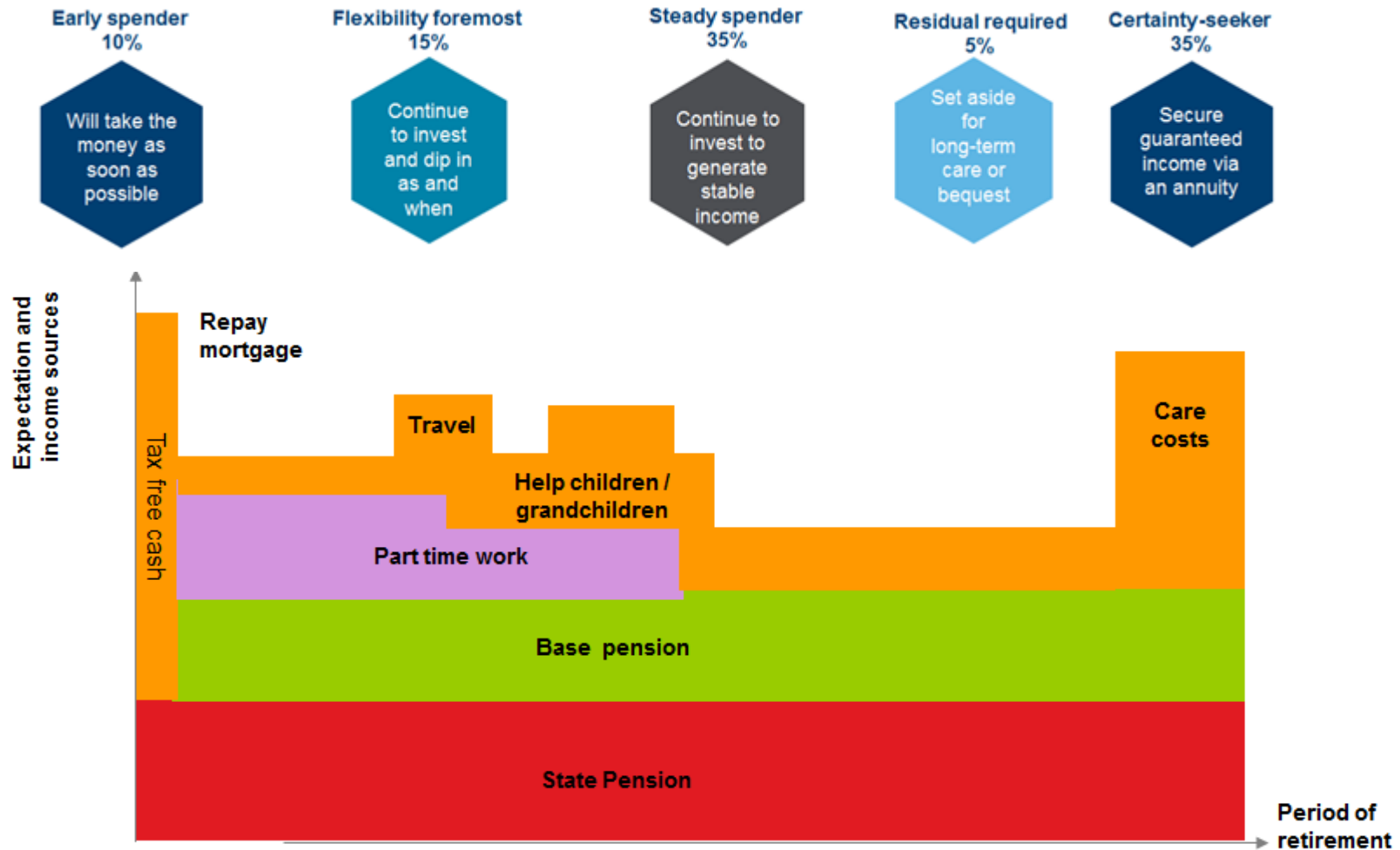
Source: Evaluate

The UK goes from one end of the scale

Country	Primary mode of access	Key determinant of how pots are accessed
Australia ¹¹⁷	Small pots as cash, larger pots are drawn down	Very shallow annuity market, no tradition of annuitisation, tax incentives and means-tested benefits
Chile ¹¹⁸	Flexible, majority annuitise, others use programmed withdrawal	Price – annuities have a government minimum rate and programmed withdrawal products are seen as expensive
Denmark	Flexible, majority annuitise, others use programmed withdrawal	Tax laws ensure that movements into different vehicles are only in the direction of greater certainty
Ireland	Drawdown	Choice Annuities seen as bad value
Israel	Annuitisation	Annuities are good value as they are partially subsidised by government
