

The Actuarial Profession
making financial sense of the future



Pensions, Benefits and Social Security Colloquium 2011
George Russell and Tom Terry



Financing pensions for public sector workers

25-27 September 2011

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What we'll talk about

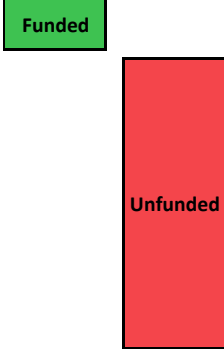
- The basics – US and UK
- Current financing issues
 - US
 - UK
- Common issues and challenges
- Open discussion

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Pensions for public sector workers

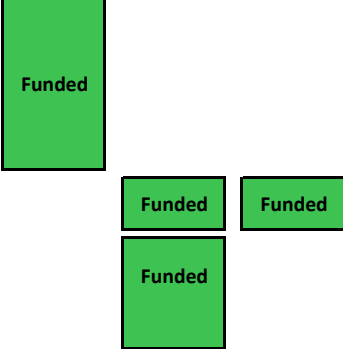
UK Pension Plans

Local Gov't Plans
Central Gov't Plans



US Pension Plans

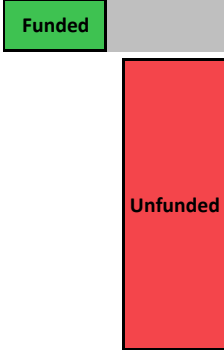
Local Gov't Plans
Central Gov't Plans
Private Plans



Pensions for public sector workers

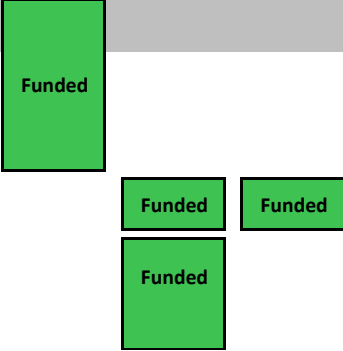
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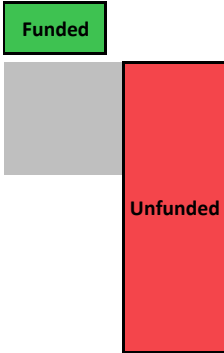
Local Gov't Plans
Central Gov't Plans
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Pensions for public sector workers

UK Pension Plans

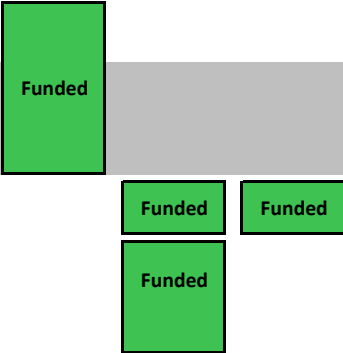
Local Gov't Plans
Central Gov't Plans



Local Gov't workers
Teachers
Police and Fire
Health Services
Central Gov't workers
Military

US Pension Plans

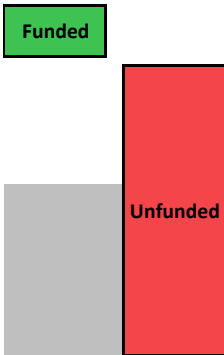
Local Gov't Plans
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Pensions for public sector workers

UK Pension Plans

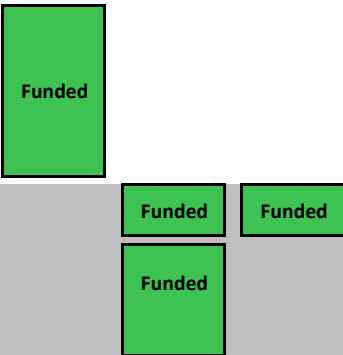
Local Gov't Plans
Central Gov't Plans



Local Gov't workers
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US Pension Plans

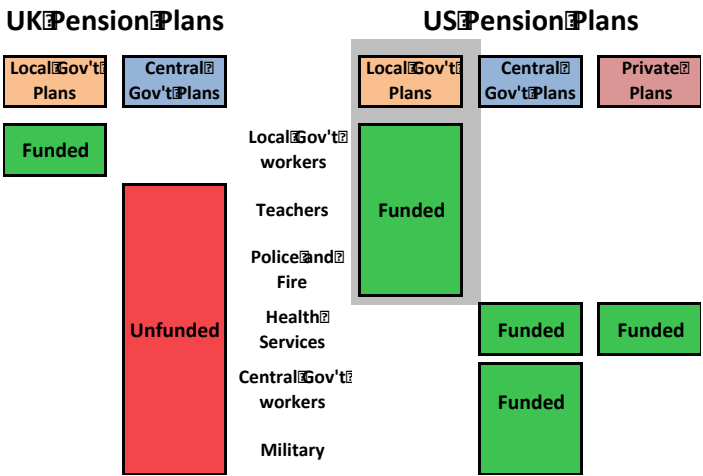
Local Gov't Plans
Central Gov't Plans
Private Plans



