The Actuarial Profession
making financial sense of the future

Pensions conference 2011
David Johnston and Hilary Salt

Public sector schemes:
Last bastion of DB

3 June 2011

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Schemes covered

Unfunded public service schemes

Not local government scheme

Five big schemes:

- NHS
- Teachers
- Civil Service
- Armed Forces
- Police

Many smaller schemes – but not significant in aggregate

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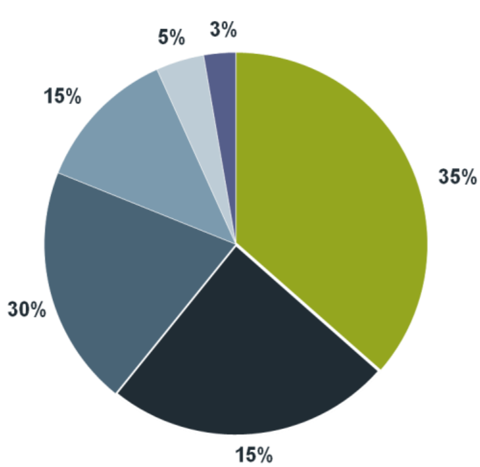
Membership headcount



Total 7.4m

- NHS - 2.7m
- Teachers - 1.8m
- Civil service - 1.5m
- Armed forces - 0.9m
- Police - 0.3m
- Other - 0.2m

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Financial statistics

07/08	Benefits paid £bn	Member contributions £bn	Employer contributions £bn	FRS17 liability £bn	FRS17 CSC £bn
NHS	5.6	2.5	5.3	242	12.3
Teachers	6.7	1.6	3.5	204	7.7
Civil Service	4.0	0.4	2.9	126	4.8
Armed Forces	3.2	-	1.5	97	2.3
Police	2.4	0.7	1.1	73	3.6
Other	1.1	0.2	0.5	30	1.1
TOTAL	**23.0**	**5.4**	**14.8**	**772**	**31.8**

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Current benefit structures

Big 3 schemes

- Most members still on NPA 60
- Typically final salary accrual 1/80 plus 3/80 automatic lump sum
- Minorities on CARE or have enhanced benefits

Uniformed service schemes are more generous

Member contribution levels vary

- Armed forces non-contributory
- Police 11%

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Previous reforms

Agreement with Unions before 2005 election

Led to reforms implemented in 2007-08:

- Limited changes to benefits and contributions
- NPA 65 for new joiners
- "cap and share"

Cap and share: taxpayer contribution capped at agreed level (eg 14% for NHSPS)

- cost pressures to be absorbed by members
- overtaken by Hutton and other changes

Indexation change RPI to CPI

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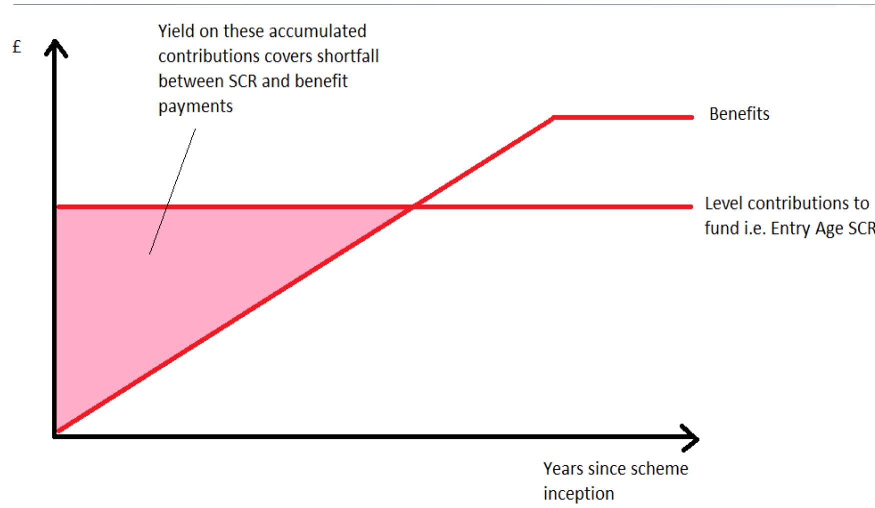
Funded v unfunded



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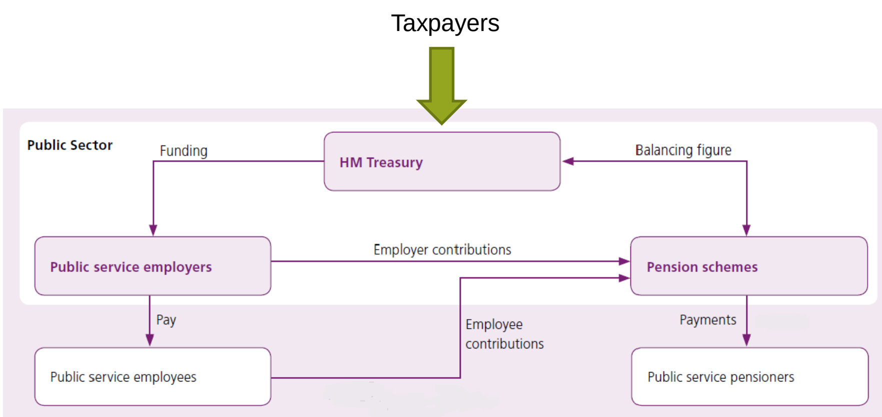
Scheme financing