Singapore ¹¹⁹	Compulsory annuitisation on savings above a minimum amount, with a choice on flexibilities within annuities LIFE Standard Plan and LIFE Basic Plan – the basic plan allows for a lower income with more for bequests	Compulsory annuitisation of funds saved in the compulsory central provident fund
Switzerland	Annuitisation	Annuities are seen as good value – they're largely offered by the pension scheme and the rates are regulated by the government
United States	Drawdown	Tradition of investing through retirement

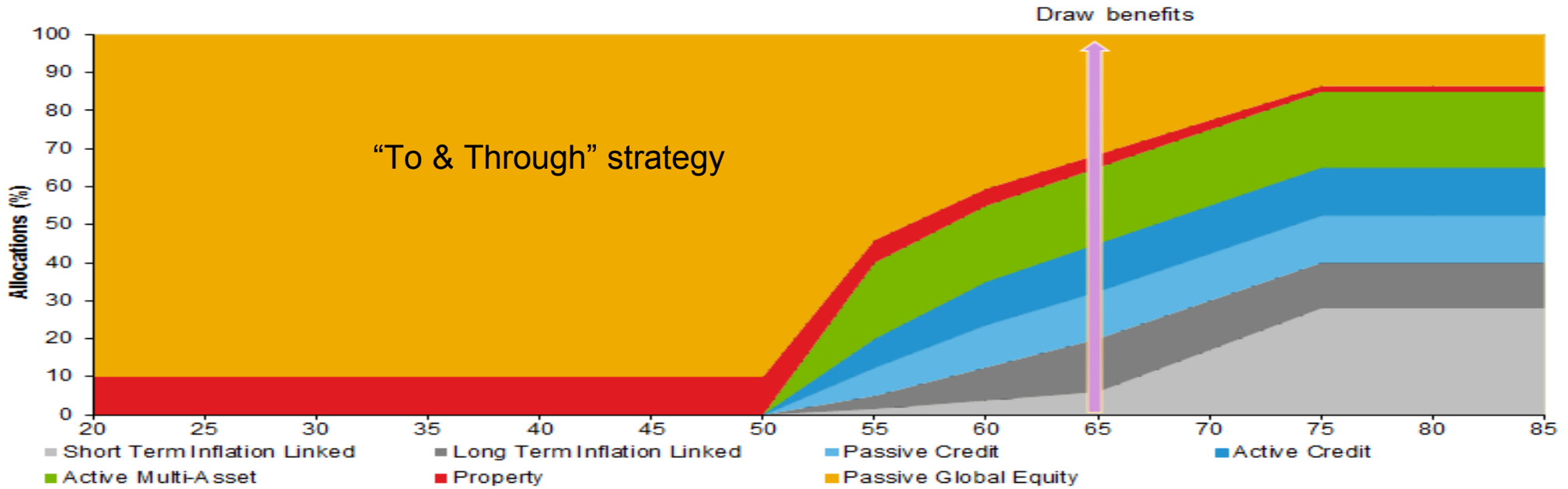
At retirement options – what do members want? What do they need?

How members want to spend their retirement income, compared to how they need to spend their retirement income



Source: UK Aon Hewitt survey with Cass Business School

Changes to DC investment strategy



To & Through

Deferred annuities

Underpin / Value Protection

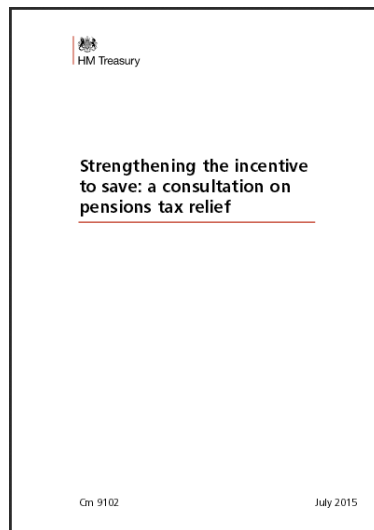
Income Guarantees

Long guarantee period

The market is continuing to innovate

Source: Aon UK Delegated DC service

UK Budget 2016 – he's at it again ...



