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Legislative Perspective

A trip around the world

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Section 1

Global legislative trends impacting retirement benefits

Global legislative trends impacting retirement benefits

Overview

Reduction in social security provision

Legislation Introducing/expanding defined contribution

Increased retirement plan governance requirements

Funding reform

Discouraging of early retirement/
support for flexible retirement

Pan European pensions

1. Reduction in social security provision

Longevity having a significant impact on cost

Reaction of public sector is to reduce benefits

Extension of retirement age under social security

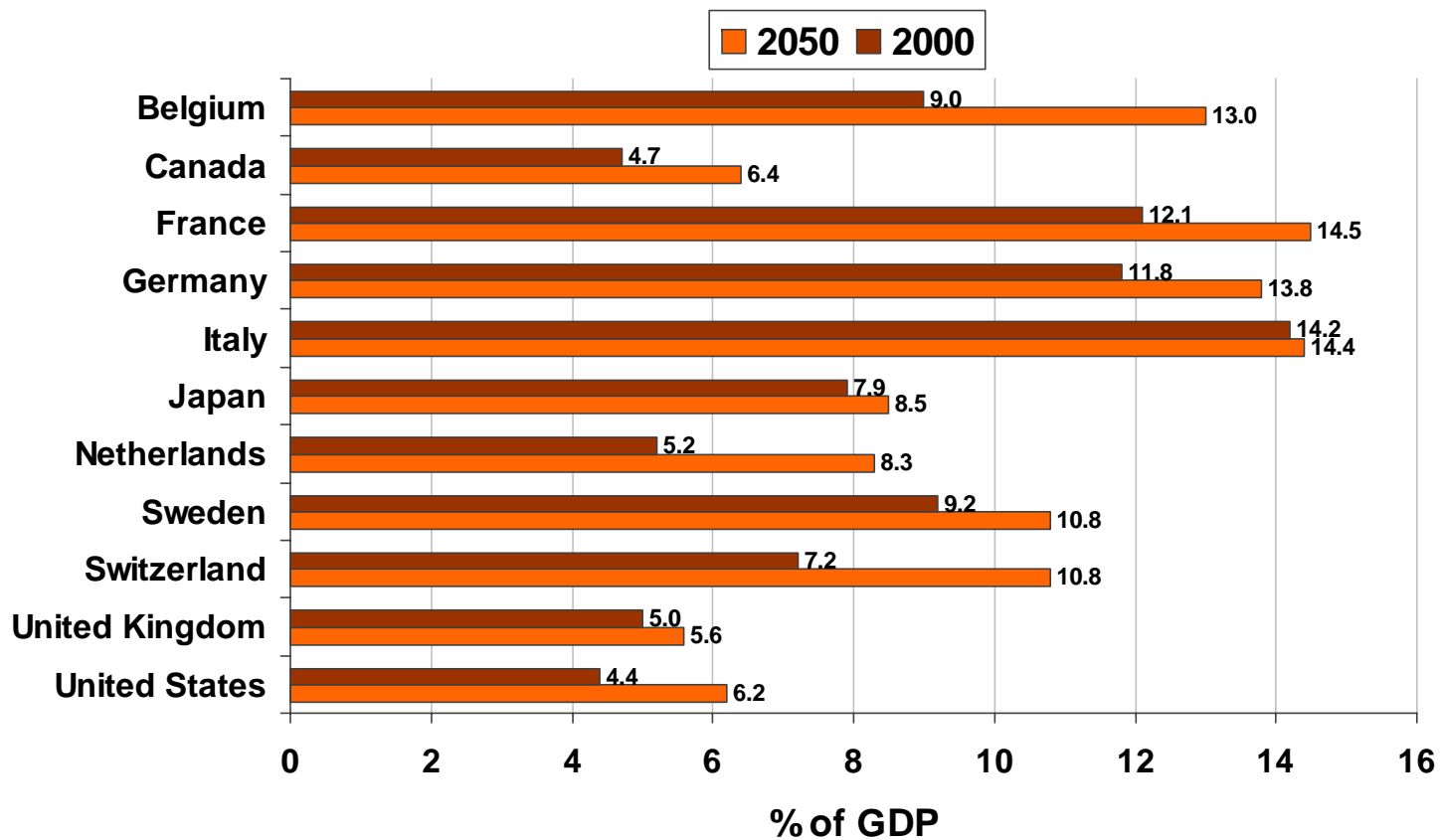
Change the benefit formula

Shift costs to private sector/mandatory provision

Reduction in social security provision
Significant increases in costs

Old-age Pension: Projected Increase in Ageing-related Public Spending, 2000-2050

(Assuming unchanged policies as from the early or mid-2000s)



