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Back to the Future

What yesterday can tell us about tomorrow's pensions

Mark Rowlinson FIA



18 June 2013

Opening comments...

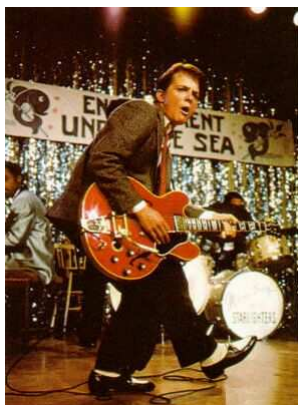


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Looking to the future



I guess you guys aren't ready for that yet. But your kids are gonna love it.



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What I've done...

- Constructed a model
- Look at the period 1970 to 2012
- Consider what has happened
- Look at different schemes
- Look at different approaches
- What does it tell us about the future?



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Big model – lots of data and assumptions!

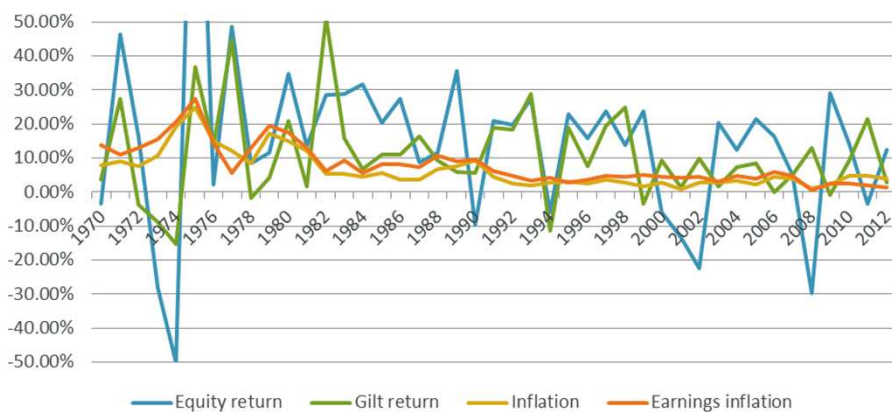
- A few thousand valuations!
- Key simplifying assumptions:
 - Everyone makes it to retirement
 - Constant workforce/scheme membership
 - We're all male
 - Contracted-in/60ths scheme
- Key data sources:
 - Survey of actuaries in First Actuarial – past practice
 - BarCap Equity Gilt Study



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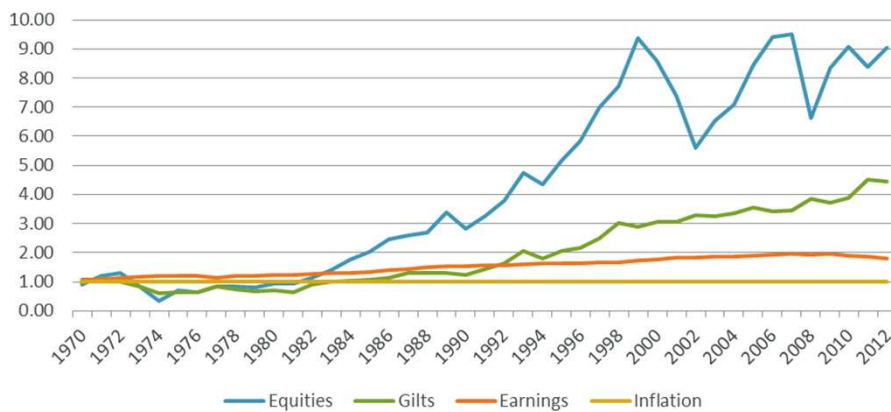
Economic environment