Even non taxpayers get 25% uplift

HM Treasury

Lifetime ISA

Save up to £4,000 each year, and receive a government bonus of 25% – that's a bonus of up to £1,000 a year. You can use some or all of the money to buy your first home, or keep it until you're 60 – it's up to you.

open a Lifetime ISA account between the ages of 18 and 40, and any savings you put into it before your 50th birthday will receive an added 25% bonus from the government

accounts will be available from April 2017

there is no maximum monthly contribution – you can save as little or as much as you want each month, up to £4,000 a year

the total amount you can save each year into all ISAs will also be increased from £15,240 to £20,000 from April 2017

use it to save for a first home

your savings and the bonus can be used towards a deposit on a first home worth up to £450,000 across the country

accounts are limited to one per person rather than one per home – so two first time buyers can both receive a bonus when buying together

if you have a Help to Buy: ISA you can transfer those savings into the Lifetime ISA in 2017, or continue saving into both – but you will only be able to use the bonus from one to buy a house

use it to save for retirement

after your 60th birthday you can take out all the savings tax-free

you can withdraw the money at any time before you turn 60, but you will lose the government bonus (and any interest or growth on this). You will also have to pay a 5% charge

Bonus stops at age 50

Penalty before age 60 if not used for first time house purchase

Pointmaker

THE WORKPLACE ISA

REINFORCING AUTO-ENROLLMENT

MICHAEL JOHNSON

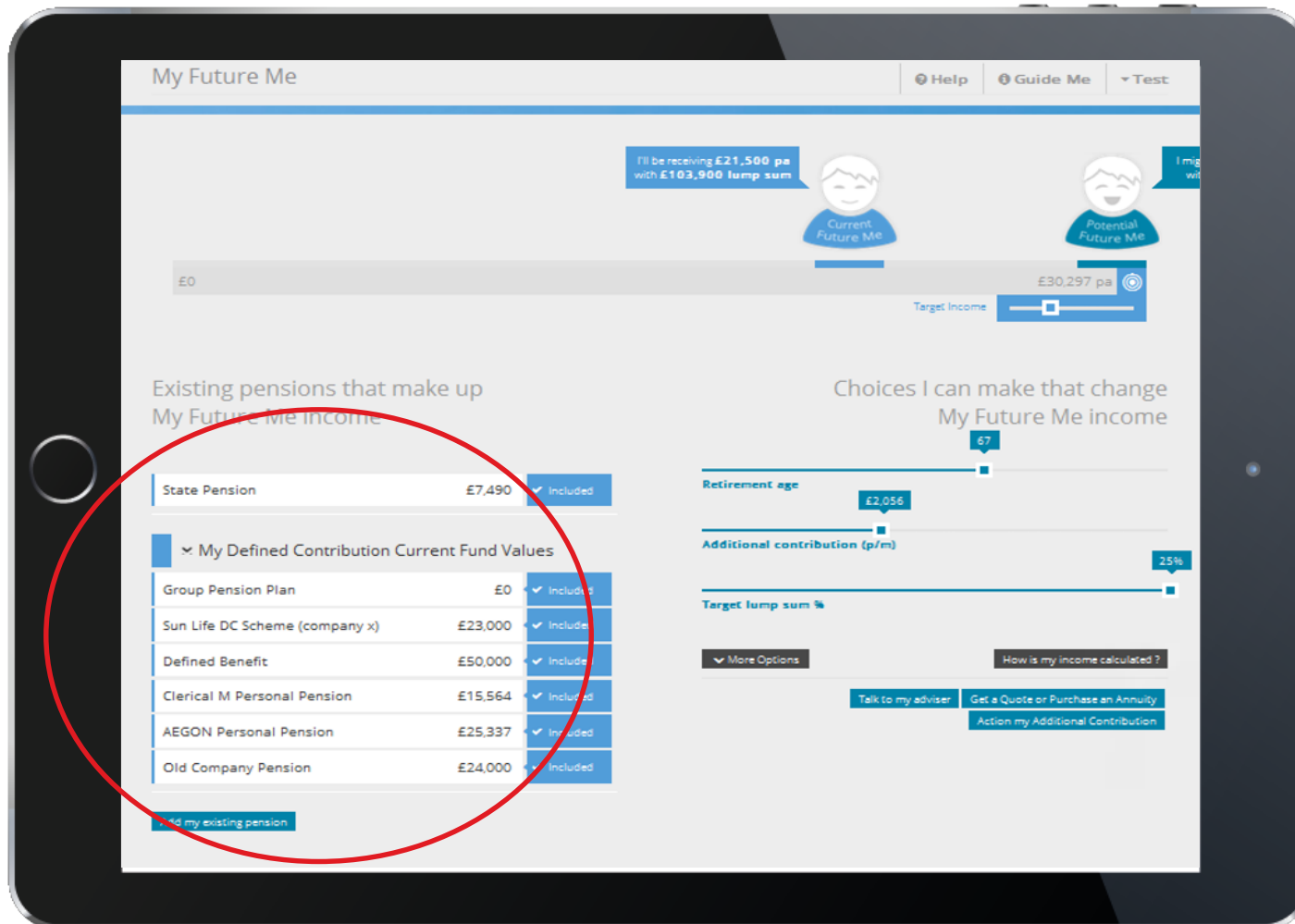
SUMMARY

- Today's workplace savings environment includes some disgruntled employees, a defunct pension industry and an under-saving population deterred from engaging with an industry that is widely distrusted. What employer would surely all parties?