Source: OECD (2005)

Reduction in social security provision

Future generations: less public pension

Since 1990, nearly all 30 OECD countries have changed their pension systems – average pension promise in 16 countries was cut by 22%

Pre- and Post-reform Gross Replacement Rates

for workers on average earnings in selected OECD countries
- % of individual earnings

| | Men | |
|-----------------|------------|-------------|
| | Pre-reform | Post-reform |
| Austria | 90.0 | 80.1 |
| Finland | 66.3 | 63.4 |
| France | 64.7 | 51.2 |
| Germany | 48.7 | 39.9 |
| Hungary | 57.7 | 76.9 |
| Italy | 90.0 | 67.9 |
| Japan | 40.7 | 34.4 |
| Korea | 69.3 | 66.8 |
| Mexico | 72.5 | 35.8 |
| New Zealand | 39.7 | 39.7 |
| Poland | 62.2 | 61.2 |
| Portugal | 90.1 | 54.1 |
| Slovak Republic | 59.5 | 56.7 |
| Sweden | 78.9 | 62.1 |
| Turkey | 107.6 | 72.5 |
| United Kingdom | 30.8 | 30.8 |

Source: OECD (2007)

Reduction in social security provision

Extension of retirement age under social security

- **Australia:** By 2014, minimum qualifying age for women will be 65 years, making it same for all
- **Belgium** As from 2009, the normal retirement age for females will be age 65
- **Colombia:** As from 2014, the normal retirement age will be increased: Males from 60 to 62; Females from 55 to 60
- **Czech Republic:** Gradually increased: Males each year by two months since 1996. By 2013, retirement age for men will be 63. Females each year by four months. By 2013, retirement age for women will be 59 to 63 (depending on the number of children raised).
- **Denmark:** Gradually increased from age 65 to 67 between 2024 and 2027
- **Germany:** Gradually increased from age 65 to 67 between 2012 and 2029. For members with at least 45 years of contribution there is no change.



