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MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

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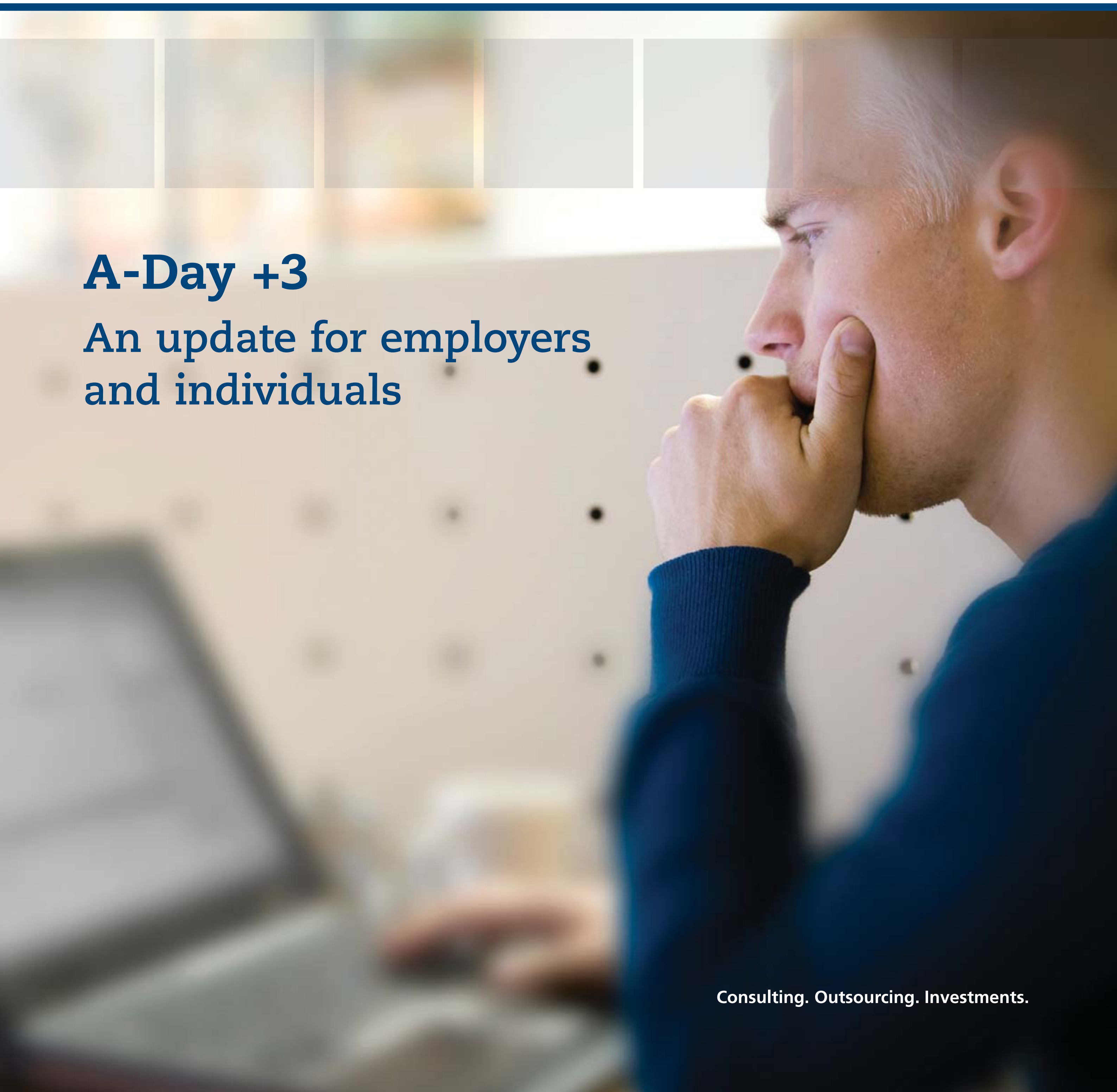


A-Day +3

An update for employers and individuals

Consulting. Outsourcing. Investments.

Introduction

As we approach the third anniversary of the pension taxation changes introduced on 6 April 2006 (A-Day), now is an important time for employers, as well as for individuals who have built up significant pension entitlements, to review their pension arrangements. The 2006 legislation introduced the concept of a Lifetime Allowance (£1.65 million for the current 2008/09 tax year) which, if exceeded, would result in the application of a penal rate of taxation.