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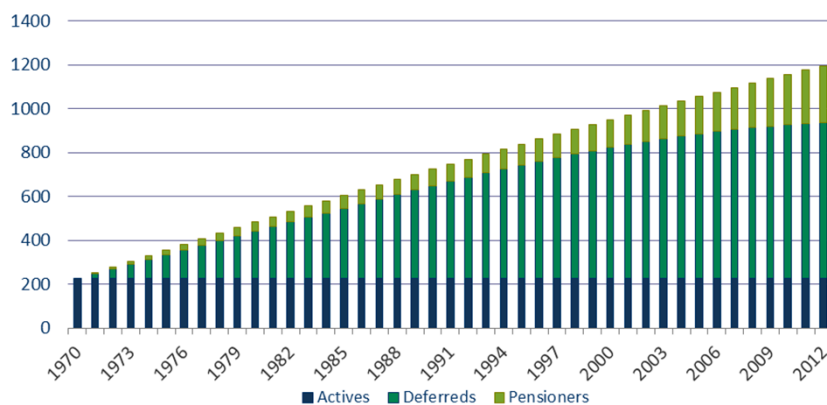
Economic environment – real rises



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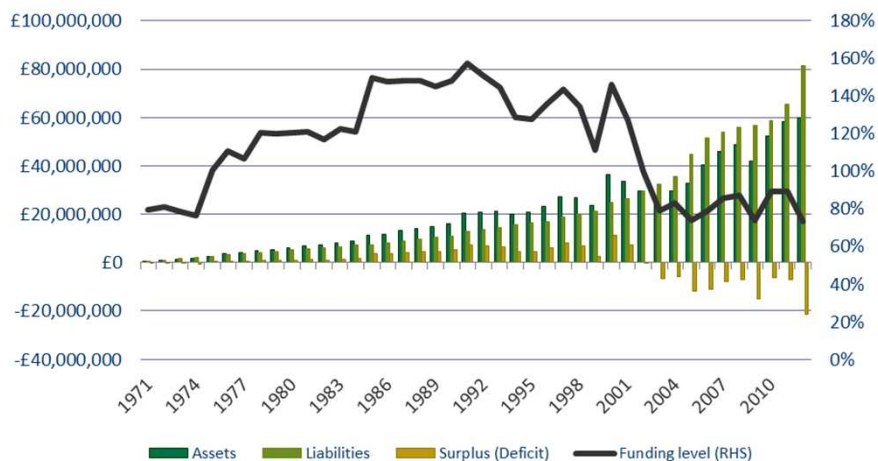
A model of reality - members



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A model of reality – assets and liabilities



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A model of reality – contributions

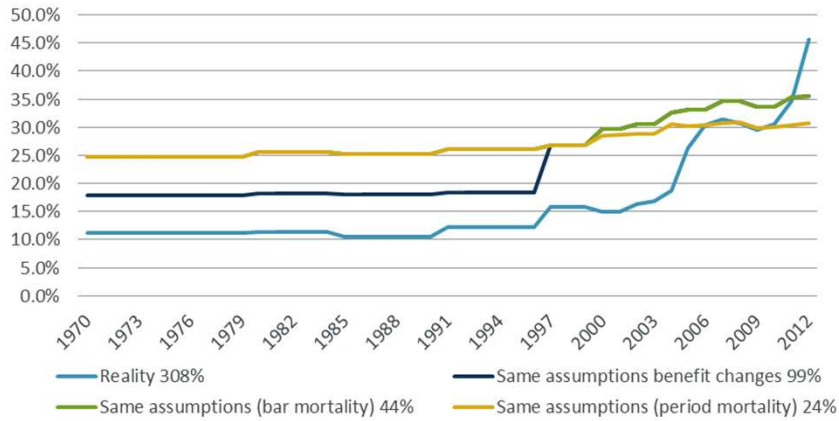


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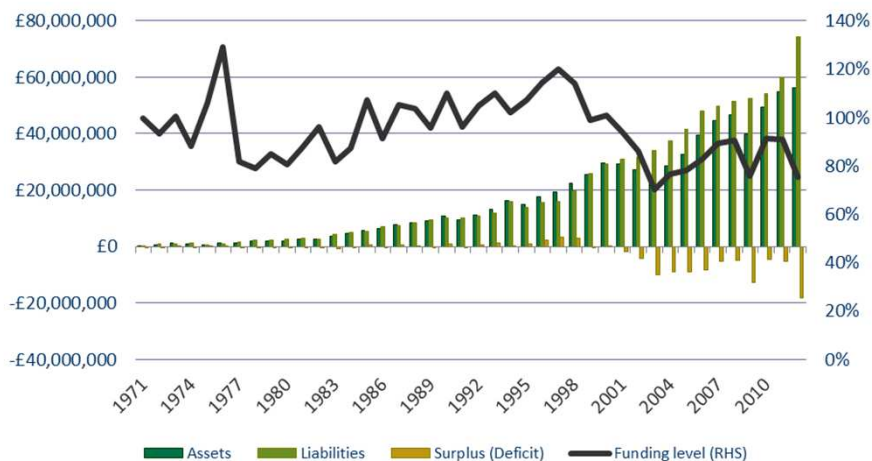
Are final salary pensions unsustainable?