Reduction in social security provision

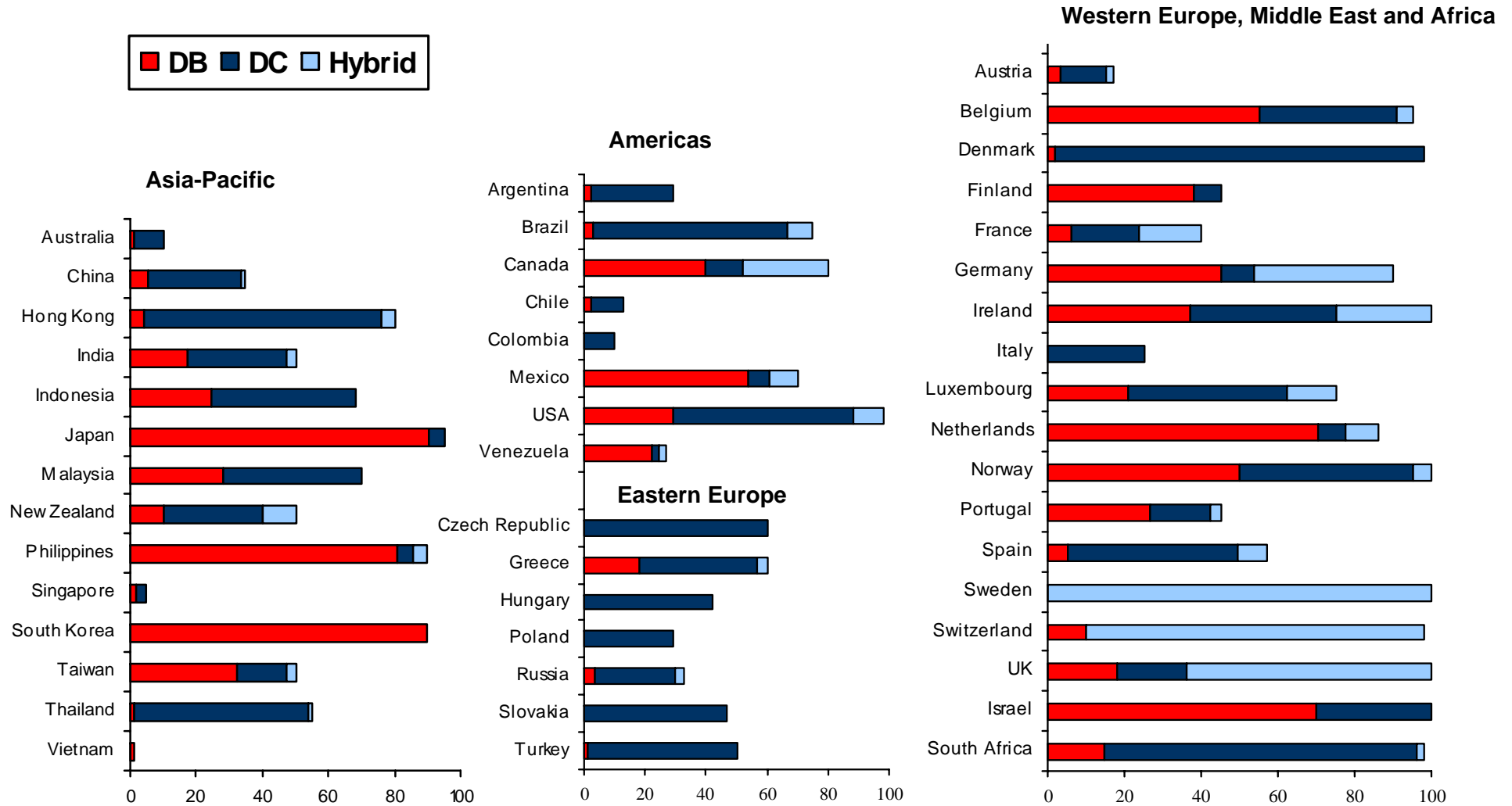
Extension of retirement age under social security (Cont'd)

- **Hungary:** Plans within government to pass legislation to begin raising the retirement ages to 64 for women and 65 for men by 2020 and then to 68 for women and to 69 for men by 2050.
- **Italy:** Government is proposing to increase the age from 57 to 58 in 2008 and then to 61 by 2013
- **Japan:** Employees' Pension Insurance: Gradually increasing from age 60 to age 65.
- **Slovakia:** Gradually increasing to 62 years for women by 2009-2014 (depending on the number of children raised)
- **United Kingdom:** A common State Pension Age (SPA) of 65 will be fully implemented before 2020. The SPA will be gradually increased between 2024 and 2046 to age 68 for men and women.



2. Legislation Introducing/expanding defined contribution

Approximate % of multinational and leading local companies



Legislation Introducing/expanding defined contribution

Some recent developments

- **Australia:** changes in mandatory superannuation including increase in pensionable earnings and choice-of-fund legislation
- **Sweden:** New defined contribution ITP plan
- **China:** Enterprise annuity
- **Hong Kong:** Proposal: member choice of MPF provider for at least their own contributions
- **Israel:** Introduced mandatory DC from January 1, 2008
- **Japan:** DC now provided by over 8,000 companies
Low contribution limits mean “DC only” is not generally viable
- **Korea:** ERSA introduces DC
- **Taiwan:** mandatory system moved from DB to DC (with grandfathering)
- **Thailand:** Government is planning to make the provident fund a mandatory vehicle in 2008/09



3. Increased retirement plan governance requirements

Increased responsibility of plan fiduciaries (e.g., trustees)

Knowledge/education requirements for fiduciaries

Formalize member participation in running the plans

Increased disclosure requirements

- To regulatory authorities
- To plan members

More stringent funding requirements

Ireland, Netherlands and the UK are three examples of countries which have recently increased plan governance requirements.