US public sector plans

	State and Local Workers	Federal Workers
Number of plans	2,500	3
Participants	20 million	10 million
Assets	\$3 trillion	\$1 trillion
Investments	Diversified portfolio	Treasury bonds
Liabilities	\$4 to \$6 trillion	\$2.5 trillion
Subject to ERISA?	No	No

US state and local plans



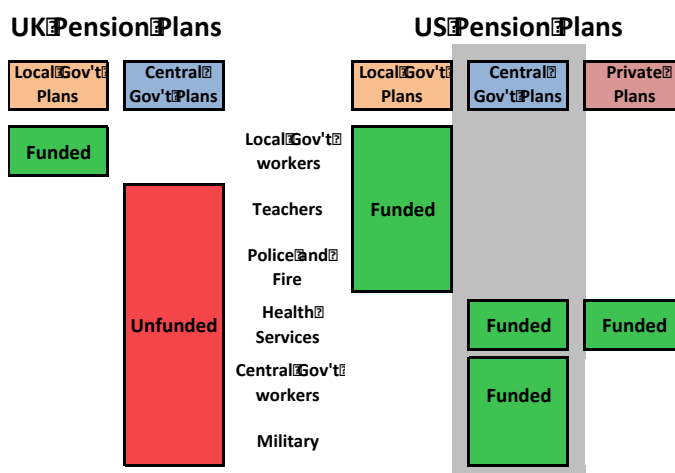
US state and local plans - issues

- Benefits
 - Well-publicized abuses
 - Apparent inability to trim future service benefits
- Funding
 - Pressure on local budgets from falling taxes in the face of rising pension funding needs
- Disclosure
 - What liability?
 - What discount rate?
- Governance
 - Highly political environment with diffused responsibilities
 - Are the proper ERM elements in place?

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US federal worker plans



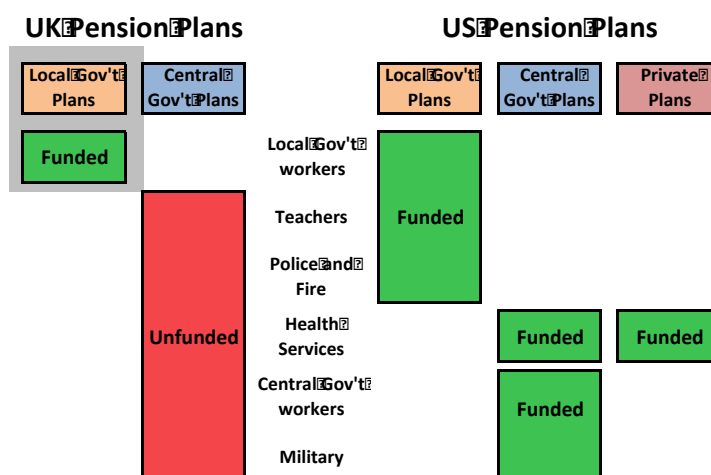
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US federal worker plans - issues

- Benefits
 - Relatively little “noise” about federal worker benefits
- Funding
 - Pressure on federal agency budgets is extraordinary
 - Significant legacy liabilities to be funded in the future
 - From the overall “unified budget” perspective, the assets of these pension trusts are also liabilities of the federal government
- Governance
 - The larger federal deficit issue is the driver

UK local government plans

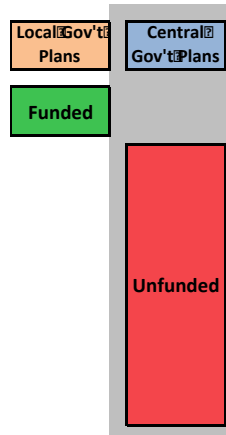


UK local government plans - issues

- Nature of 'funding'
- Regulation/governance
- Discount rates
- Investment management
- Administration

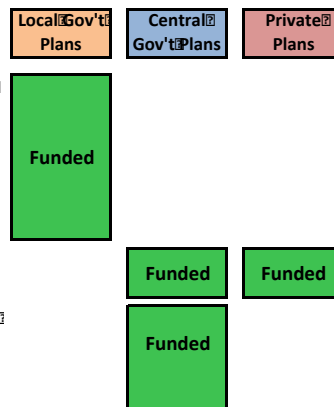
UK central government plans

UK Pension Plans

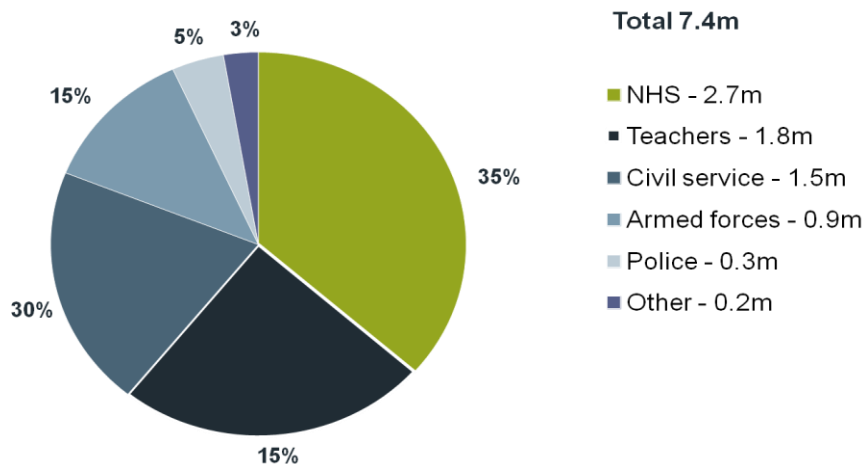


Local Gov't
workers
Teachers
Police and
Fire
Health
Services
Central Gov't
workers
Military