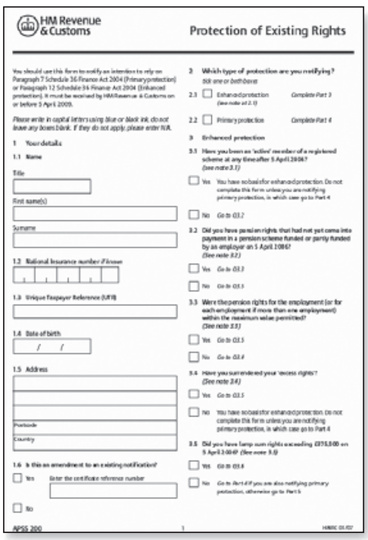
Individuals who intend to take advantage of the transitional protection rules enacted at A-Day must plan ahead so they can take action by 5 April 2009 in order to avoid adverse tax consequences.

What actions are required from individuals?

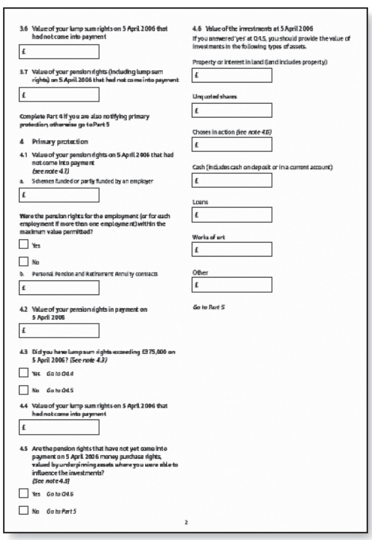
Individuals who have built up significant pension entitlements may be eligible to take advantage of the transitional protection rules introduced in the A-Day legislation. For those eligible, the transitional protection rules mean they will pay significantly less tax when they bring their pension benefits into payment. Tax is always something best (legally) avoided – especially when the associated marginal tax rates are currently a punishing 55 percent!

Individuals seeking to apply for transitional protection must complete form APSS 200 and submit it to Her Majesty's Revenue & Customs (HMRC) by 5 April 2009. Failure to complete the form properly and on time will result in adverse tax consequences.

Form APSS 200


HM Revenue & Customs

Protection of Existing Rights



Individuals will need to allow plenty of time to complete the APSS 200 form because detailed information is required for all their pension entitlements as they stood at A-Day. This includes entitlements from pension benefits earned with previous employers as well as from any personal pension arrangements. In some cases it can take a long time to obtain this information from scheme administrators.

While the APSS 200 form includes supporting instructions, there are several areas where it is easy to make a mistake. Completing the form incorrectly could potentially give rise to future tax charges that might otherwise have been mitigated. Mercer's specialists can assist individuals to collate the necessary information and complete the form properly.

Individuals may wish to revisit their post-A-Day strategy

In the period leading up to A-Day, many people who had built up significant pension entitlements took professional advice with a view to optimising their tax-efficient pension savings.

This advice was arranged either by their employer at the time or by the individuals themselves. Emerging from this advice might have been a strategy that considered:

- The additional level of savings required to meet their retirement objectives;
- The optimal time at which to bring their pension benefits into payment;
- The merits of opting-out of pension provision, normally in favour of a salary supplement, if appropriate; and
- The decision on whether to apply for primary protection, enhanced protection or both under the transitional protection rules.

In particular, this advice would have been based on personal circumstances at A-Day taking into account the individuals' retirement objectives (such as their preferred retirement age and the form in which they wish to take their benefits) and assumptions such as future investment returns, salary growth and inflation.

Since A-Day, circumstances have changed dramatically – investment returns have been tremendously volatile (the FTSE 100 Index has fallen considerably), and market expectations for inflation have increased significantly. In addition, actual salary

growth may have turned out to be different from that assumed in 2006. HMRC has also subsequently clarified some of the more complex issues around transitional protection and the Lifetime Allowance.

