Society of Actuaries in Ireland
Annual Convention

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Update on UK Issues

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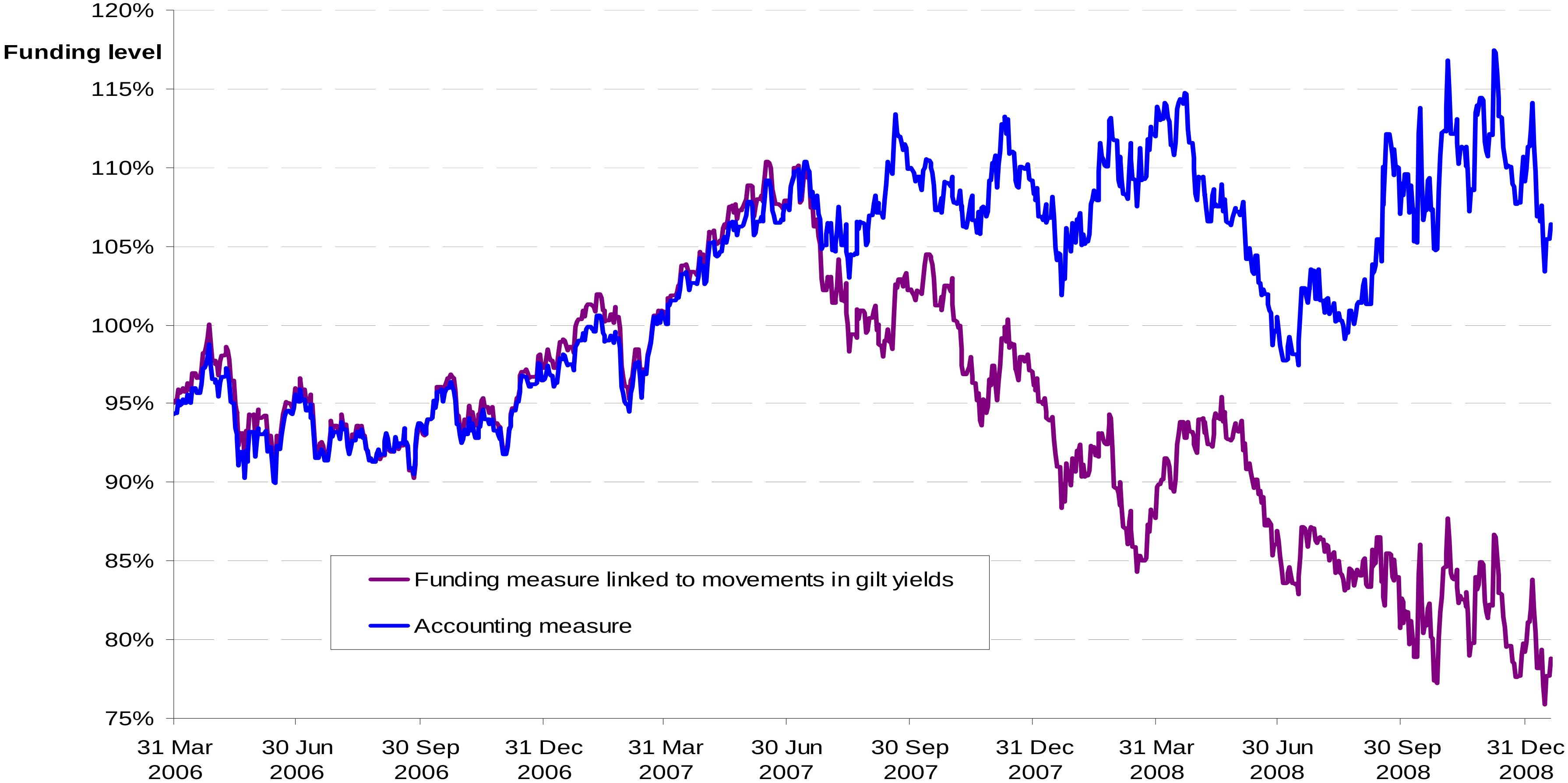
Topics

- Funding levels and deficits – how are trustees and employers dealing with current market conditions?
- The Pensions Protection Fund – how's it doing?
- Latest views on mortality
- Auto-enrolment and personal accounts
- General discussion and questions

