

The Actuarial Profession
making financial sense of the future

What will a pension scheme look like in 20 years time?
John Cockerton, Towers Watson



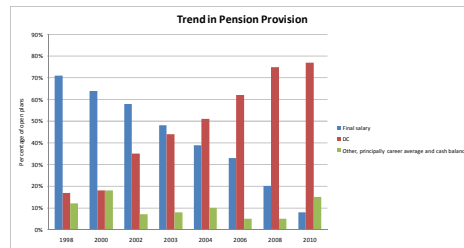
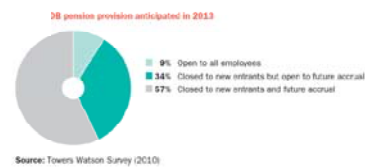
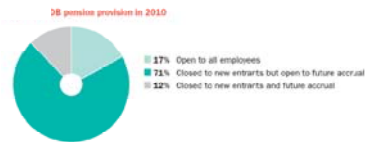
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Agenda

- A brief history!
- Drivers and factors
- The immediate future
- The longer term
- What **we** need to do to encourage change!

Trends

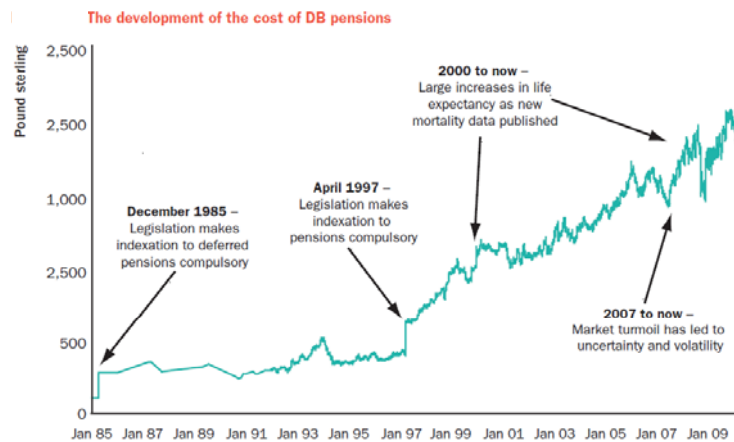


There is a clear trend for a move away from final salary

A history of DB plans in the UK

- Prior to 1990 (roughly)
 - Indexation largely provided on discretionary basis
 - Viewed as guaranteed by “the fund” by employees
 - Not debt from an employer perspective
 - Strong market performance never exposed the financing risks
 - Low compliance cost
- Since the 90's
 - Discretionary increases became guaranteed
 - Longevity risk became apparent
 - Investment performance “unmasked” the risks within DB plans
 - Pension commitments are now enforceable corporate debt
 - Compliance cost is high (including PPF)

The development of the DB cost profile

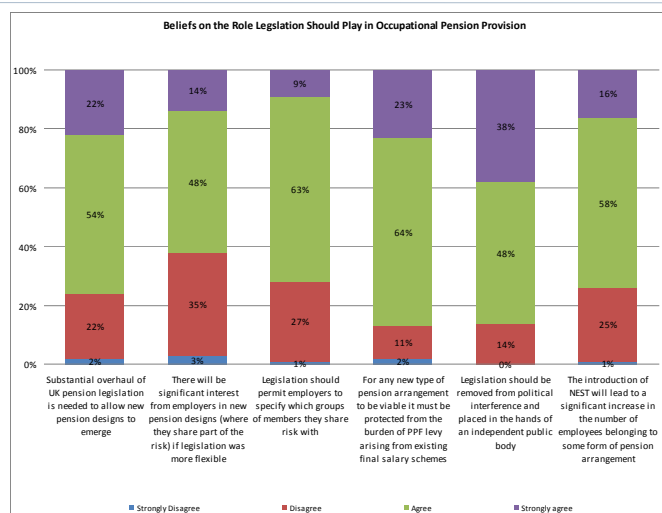


So is the future defined contribution?

- For many DC is the design of choice
- Some organisations however believe that there are advantages to offering something different
 - Competitive advantage in the employment market
 - Retention and reward of key staff
- But is this wishful thinking?

DC will preferred choice by some (many) but other may seek to do different

The role of legislation – market views



Source: Towers Watson pension strategy survey

What would a new framework look like?

- **Freedom over benefit structure:**
 - Member only or spouse's benefit
 - Increasing or not in deferment or payment
- **Align risk management with those taking risks**
 - Sponsor's take financial risk so give them power to manage the risk
 - Controls are required to ensure risk taking is sensible (today and tomorrow)

What would a new framework look like?

- **Permit risk sharing frameworks:**
 - But require that they have a plain English set of principles
 - Need to be clearly communicated, understood and *trusted*
- **Employees or members:**
 - Why share risk with someone who is not connected to the business?
 - Allow an enforced fair transfer to DC on leaving service voluntarily (protection on redundancy required)

Possible designs: Collective DC

- Has been used in the Netherlands
- Current difficulties exist because of underfunding: there may be a cut in all members benefits
- Contains significant cross generational funding which only works where the culture supports this
- 14 funds are due to cut benefits by 1 January 2011!

Possible designs: Conditional indexation

- CARE with discretionary indexation?
- Who controls indexation?
- Is the discretionary indexation process clear and can it be trusted?
- Will it be robust when plans mature
 - consider a plan with 1/3 active members, sponsor preference to keep discretion down and adjust pay?

Possible designs: limited duration plans

- Pensions units with limited guarantee period (say 10 years)?
- Guarantees fall away on leaving service
- Units can be reinvested on expiry of the guarantee period
- Short term aligns more closely with shorter term corporate focus

Influencing change

- Incremental change is not enough! This is a big problem and demands a big solution
- As a profession and industry we need to influence:
 - Political parties
 - DWP
 - EU parliament

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