4. Funding reform

Examples of more stringent funding requirements

- **Indonesia:** New government regulations to be issued this year requiring employer funding of the mandatory Termination Indemnity
- **Japan:** Companies are not allowed to set up a new TQPP from April 2002 and all TQPP plans must be eliminated by 2012.
- **Quebec:** New measures will come into force on January 1, 2010.
Some highlights:
 - Introduction of a plan specific provision for adverse deviation (PFAD).
 - Annual requirement to complete plan valuations (can be partial if the plan is solvent and fully funded).
 - Letter of credit can be used to fund a portion of the solvency deficit (maximum of 15% of actuarial liability measured on a solvency basis)

Funding reform

Examples of more stringent funding requirements (Cont'd)

Netherlands: New funding requirements (FTK) became effective January 1, 2007.

- Moved to a market value of liabilities
 - Based on fixed discount rate under prior regime
- Introduction of a minimum funding test
 - Must be at least 105% funded
- Introduction of a target funding level
 - Ensure that plan has a 97.5% probability of remaining above the 105% funding level during a one-year period
 - 15-year period to reach the required level
- Additional reserve may be established for “conditional” benefits
 - Under FTK circumstances where “conditional” benefits are paid must be clearly defined
- Caused companies to reassess benefits policy, contribution policy and investment policy