Are final salary pensions unsustainable?

- Yes
 - When you look at the overall increase
- No
 - When you look at the actual increase in benefit cost
 - It is our funding mechanism that causes the problems
- => We need to look at different approaches to funding

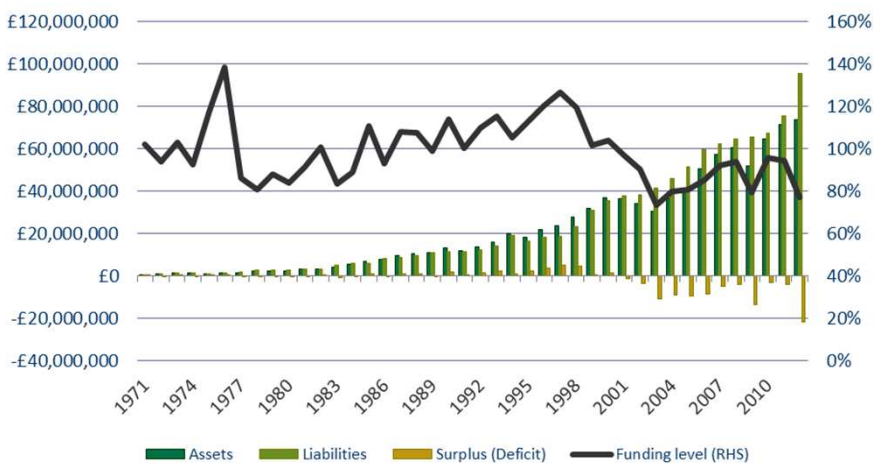
What if we always had market valuations?



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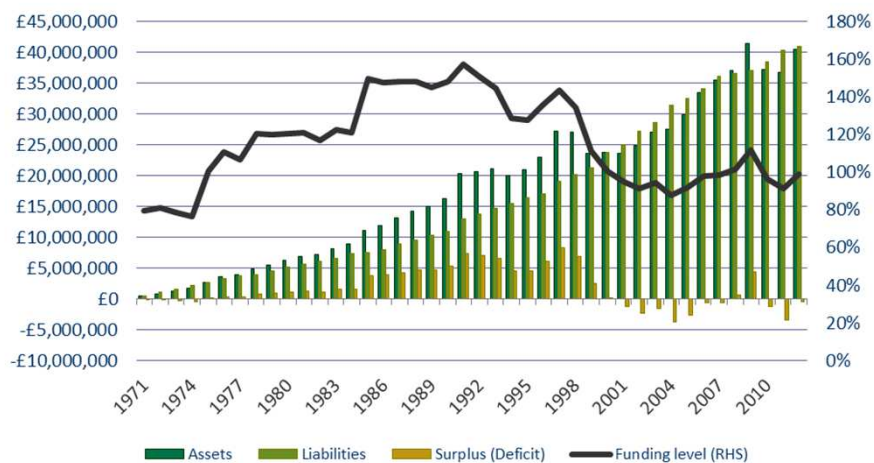
Gilts based - no outperformance



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What if we'd kept DCF?