Source: IPSPC interim report (2010)

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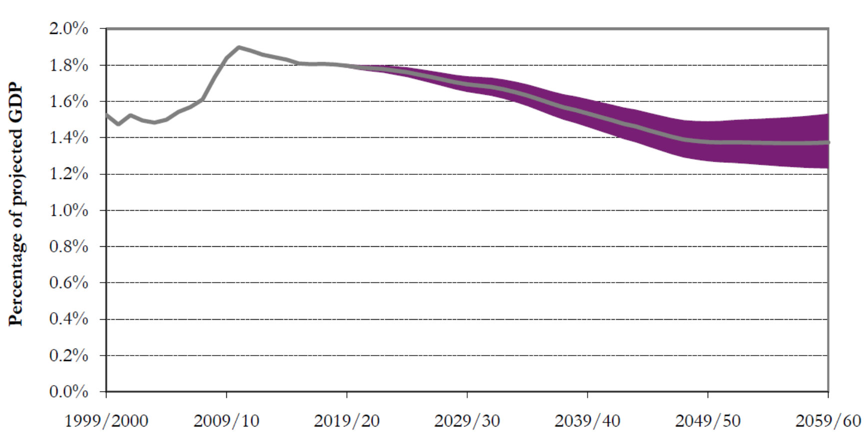
Unsustainable costs? – payments as % GDP



Source: IPSPC interim report (2010)

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Discount rate change

HMT reviewed previous 3.5% real (net RPI) rate used for setting contributions

Five objectives (first two most important):

- Fair reflection of costs
- Reflect future risks to Government income
- Support plurality of provision of public services
- Transparent and simple
- Stability

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Discount rate change

Alternative methods considered:

- consistent with funded schemes
- based on ILG yields
- GDP growth
- based on Social Time Preference Rate

Govt recognised case to be made for all options

In light of objectives decided to use GDP growth

- "theoretically sound and practical"
- rate adopted is 3% real (net CPI)

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ILG yields

Some arguments put forward:

- Value attached by capital markets to Govt cash-flows
- Cost for a funded scheme backed by assets of an equivalent maturity, risk profile and credit quality
- But does it represent cost to Government?
  - when Govt is monopoly supplier to ILG market
- Yields would rise if more ILGs issued to fund schemes
- "would not assist the objective of stability nor the fair reflection of costs" (Actuarial Profession response)

Ultimately Government finds the arguments against this option persuasive

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GDP growth

Some arguments put forward:

- Future source of income to fund liabilities is the tax base, so contributions should be set with reference to future growth of that income stream
- Best ensures that the future cost of the public service unfunded schemes remains affordable
- Intergenerational fairness
- Makes comparison with private sector more difficult
- Drawback of basing on a forecast

Ultimately Government believes this option best meets the purposes and objectives identified

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Public service pension scheme reform: Permanent revolution

- 2008 changes and cost sharing
- Hutton review
- Change from RPI to CPI
- CSR requirement for additional 3% member contributions
- Discount rate consultation
- Review of Fair Deal
- Reduction in annual allowance and lifetime allowance

- Pay freeze and reform within the services

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Non Hutton changes

- Member contribution increases in April 2012:
  - “low paid” protected
  - Progressivity
  - Minimising opt outs
- Discount rate reduction:
  - RPI + 3.5% pa
  - CPI + 3% pa
  - Perhaps broadly “spends” the extra 3%
  - But past service, salary increases?

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Hutton Changes

- Government accepted recommendations “as a basis for consultation” but formal proposal not until autumn
- Hutton rejects use of pension as a recruitment and retention tool as too inflexible
- Stresses need for adequacy and fairness – and maximising participation
- Believes changes can be made in this Parliament
- Lots of detail left for “consultation with staff”: accrual, indexation, contributions

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“The Deal”: Main Hutton Recommendations

- CARE for the future
- Accrued rights protected – including the salary link
- Indexation should be in line with average earnings
- Future benefits payable at SPA – future changes affect all new style benefits
- Capped costs with default changes
- New governance, disclosure, legal basis
- What did Hutton reject?

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Challenges to the reforms: Member issues

- Contribution increases:
  – What are we buying?
  – Within and across scheme “fairness”
  – Pay freeze + contribution rate rise
  – Opt outs / non joiners
- Legal challenges on CPI and SPA
- Scheme by scheme versus overall talks
- Industrial action

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Challenges to the reforms: Employer issues

- Recruitment, retention and return
- Reform of public services and need for “buy in”
- Access to schemes: review of Fair Deal and Hutton recommendations
- Governance arrangements
- Consultation processes: now and for cost capping
- NEST and auto-enrolment
- Ending contracting out

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Considerations for the Profession

- Responses to discount rate consultation
- Need for profession to be commenting on public service pensions?
- Role of actuaries, firms, GAD, charities and disclosure of information
- Are things different for actuaries working in and around government?
- Will the public service settlement be relevant for the private sector?

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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.

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