5. Discouraging of early retirement/support for flexible retirement

- **France:** Indemnities paid on retirement prior to age 65 are now tax disadvantaged (mainly from the employer's perspective) compared to payments from age 65
- **Netherlands:** From 2006, enhanced early retirement benefits are no longer tax effective to employees
- **UK:** flexible retirement possible from April 6, 2006
 - Prior rules required members to leave service to receive benefits
 - Now it is up to the employer and trustees to consider if a flexible retirement policy should be introduced and how it should be administered

Discouraging of early retirement/support for flexible retirement

Germany: Altersteilzeit (ATZ) arrangement

- Transition from (full or part-time) employment into retirement before the legal retirement age
- Typically two types:
 - Work 50% each year receives 50% of pay
 - Work 100% for first half of ATZ period and paid 50% for entire period
- Employee receives an annual bonus (generally equal to 10%-15% of their most recent regular pay before the start of the ATZ period);
 - The regular combined paid compensation will normally equal about 60-65 percent of the participant's most recent regular pay prior to the start of the ATZ period
- Government provides a subsidy (reimbursement) to the employer for the bonuses paid to the employee
- Provision set to expire in 2009 unless legislation extended

6. Pan European pensions

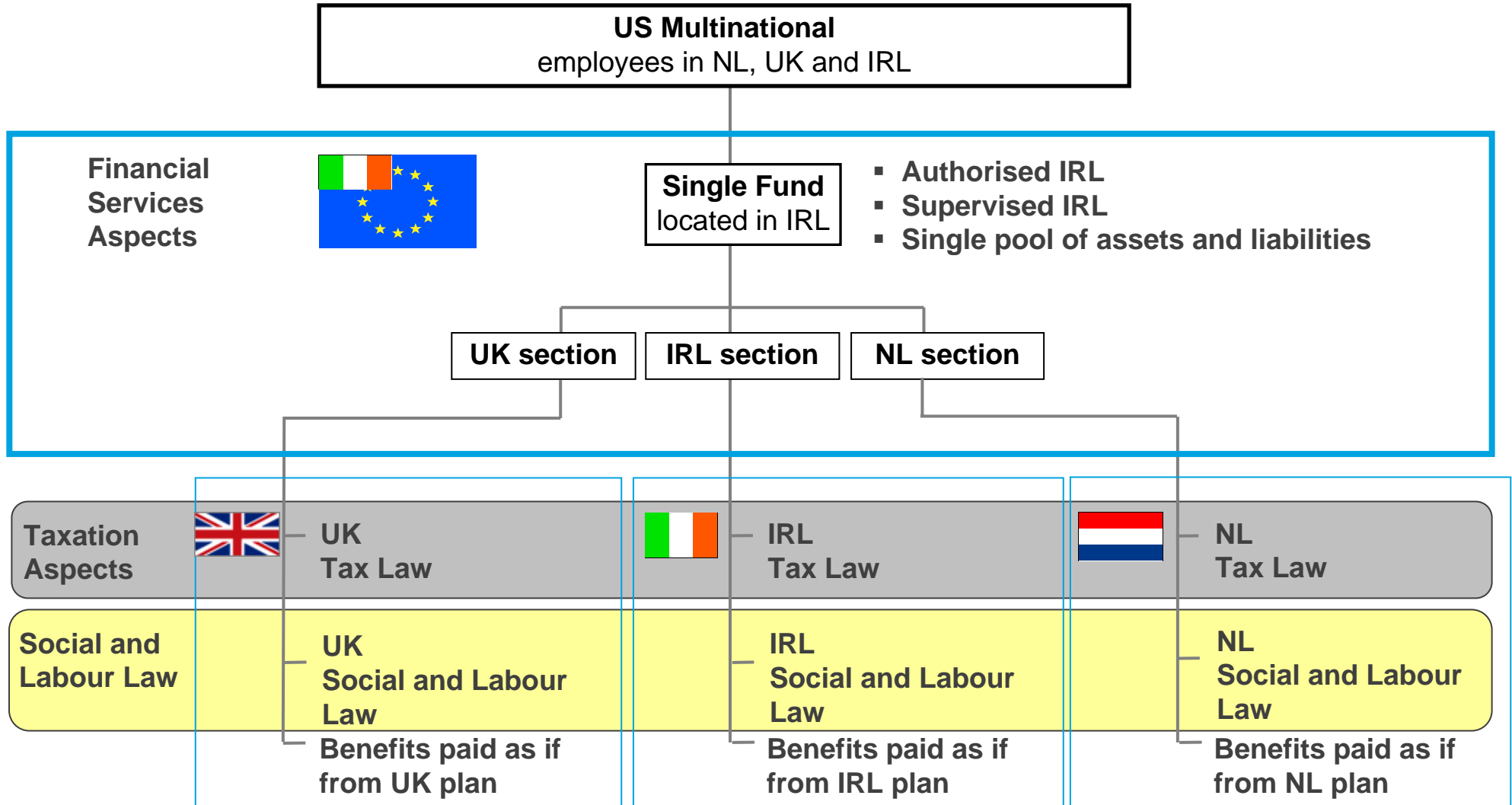
Why the interest?