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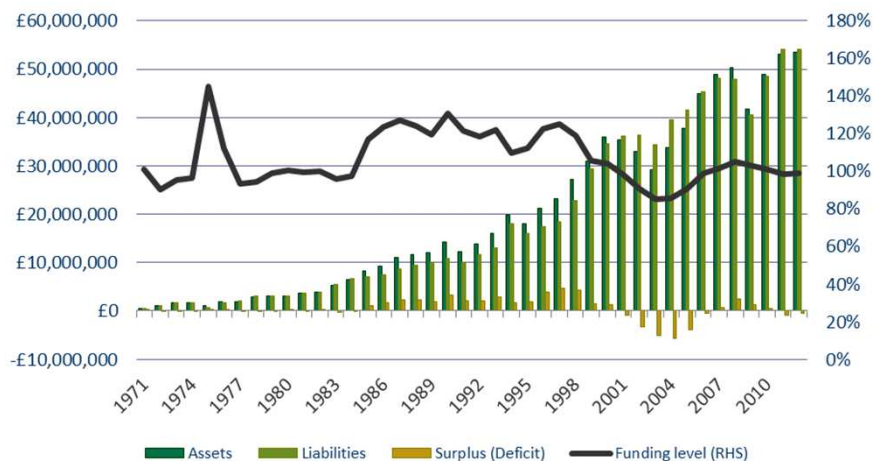
Market valuation vs DCF

- My conclusion is market value is better than DCF
 - More transparent
 - Less odd looking results
 - More volatile
 - BUT... not so much more than DCF to be concerned

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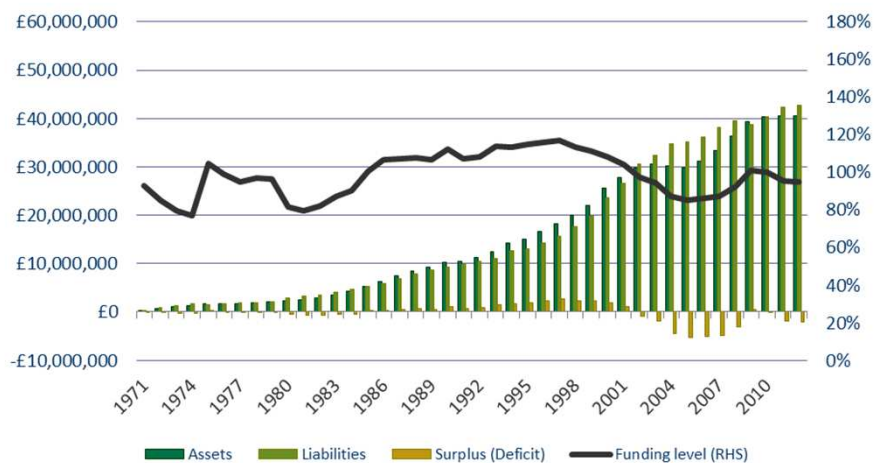
Market value with proper equity assumption



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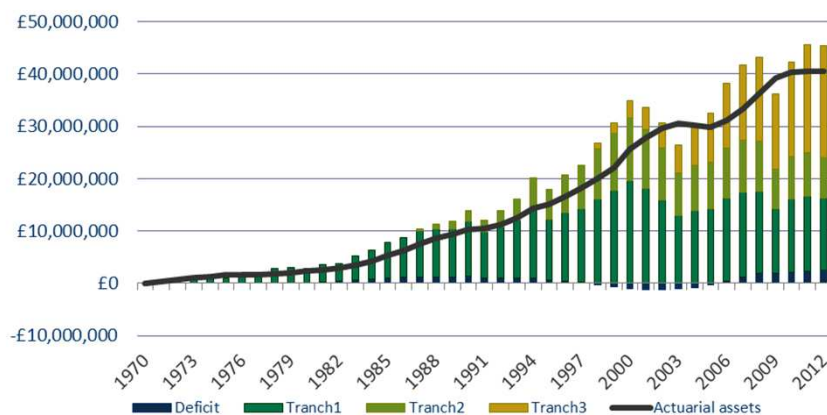
To smooth or not to smooth?