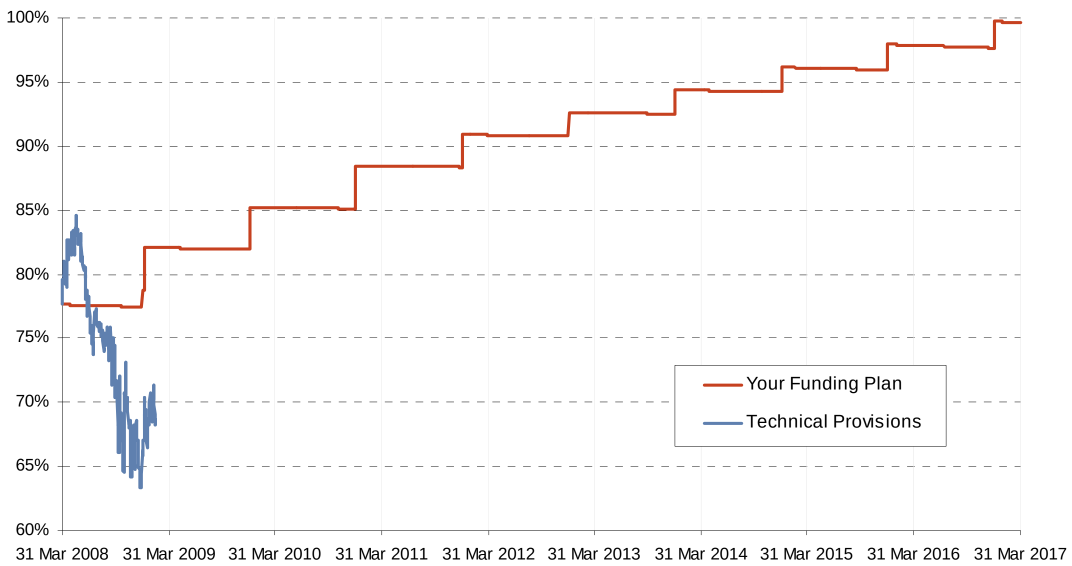
Funding Levels and Deficits

…all familiar with what’s been going on….



…and how funding plans have been blown off - course

Estimated progress against Your Funding Plan



Latest position vs Your Funding Plan

Shortfall against expected position under original funding plan	£ 20.8 M
Remaining time under funding plan	8.13 years

Possible options to get back to Your Funding Plan

Additional contributions over recovery period	about	£ 3.1 M p.a.
OR Investment outperformance over recovery period	about	2.4% p.a.
OR Additional time until fully funded if deficit contributions were to continue beyond 31 March 2017	about	9 years

Reliance on Covenant

Estimated buyout shortfall	£ 90 M

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Brief reminder of UK funding regime

•No prescribed basis or deficit recovery periods

•Trustees and employers (generally) have to agree ‘prudent’ funding assumptions

•Deficits to be corrected over a period based on ‘reasonable affordability’

•Funding supervised by the Pensions Regulator (“ tPR”)

- Trigger system to prioritise work loads
  - Relative strength of assumptions against accounting liabilities and PPF liabilities (more later)
  - Length of recovery period and ‘back end loading’
  - Subsidiary triggers around mortality assumptions used and buy – out liabilities

Plenty of scope for debate between employers/ trustees

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Response by tPR

"Trustees of pension schemes in deficit are unsecured creditors of their sponsoring employer. We are sensitive to the pressures many of these employers face in current economic conditions with falling asset prices and increasing deficits. There is no reason why a pension scheme deficit should push an otherwise viable employer into insolvency. But the pension scheme recovery plan should not suffer, for example, in order to enable companies to continue paying dividends to shareholders."

- **Funding regime is flexible enough to cope with current economic situation**
- **Primary focus should be ensuring strength of technical provisions , recognising improving longevity and any changes to employer covenant**
- **Longer recovery periods may be necessary to remove deficits**
- **Trustees to be diligent in monitoring covenant – and look out for fraudulent activity**

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What are employers doing?

Reviewing critically assumptions used at previous valuations and challenging the trustees on the level of prudence they've been using

– Usually employing an independent actuarial firm to advise

Looking at ways of alternative financing /ways to improve covenant eg

– Parent company guarantees

– Escrow accounts

– SPVs

– charges over assets

Employers hope that by giving security, trustees will agree to deferral of contributions to help short term cash flow

And trustees?

- **Generally quite concerned by recent cases of corporate failures, so torn between trying not to damage employer yet ensuring members are protected as well as possible**
  - Growth in independent trustees
- **More independent covenant assessments to assess strength of business and affordability of contributions**
- **Resisting weakening of assumptions and building in higher longevity**
- **Bit suspicious of alternative funding approaches which have impact of deferring cash**
- **Increasing tendency to approach regulator if they can't agree with employer….**
- **…regulator generally reluctant to get involved in settling disputes and will try to facilitate agreement without imposing a solution**

Pension Protection Fund

Pension Protection Fund (PPF)

•**Established in 2006 to provide a ‘lifeboat’ for schemes in wind –up where**

- assets insufficient to secure full benefits on an insurance annuity basis
- employer insolvent and incapable of financing the shortfall

•**Provides:**

- Continuation of pensions in payment for those above NRA
- Pension increases at 2.5% (or inflation if lower but only on post 1997 service (and standardised spouses pension)
- 90% of accrued pension for members below NRA , with monetary cap (£28,740 if NRA 65)

•**Funded by levy on DB schemes**

Headline figures

100 schemes in PPF covering 31,000 members (31 March 2009)