- Financial economies of asset and liability pooling
 - Reduced management and administrative fees
 - Leverage cash flows
 - Offsetting surpluses?
- Improved governance and operation
 - An increased focus in recent years
- More focus on risk management which is streamlined through a single structure
- Corporate branding
 - Consistent branding
 - Mirror corporate structure



Pan European pensions

Single Fund with National Sections (EFRP* Model)



* European Federation for Retirement Provision

Pan European pensions Hurdles

As yet, no 'ready made' vehicle or solution available across all Member States

Implementation of such an arrangement is a long-term process

Lack of clarity/understanding of the local social and labour laws that a fund would be subject to in each Member State

Still tax issues around the operation of a plan particularly around cross-border transfers of capital and interest and dividend payments



Section 2

2008 US legislative outlook

US legislative trends affecting retirement benefits

Overview

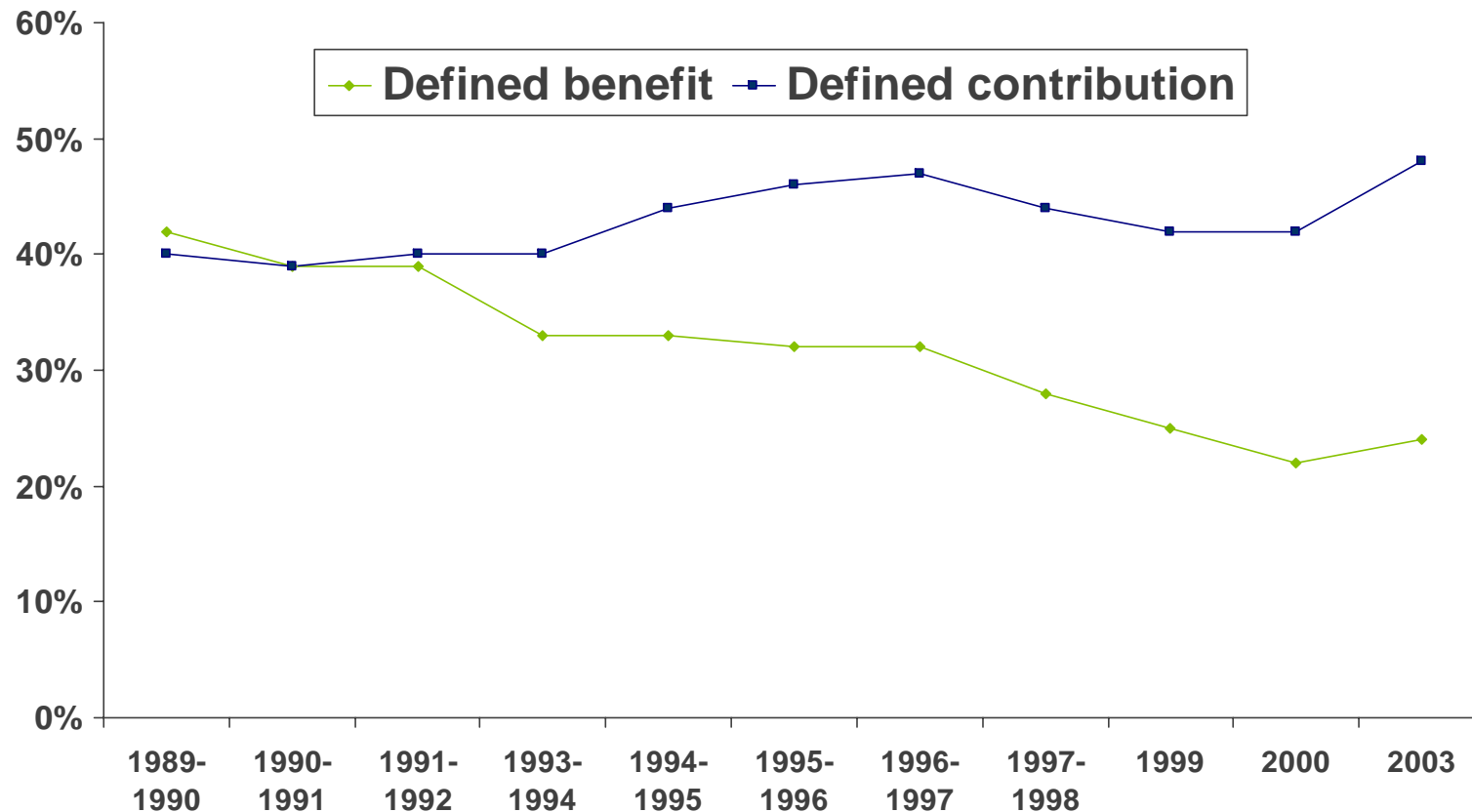
- Trend to DC designs accelerated by Pension Protection Act
- Congressional follow-up – current state-of-play
- Presidential candidates' retirement proposals
- Post-election retirement policy themes, legislative challenges



Shift from DB to DC

A strengthening trend over time

Percent of US workers participating in a plan



Figures represent private industry only. Source: U.S. Department of Labor, Bureau of Labor Statistics.



DC plans readied for primary role

PPA brings significant change

Addresses some behavioral issues

- Automatic enrollment – Barriers removed and incentives added
- Default investments – Fiduciary relief opens door to more aggressive default funds
- Investment advice – Clarification of fiduciary requirements