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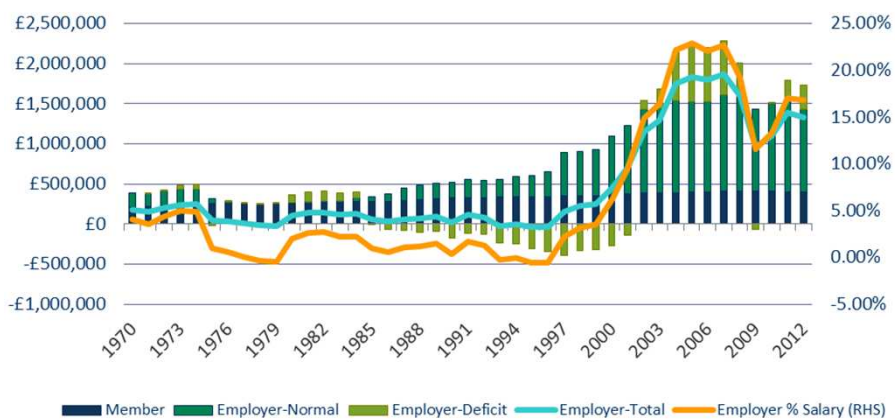
Smoothed assets



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Contributions under this approach



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Final thoughts on valuation approaches

- This approach is less prudent
- But it is still prudent
- Questions:
 - How prudent do we need to be?
 - Security or affordability?
 - Certainty or better benefits?

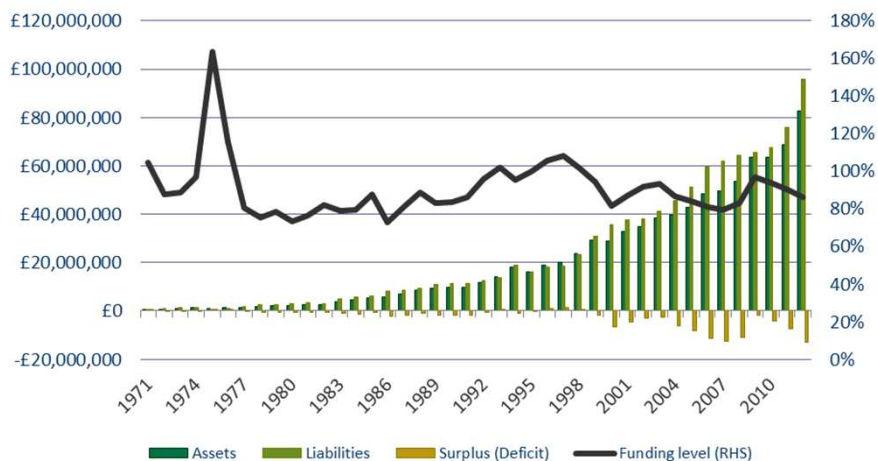


Final thoughts on valuation approaches

- Current regulation
 - built around PPF protection
 - member protection not really there
 - high costs
- Instead of the PPF being the problem make it the solution
 - No need to worry about security
 - Can focus on efficient vehicles and good member outcomes