As a result of all of this, now is an opportune time for individuals to revisit their post-A-Day pension strategy to ensure their previous decisions remain optimal – and, if not, make appropriate adjustments. By revisiting their post-A-Day strategy well in advance of 5 April 2009, individuals can also ensure that their HMRC forms are completed to correctly reflect their desired strategy.

CASE STUDY 1

At A-Day, Paul was actively participating in a defined benefit (DB) scheme and had built up accrued pension rights under that scheme worth £1.8 million. In addition, he had pension rights worth £1.0 million on a defined contribution (DC) basis from his prior employment. Based on this information and strong expectations that he would soon receive a significant promotion and associated pay rise, Paul decided to opt out of his employer's DB scheme and instead receive a salary supplement. As part of this decision, despite being able to apply for both forms of protection, Paul opted simply to apply for enhanced protection under the transitional protection rules, because of his strong expectation of significant future pay rises.

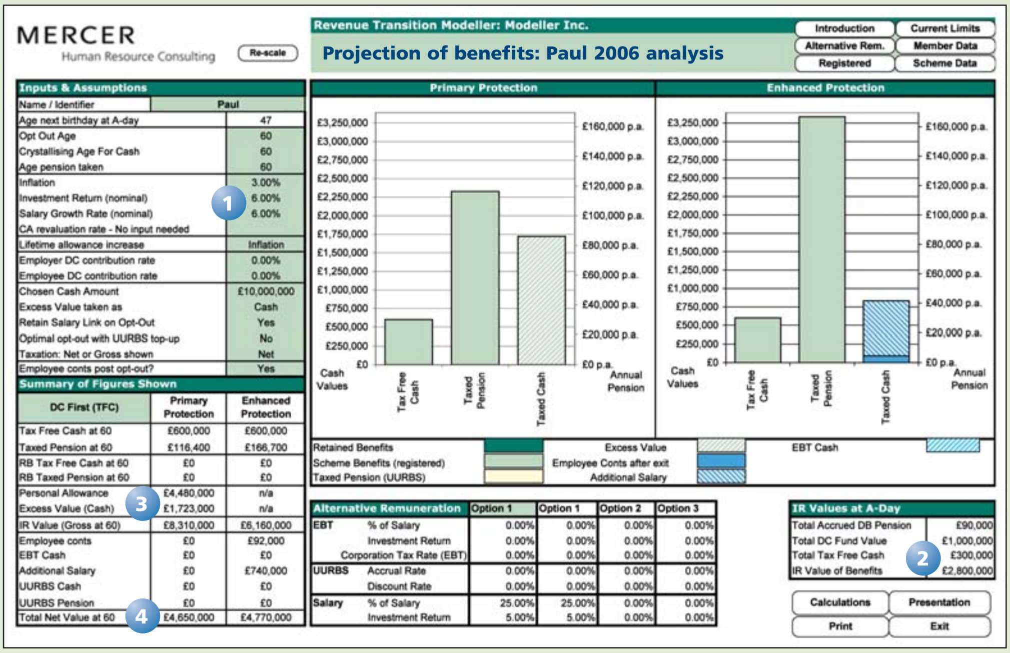
Since A-Day, Paul's DC entitlements have lost 30% of their value, he did not receive his promotion and his salary has not increased at the rate that he had expected. Additionally, increases in inflation expectations and life expectancy mean that the cost of securing a pension from an insurance company has risen. After taking these events into account, Paul decides to opt back in to his employer's DB scheme and apply for primary protection instead. In reviewing his strategy well before 5 April 2009, Paul is able to change his original decision and, by doing so, can now make additional voluntary contributions to increase his tax-efficient pension savings.

Turn to the next page to see how the *Mercer Revenue Transition Modeller* helped in this case.

How the Mercer Revenue Transition Modeller helped

Before A-Day

Paul met with a Mercer consultant before A-Day to discuss his post-A-Day pension strategy. Using the Mercer Revenue Transition Modeller, Paul explores various retirement scenarios based on his views about the future. He is interested in retiring at age 60.



1. At A-Day, Paul anticipated significant future salary increases due to anticipated promotion (6% each year in this case).

2. The value of his pension benefits at A-Day was £2.8 million, so he was eligible to register for both primary and enhanced protection.