£4m pension payments per month

Further 290 schemes being assessed for eligibility

Estimated deficit of UK DB plans on PPF liability basis - £242bn (31 March 2009)

2009/10 levy income - £700m

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Levy calculation

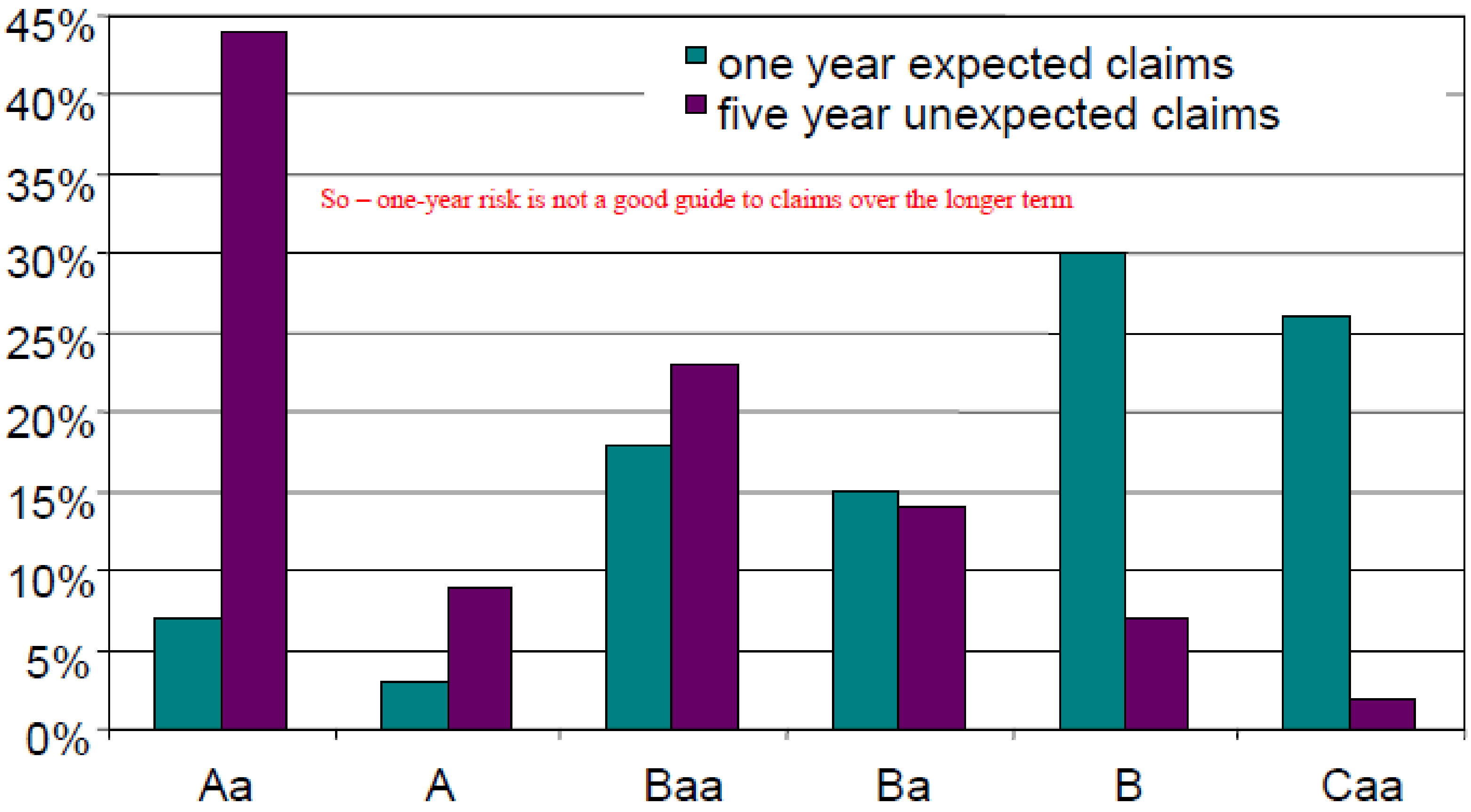
- Aiming to collect £675m pa (linked to wage inflation) over next few years

- 20% on a scheme basis (% of relevant liabilities)

- 80% risk based (ie 1 year expected claim)
  - Funding level
  - Assessed short -term risk of employer insolvency (D&B score)

Currently consulting on changes to bring in longer term risk (next 5 years)

Rationale



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Proposed approach

Risk based levy				Scheme based levy
Expected claims	+	Contribution to unexpected claims	+	Percentage of scheme liabilities

- Insolvency risk (P) & underfunding risk (U)
- P x U x LSF
- U will reflect investment risk of scheme

- Uses conditional insolvency (Q) & underfunding (V) risks
- Scaled down to achieve stable levy total
- Calculated based on existing data
- V reflects scheme investment risk