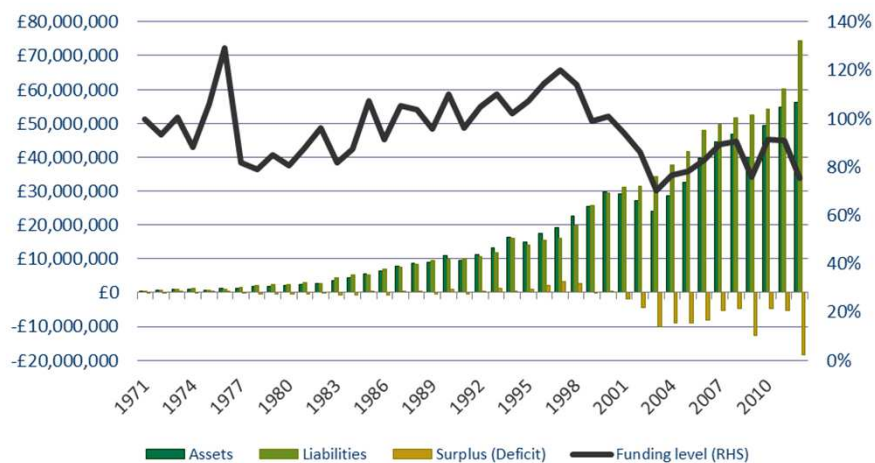
Asset strategies - 100% bonds



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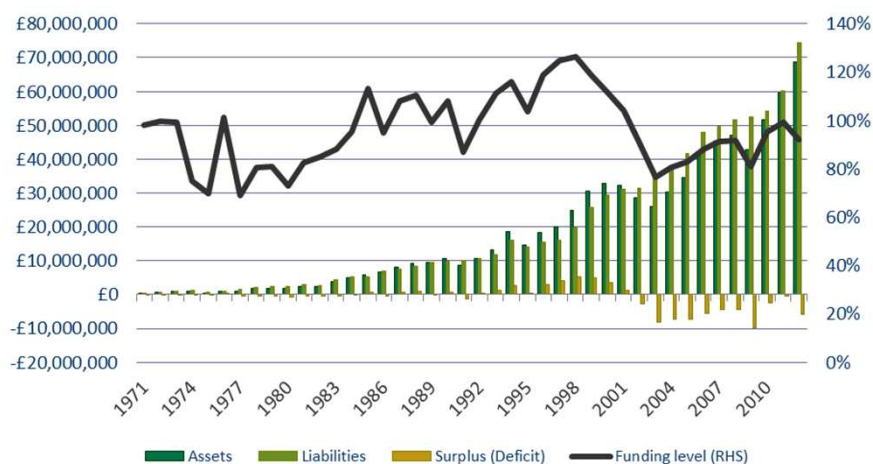
Asset strategies – compared with 70/30



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Asset strategies – Add in LDI



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Is DC the answer?

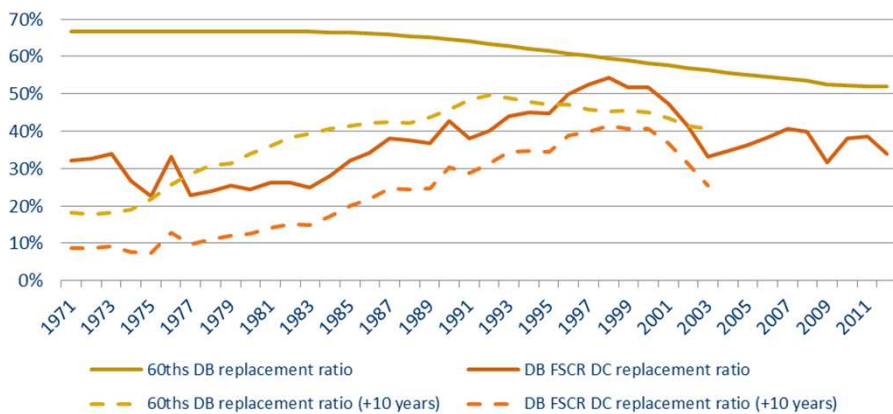
- UK seems to have decided so
 - Replacement scheme when DB closes
 - Vehicle of choice for state auto-enrolment - NEST
- The good
 - Easy and risk free for the employer (in the traditional sense)
 - Value very transparent
- The bad
 - It's not really pension, just savings
 - Inefficient
 - Lots of risk and much to understand for members



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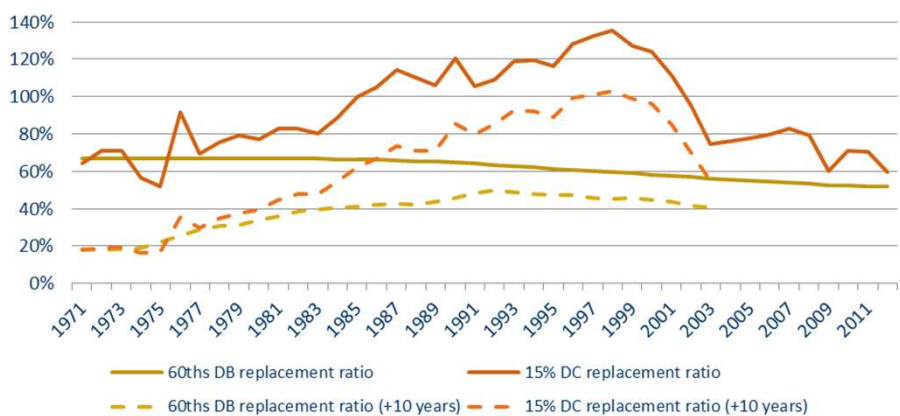
Is DC the answer? – 40y member outcomes