PPA = significant change

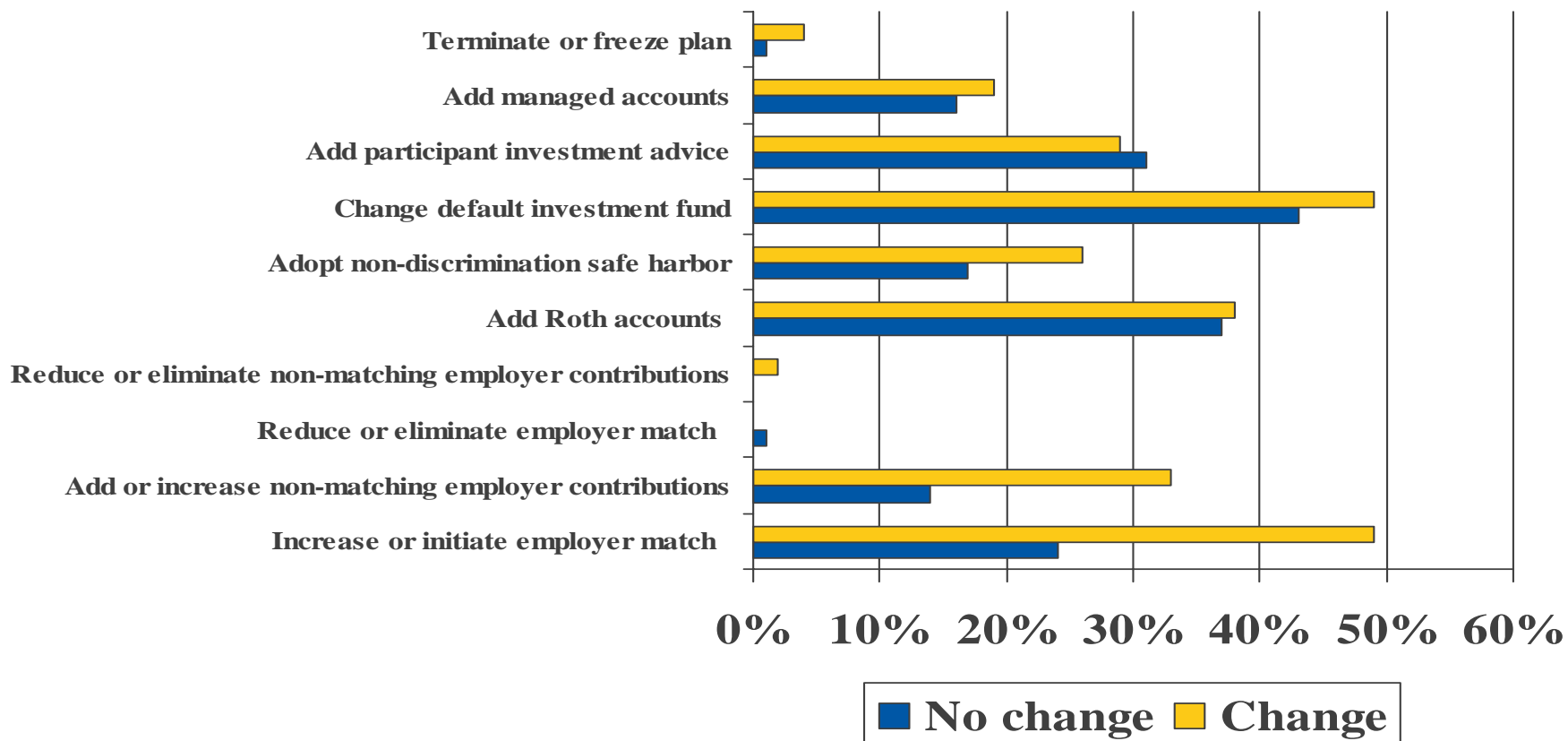
More options for participants

- Company stock – New diversification requirements
- Faster vesting – Same rule now applies to both matching and non-matching employer contributions
- Permanence for 2001 EGTRRA reforms

Where plans are headed post-PPA

Transformation is underway

Percentage of DB sponsors making specific DC plan changes as a function of whether they have modified the DB plan in the last two years




Source: Tabulations from EBRI/Mercer Survey of Retirement Program Changes After PPA and New Accounting Rules, April 2007

New challenges, government oversight

Demanding higher performance and accountability

- More at stake for DC system
 - Ready for prime time?
 - Workforce effectiveness risk
- With more responsibility comes more scrutiny, accountability
 - Litigation (stock drop cases, fees, evolving case law on fiduciary standards, ERISA remedies)
 - Intensifying focus on governance
 - Department of Labor, Congress moving to enhance fee disclosure



Policymakers planning
more changes to
bolster DC system

110th Congress set to adjourn

Retirement-related loose ends

- PPA technical corrections (S 1974, HR 6382)
 - Both bills would allow DB asset “smoothing”
 - Mandatory nonspouse rollovers, Roth rollovers
 - Three-year vesting requirement for hybrid plans clarified
- Retirement plan fee legislation (HR 3185) dead – for this year
- Restrictions on pension investments in commodities (S 3268, HR 6604)
- Eased retirement plan rules for Midwest flood victims (S 3335)
 - Katrina relief extended to IA, AK, IL, IN, KS, MI, MN, MO, NE, WI
 - Relief may be extended for Hurricanes Gustav and Ike
- Restrictions on offshore nonqualified deferred compensation (S 3335)