Reactions to consultation

- **Fairly lukewarm**
  - fiddling with details rather than addressing fundamental issues
  - Size and affordability of levy
  - Long term viability
  - Transparency

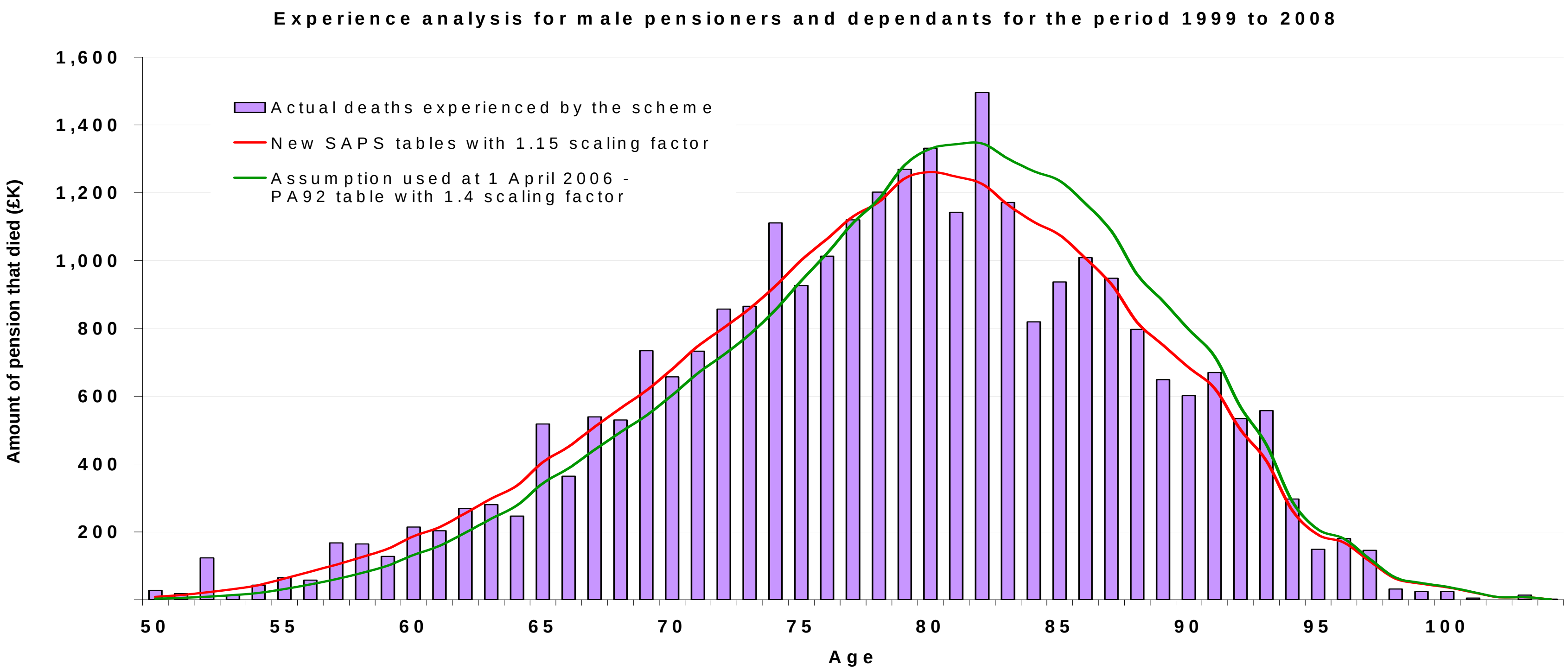
Government guarantee needed?

Or is commercial insolvency insurance the way forward?