- Following the government's adoption of the Lifetime ISA, this paper proposes the introduction of a Workplace ISA to complement it, and the inclusion of both ISAs in the auto-enrolment framework. This would discourage opt-outs, thereby enhancing employee engagement with savings. The key features of the workplace are summarised overleaf.
- Including the Lifetime and Workplace ISAs within the auto-enrolment framework would enable employees to choose where auto-enrolment (AE) contributions would be accumulated. The choice would be between a Lifetime ISA (employee contributions), a Workplace ISA (employer contributions) and the employer's own occupational pension scheme (all contributions). Auto-enrolled Lifetime ISA contributions would provide employees with the benefit of flexible access, which would likely discourage them from opting out of auto-enrolment. This is important given that within the next three years, employer statutory minimum contributions are set to quagmire. Being in control is closely allied to being motivated (perhaps, in this case, to save more), and therefore engaged.
- Given that more than half of the working age population is ineligible for auto-enrolment, including 25% of employees, the DWP should sponsor a Workplace ISA for them, perhaps delivered through NEST. NEST should of course, be exposed to private sector competition.
- NICs reflect on employer contributions goals to shareholders rather than savers; employees are oblivious of it. Consequently, as an incentive to encourage individuals to engage with saving, it is ineffective. NICs relief should be rededicated as the 25% bonus, paid directly into the employee's Lifetime and Workplace ISAs. Thus viable, it would be more appreciated by the individual.