Section 3

Political state-of-play and election outlook

Political state-of-play and election outlook

GOP lawmakers brace for cold November, White House race a toss-up

- Democrats control Congress . . .
 - Senate (51 Democrats, 49 Republicans)
 - House – (231 Democrats, 198 Republicans)
- And appear poised to strengthen their grip . . .
 - GOP must defend 23 Senate seats compared with Democrats' 12
 - Wave of Republican retirements
 - House – 23 Republicans, 3 Democrats
 - Ds could capture as many as half those seats
 - Senate – 5 Republicans, 0 Democrats
 - Ds could pick up 5-7 seats
- Race for the White House
 - Obama or McCain administration likely to bring big benefits changes



Section 4

Presidential candidates' proposals

Presidential candidates' proposals

Retirement

- Obama
 - Automatic payroll deduction IRAs
 - Expanded, refundable Savers Credit directed to accounts
 - 50% of first \$1,000 in savings for families making \$75,000 per year
 - Greater DB plan investment transparency
 - More information for participants on investments, strategies
 - Enhanced bankruptcy protection for benefits
 - Benefits higher on list of employer debts; executive bonuses limited
- McCain has not yet announced specific retirement proposals
- Social Security positions
 - McCain supports optional personal accounts
 - Obama proposes increase in wage base subject to taxation



Section 5

Post-election policy themes, challenges

Post-election policy themes

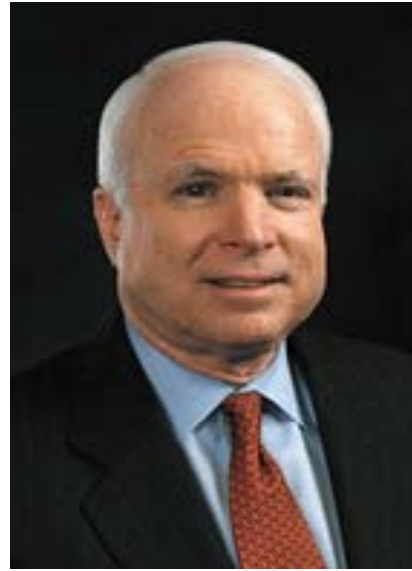
Expanding coverage, DB-ification of DC system

- Addressing the Coverage Gap
 - Automatic payroll deduction IRAs
 - Expanded Saver’s Credit/government match
 - Mandated contributions for those without plans
- Proposals to further bolster DC system, participant protections
 - Fee disclosure/regulation of investment offerings
 - Mandatory immediate enrollment
 - Faster vesting
 - Curbs on early withdrawals, minimizing “leakage” from DC system
 - Cover part-timers
 - Expanded ERISA remedies
- Increasing focus on DC plan distributions
 - Annuity incentives, “longevity insurance,” new default distributions for DC plans
- Phased retirement
 - Congress, regulators continue efforts to encourage retention of older workers

Tax, entitlements changes ahead

Retirement plan changes will be in play

- Tax, entitlement reform will likely affect employer plans
 - How to pay for Iraq, entitlements, AMT fix, financial bailouts, Bush tax cuts?
 - Bipartisan criticism of current retirement tax incentives
 - Support for “leveling the playing field for savings”
- Expiration of Bush tax cuts make tax reform in 2009 virtual certainty
 - Democratic Congress will move to reallocate tax burden and raise certain taxes -- regardless of who is President



Tax, entitlements changes ahead

Retirement incentives questioned

| Tax Expenditure | 2007 Revenue Loss |
|------------------------------------|-------------------|
| Employer-sponsored retirement/IRAs | \$134 billion |
| Capital gains and dividends rates | \$127 billion |
| Employer-provided health care | \$106 billion |
| Child credit and EITC | \$103 billion |
| Home mortgage & home exclusion | \$102 billion |
| Cafeteria plans | \$30 billion |
| Life insurance and annuities | \$29 billion |

Source: Joint Committee on Taxation, JCS-3-07, Sept. 24, 2007

Cost of retirement tax incentives exceeded actual savings by more than \$60 billion in 2007, according to Tax Policy Center analysis

Tax, entitlements policy outlook

Potential repercussions for retirement plans

- The need for “revenue raisers”
- Possible limits on tax treatment of employer retirement plans
 - Reductions in qualified plan limits
 - Imposition of new income limitations
- Possible reallocation of employer plan incentives
 - Replacement of deduction/exclusion with credits
- Other potential revenue raisers
 - NQDC changes, executive pay restrictions, HSA changes



Questions?



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