Mortality

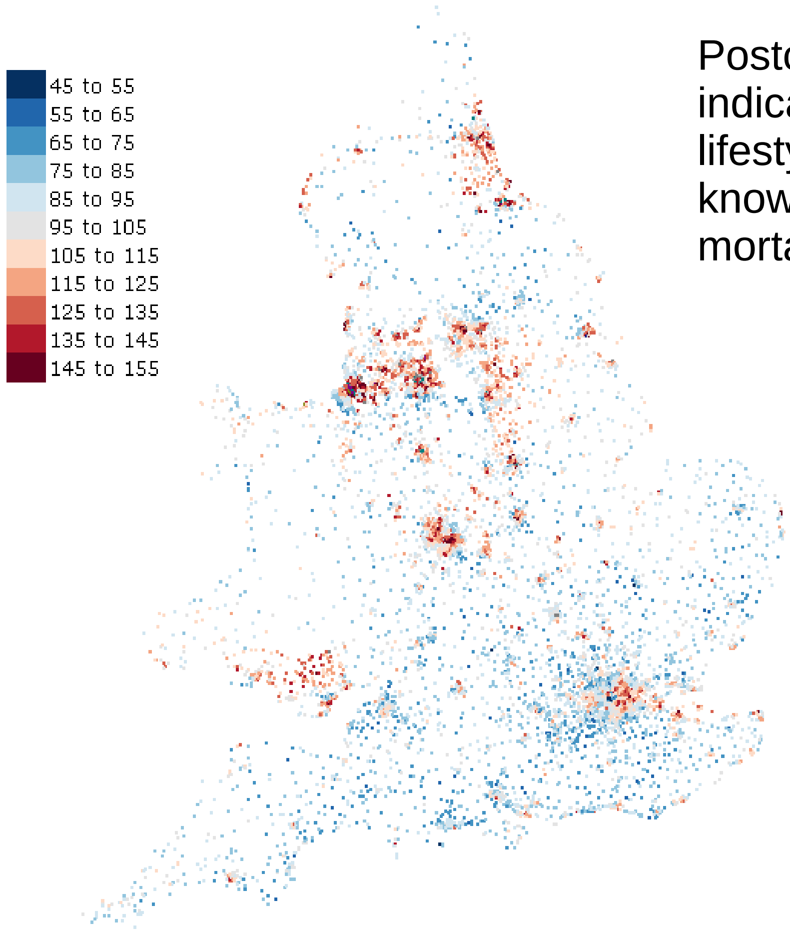
Current rates of mortality for existing membership

- SAPS tables being used for mortality experience investigations



- Although a better 'shape', impact moving to new base tables is small – typically less than 0.5% of pensioner liabilities

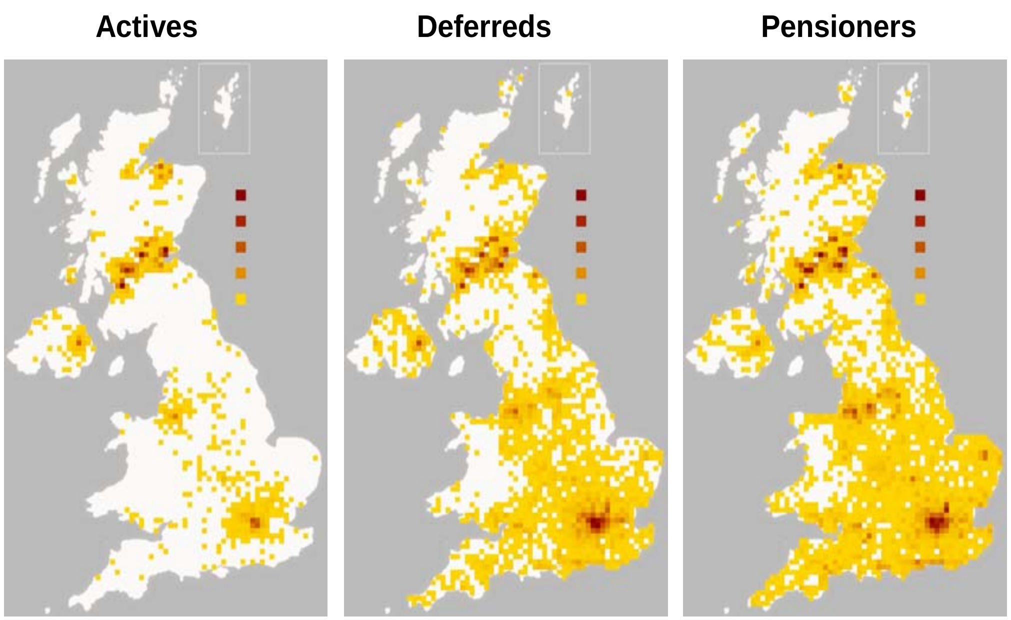
Location matters….