US Pension Plans



Membership headcount



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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 plans

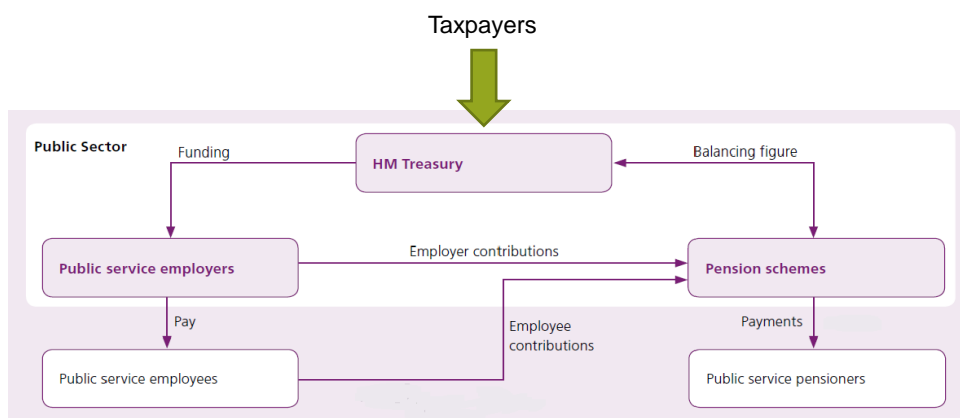
- Most members still on NPA 60 (NPA 65 for new joiners)
- Typically final salary accrual 1/80 plus 3/80 automatic lump sum
- Minorities on career average or have enhanced benefits

Military/police/fire are more generous

Member contribution levels vary

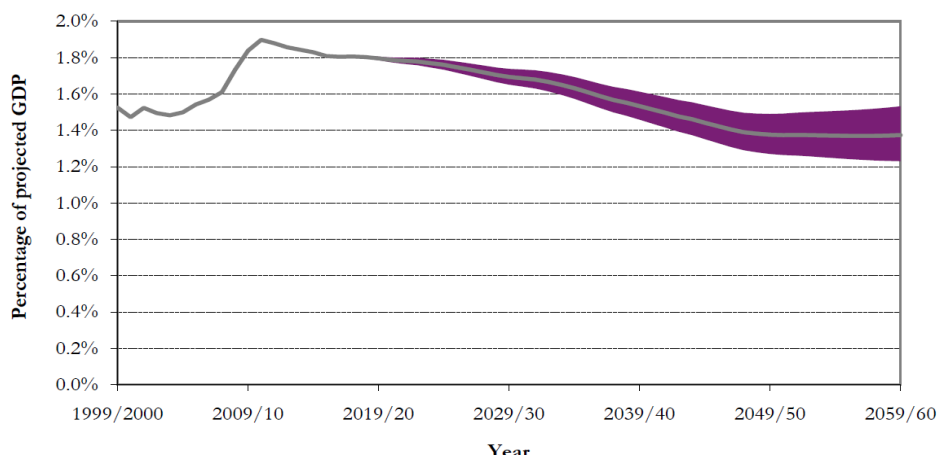
- Armed forces non-contributory
- Police 11%

Plan financing



Source: IPSPC interim report (2010)

Unsustainable costs? – payments as % GDP



Source: IPSPC interim report (2010)

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Discount rate change

Gov't 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 plans
- 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)

ILG yields

Some arguments put forward:

- Value attached by capital markets to Govt cash-flows
- Cost for a funded plan 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 plans
- “would not assist the objective of stability nor the fair reflection of costs” (UK actuarial profession response)

Ultimately Government found the arguments against this option persuasive

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 plans 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

Public service pension reform

- Hutton review
- Change from RPI to CPI
- Requirement for additional 3% member contributions
- Discount rate consultation
- Pay freeze and reform within the services

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

Hutton Changes

- Government accepted recommendations “as a basis for consultation”
- Hutton rejected use of pension as a recruitment and retention tool as too inflexible
- Stresses need for adequacy and fairness – and maximising participation

“The Deal”: Main Hutton Recommendations

- Career average for the future
- Accrued rights protected – including the salary link
- Indexation should be in line with average earnings
- Future benefits payable at state pension age – future changes affect all new style benefits
- Capped costs with default changes
- New governance, disclosure, legal basis

US and UK: common issues and challenges

- Affordability and sustainability
- Adequacy
- Fairness within public sector and relative to private sector
- Sharing of costs with workers
- Viability of funded pension provision at entity level
- Transparency and governance

Open discussion

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 presenters.