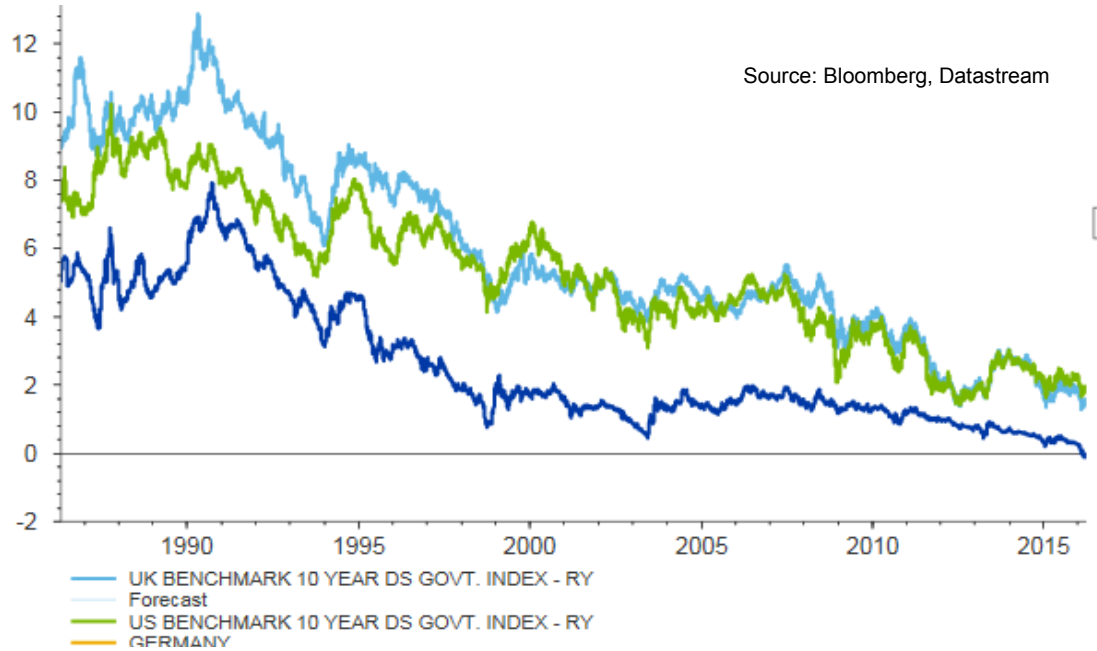


A Pensions dashboard – or better still a savings dashboard

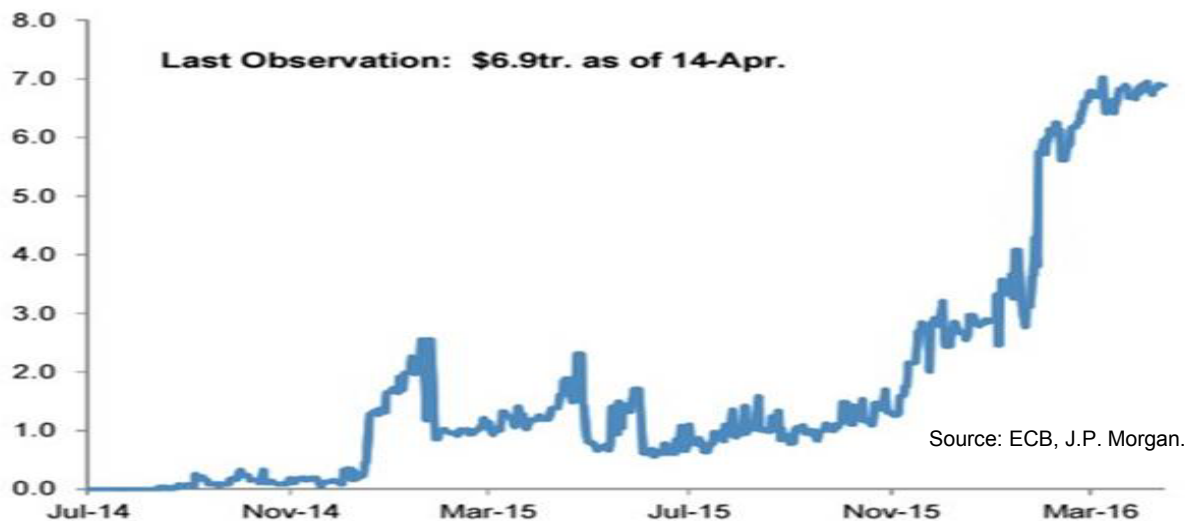
The government will “ensure the industry designs, funds and launches a pensions dashboard by 2019.”



Recent market factors have been quite extraordinary



Bond yields have been falling for more than 20 years.



The volume of bonds trading with negative yields reached \$6.9 Trillion as at April 2016.

And now events rear the ugly head again



11,000 jobs
20,000 pension fund members



15,000 jobs
130,000 pension fund members

I remain optimistic about our future



Biography and Disclaimers



Kevin is an experienced pension consultant who has been advising high profile clients for over 40 years. He is a qualified scheme actuary who has been involved with many different aspects of pension, investment and broader employee benefits, including the establishment of the Aon Hewitt UK Defined Contribution team. He was the inaugural UK lead for Global Risk Services, a fusion of actuarial and investment skills designed to help clients make sense of rapidly changing investment markets and new risk driven solutions, as they guide their plans to a more stable future.

He continues to act as pension adviser on a limited number of client assignments and one off references. He is practicing what he has been preaching about phased retirement by working four days a week. He still harbours an ambition to transform the UK pensions landscape, by making Collective Defined Contribution plans a reality; but just in case they do not materialise, he is also working on introducing a DC mastertrust with an in-built decumulation solution to the market.

The author's views are his alone and Aon Hewitt reserves the right to dissociate itself completely from any old drivel he spouts ...

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