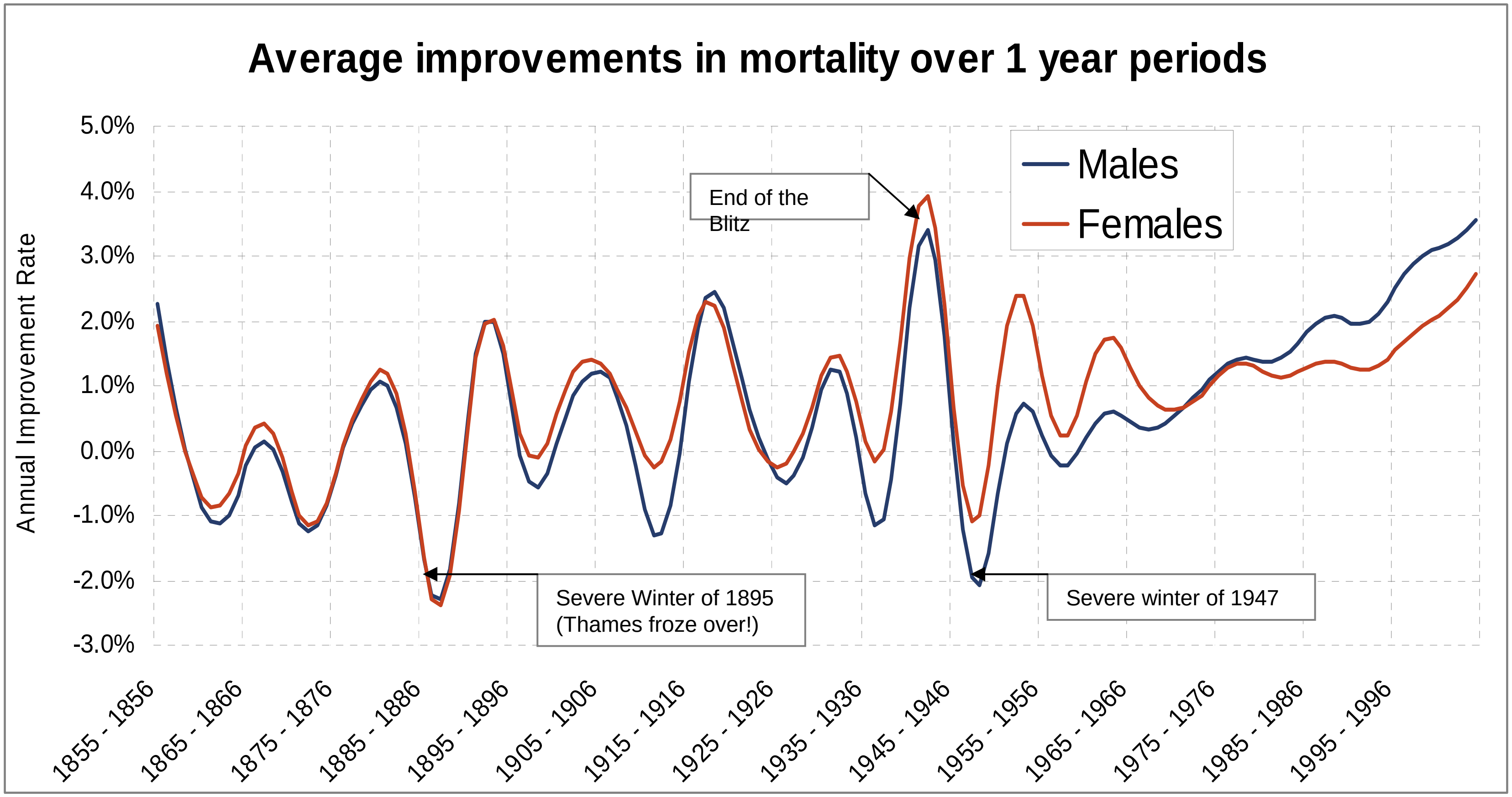
Postcode a is good indicator of the wealth and lifestyle factors which are known to influence mortality