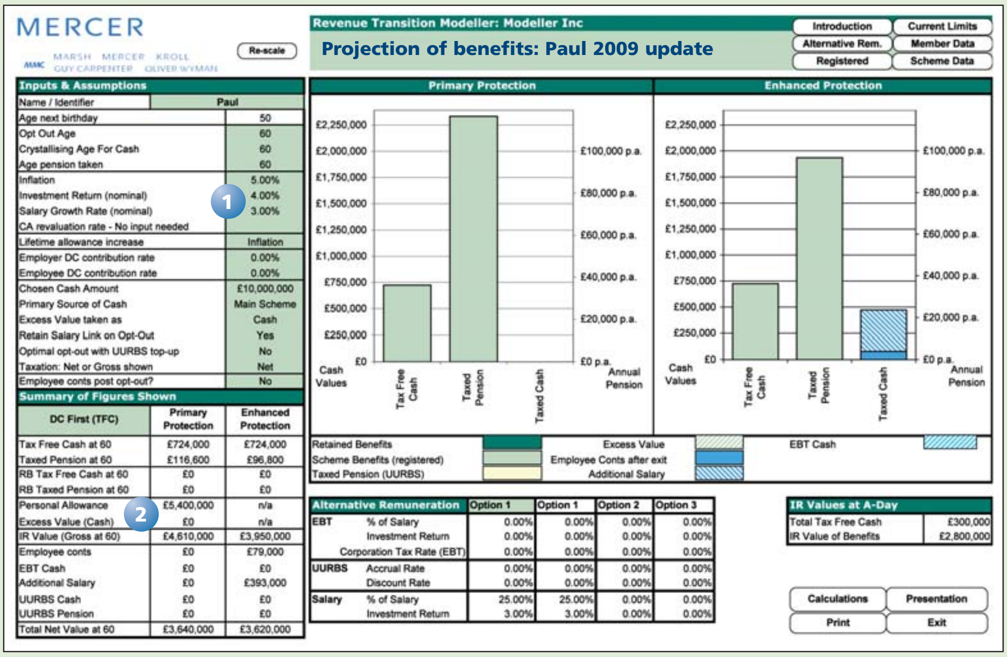
3. If he registered for primary protection and continued to build up benefits in the DB pension scheme until retirement at age 60, he would find that the value of his benefits (£8.31 million) would then exceed his estimated Personal Lifetime Allowance of £4.48 million. A 55% tax charge of £2.11 million would be due on the excess amount, leaving him with a net excess value of £1.72 million.

4. Based on the assumptions made and the salary supplement available, enhanced protection looked the more favourable, in terms of the overall net value of the package, and Paul completed and submitted his APSS 200 form to HMRC on that basis.

Almost three years later

Paul's Mercer consultant calls almost three years later to ask whether he would like to reassess his post-A-Day pension strategy before it is too late. Using the Mercer Revenue Transition Modeller, Paul revisits the same retirement scenarios but, this time, he allows for actual experience since A-Day.

Paul's promotion did not happen and his pay has remained relatively stable. In addition, his DC funds have fallen by around 30% in value. As a result, the assumptions he made at A-Day have not been experienced in practice.



1. Paul now anticipates lower future salary increases and investment returns but higher future inflation.

2. Under the primary protection projection scenario, Paul no longer faces a penal tax charge on his benefits on retirement at age 60. He now has scope to make further pension contributions to maximise his tax-efficient pension savings. Based on the assumptions made, accumulated savings of £790,000 (i.e. £5.40 million – £4.61 million) may be made before age 60. Therefore, Paul decides to register for primary protection, re-submits his APSS 200 form on that basis, and opts back in to the scheme.

CASE STUDY 2

At A-Day, Jane was aged 46 and had been a member of a generous defined benefit (DB) scheme for many years. She had accrued pension rights under that scheme worth £2.2 million. Jane expected to remain with her current employer until she reached her normal pension age of 60. Jane considered registering only for primary protection and staying in the DB scheme. However, following help from her Mercer consultant, it became clear that the projections indicated that she would be subject to a large tax charge because her benefits would exceed the Lifetime Allowance. Based on this information and taking account of the alternative salary supplement provided by her employer, Jane decided to opt out of the DB scheme and receive the salary supplement available. As part of this decision, Jane opted to apply for both enhanced and primary protection under the transitional protection rules (known as "enhanced dormant primary" under the new jargon).