Current rates of mortality - bringing in the ‘postcode’ effect

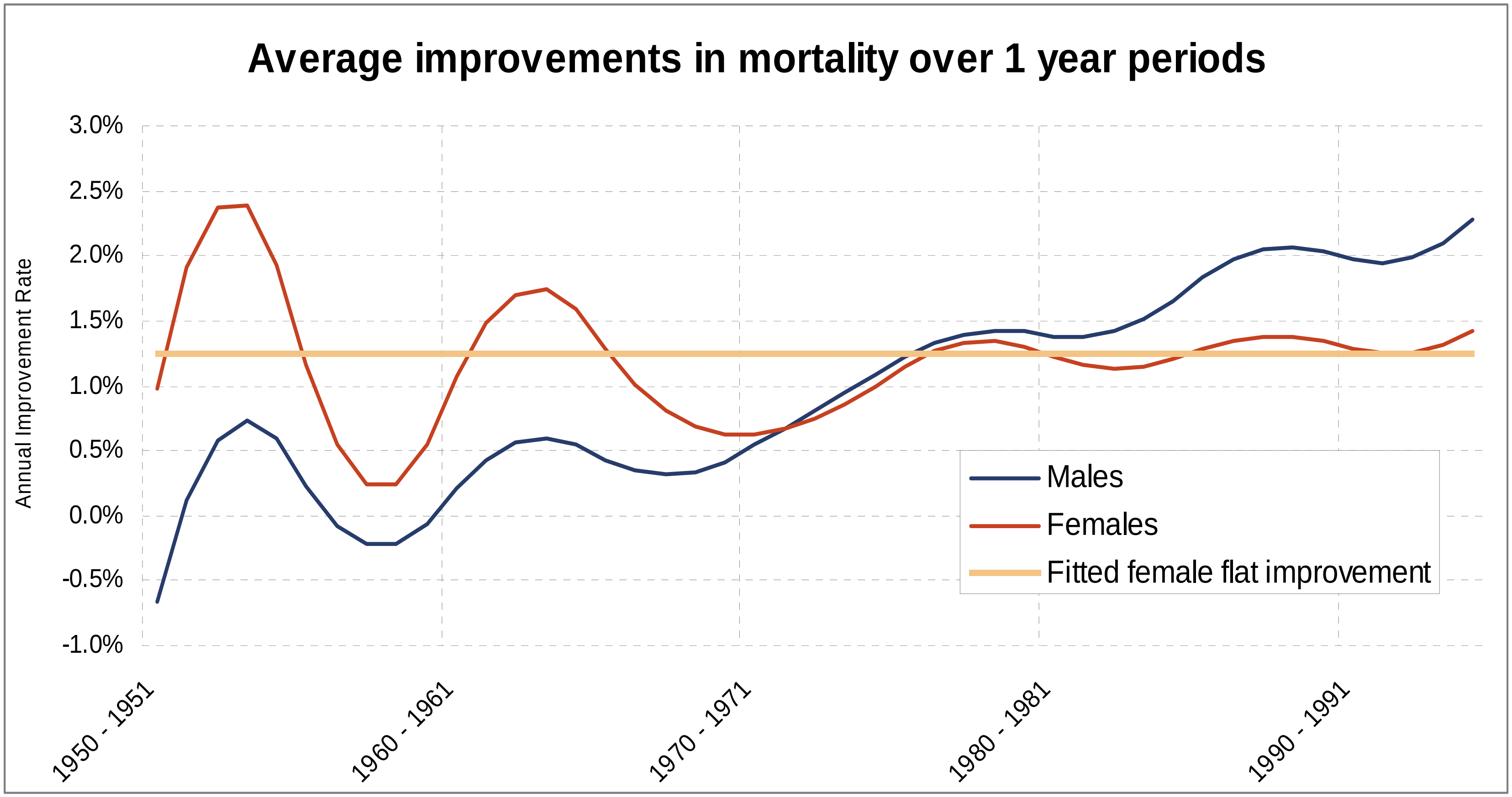
- Very useful in smaller schemes with insufficient information to perform a full experience investigation…
- …and to help compare the mortality characteristics of pensioners with deferreds and actives
- ..and to adjust the overall experience results to give ’member by member’ rates
- Postcode doesn’t allow for occupation (has your neighbour got the same job as you?)
- So doesn’t replace experience investigations where there is enough data
- Models being developed to enable individual mortality rates to be modelled from age/ sex/ pension amount/postcode data



Allowing for mortality improvements – long term trends

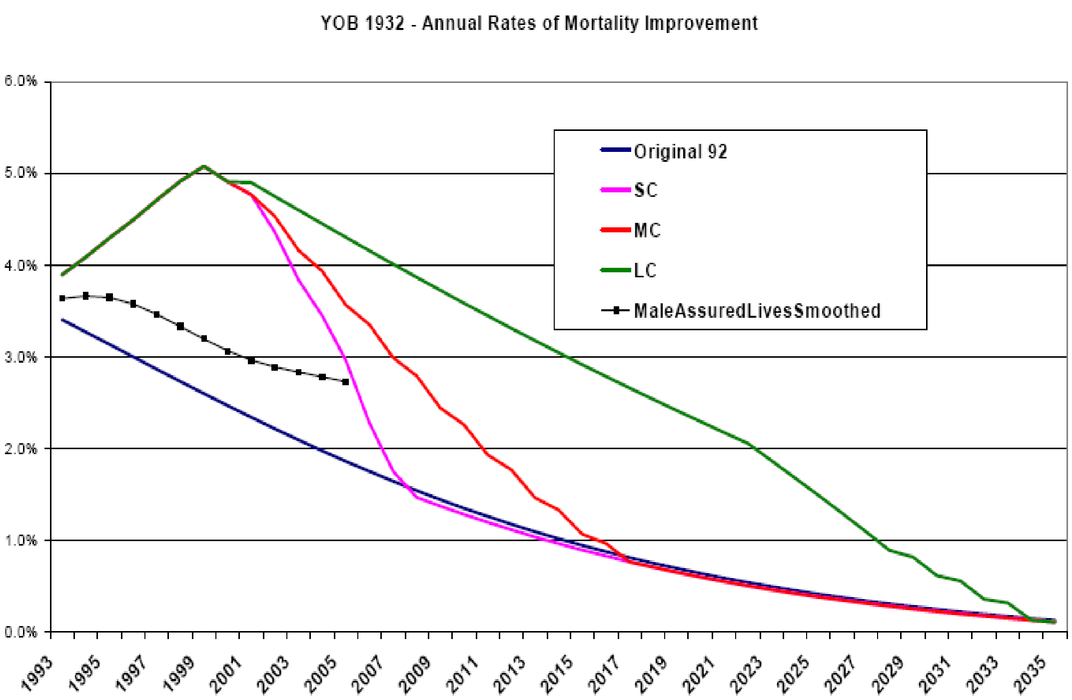


Allowing for mortality improvements – more recent trends



Long term rate of improvement– conclusions

- Above suggest that a long term rate of improvement of around 1.25% per annum **may** be appropriate..
- …but other views entirely defensible
- Shorter term impact – the ‘cohort effect’
- Long cohort over-states current rates of improvement



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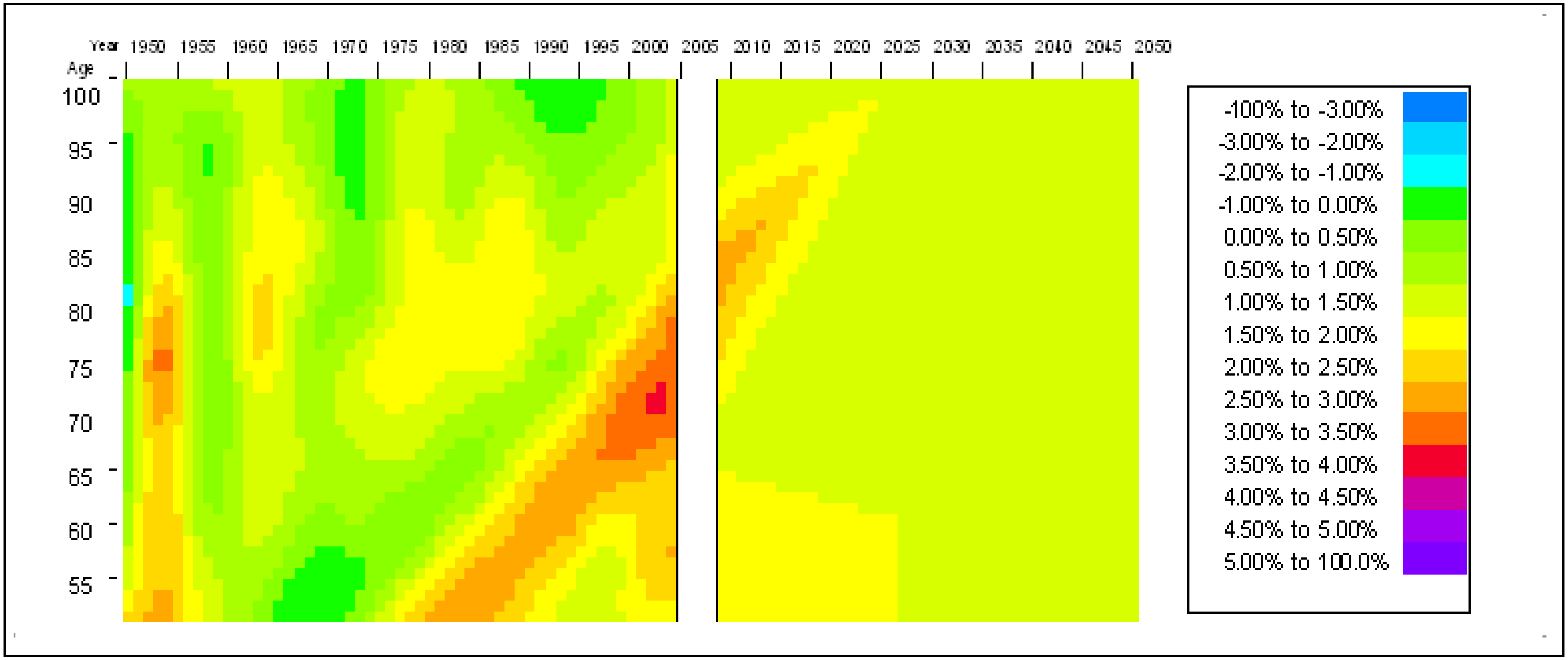
Fitting the cohort

England & Wales Females - 60% of Long Cohort with a 1.25% long term improvement



Auto enrolment and Personal accounts

•From 2012 (but with some phasing in up to 2015), employers must auto – enrol into a qualifying scheme all employees aged 22 and over and whose earnings reach qualifying level

•Fairly onerous timescales (14 days 'joining window', 30 day opting out period etc)

• Qualifying earnings – total earnings between c£5k and £33.5k pa

• Minimum Contribution levels (after phasing in) 8% in total (including tax relief) , of which employer contribution of 3% minimum

•If employer does not have a qualifying scheme, personal accounts are the default scheme

•DB schemes – if accrual rate at least 1/80 contracted out or 1/120 (contracted in) then will satisfy the quality test

•DC – must meet contribution levels described above

•Hybrids – more complicated !

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Issues

Administration of auto enrolment – especially small employers without a current scheme

Inflexibility for existing DC schemes to satisfy the quality test – pay definition may well be different (eg basic pay rather than total earnings in a band)

Interaction with means-tested state benefits – big issue

Seen as an employment tax by some in a difficult economic environment

Levelling down of existing schemes

Concerns over Personal Accounts ability to deliver – potentially 7M employees in a new 'state run' DC scheme

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Questions?