Two years later, Jane (now aged 48) learns that her employer is likely to begin a voluntary redundancy programme over the course of the next two years. Jane is considering taking advantage of this redundancy programme and the ability to retire early before the new minimum retirement age (55) is introduced on 6 April 2010. If she does not retire before 6 April 2010, when she will be 50, she will have to wait until April 2015 before she can draw her pension benefits. Jane therefore decides to explore the possibility of retiring on 5 April 2010. Under the terms of the DB scheme, her pension at age 50 would be reduced by 40 percent to reflect its early payment and, therefore, the HMRC value of her pension entitlement would decrease. Jane would now no longer be affected by the Lifetime Allowance on early retirement. In addition, Jane would also be able to allocate some of the redundancy package into the pension scheme to increase her tax-efficient pension savings. After considering this option, Jane decides to revoke her enhanced protection application and opt back in to her employer's DB scheme, thus falling back on her primary protection election.

How can Mercer help individuals now?

Mercer is able to provide advice and assistance far beyond just completing the APSS 200 form. Mercer's "A-Day +3" specialists, who have a strong background in retirement and personal financial planning, work with individuals to help them revisit their post-A-Day strategy and ensure that the optimum approach, tailored to their personal circumstances and objectives, is in place.

These specialists are also able to call upon the expertise of Mercer's technical research team and other colleagues who have experience in advising companies and scheme trustees on issues arising from the 2006 legislative changes.

Using our interactive tool, the *Mercer Revenue Transition Modeller*, our specialists are able to project outcomes under a number of different "what if" scenarios. This enables the individual to confirm whether his or her current strategy is appropriate or, if not, to develop a new strategy.

Opportunities for employers

A-Day +3 is an excellent opportunity for employers to revisit their post-A-Day strategy (or, alternatively, develop one if it is not already in place), to ensure that their retirement provision continues to make a positive contribution towards their reward programme and that it is competitive, attractive and tax-efficient for both existing employees and new recruits at a senior level.

This does not need to be a costly proposition for employers. For instance, offering employees who are impacted by the Lifetime Allowance (or who are, in the fullness of time, expected to be), the opportunity to opt out of the pension scheme and instead receive a salary supplement can be a win-win situation for both the employer and employee. The employer can limit their exposure to DB pension risk, and the employee can limit their exposure to a marginal tax rate currently at 55% in retirement.

Mercer specialists are able to help employers in this regard, having managed similar projects for many companies from small firms to FTSE 100 companies and other large employers.

Ongoing advice for individuals

The two case studies discussed demonstrate how changes outside an individual's control give rise for the need for their developed strategies to be dynamic. Individuals should be alert to changes in both personal and external circumstances so they can take appropriate action to enable them to achieve their retirement objectives. Consequently, although the imminence of the 5 April 2009 deadline requires immediate action, it would be prudent for pension plan participants to keep their arrangements under regular review. Mercer has a highly qualified team who would be pleased to provide ongoing assistance to corporate clients and their employees.

Who to contact

If you are interested in understanding more about how Mercer can help employers or individuals, contact your usual Mercer consultant.

Alternatively, you can contact one of Mercer's A-Day + 3 specialists below:

Nigel Roth, London
nigel.roth@mercer.com
020 7178 3526

Roger Breeden, London
roger.breeden@mercer.com
020 7178 5784

Tim Robson, London
timothy.robson@mercer.com
020 7178 5781

Tanya Wanless, London
tanya.wanless@mercer.com
020 7178 3269

Kevin Painter, Leeds
kevin.painter@mercer.com
0113 394 7684

Jim Finlay, Manchester
jim.finlay@mercer.com
0161 837 6635

Stuart Moment, Birmingham
stuart.moment@mercer.com
0121 623 1111

Tim Wagstaff, Glasgow
tim.wagstaff@mercer.com
0141 248 5511

Important information

The content of this brochure is for information purposes and does not constitute individual financial advice. It is based on our interpretation of the tax regulations at the time of writing and is subject to change in the future.

MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

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For further information, please contact your local Mercer office or visit our website at:

www.mercer.com

Mercer
Tower Place
London
EC3R 5BU
Tel +44 (0)20 7626 6000
Fax +44 (0)20 7929 7445

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