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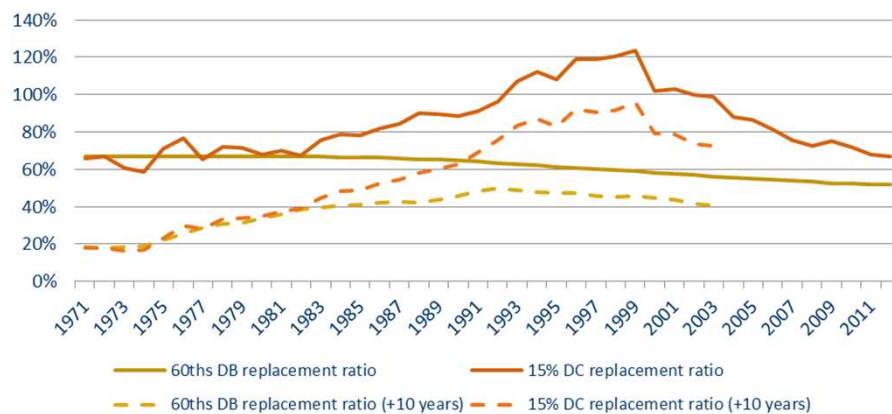
Is DC the answer? – 40y member outcomes



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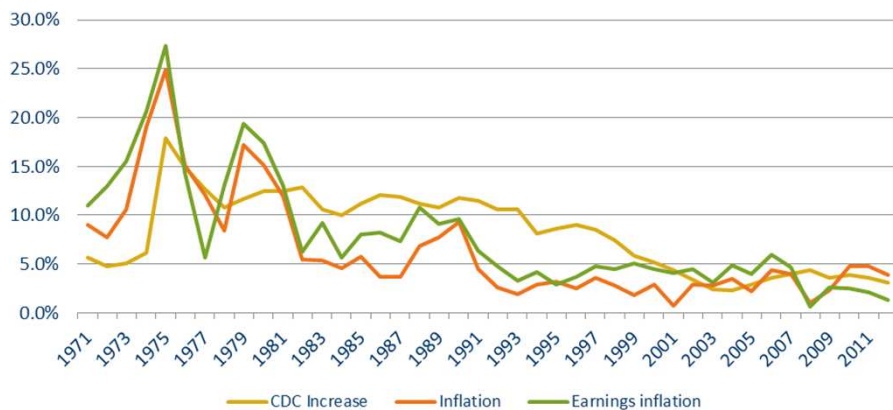
Is DC the answer? - lifestyling



Collectively we do better - CDC

- Contributions fixed like DC
- Assets equal liabilities like DC
- Career average benefits like DB
- Increases dependent on performance
 - Before and after retirement
 - In and out of service

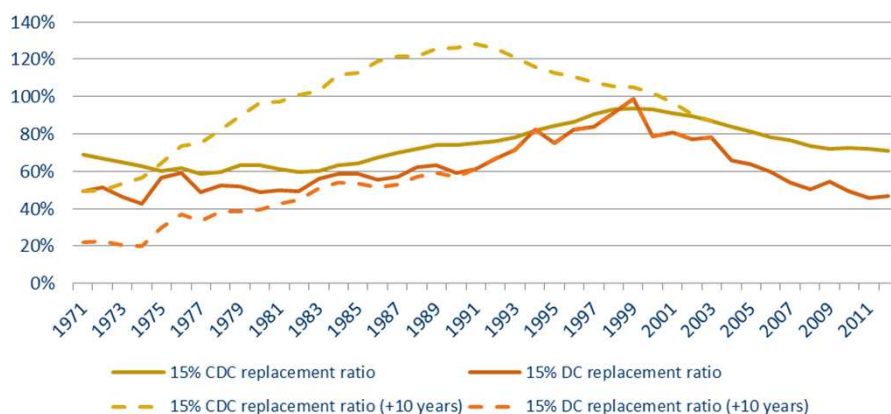
CDC – Increases



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CDC – Member outcomes



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Conclusions on CDC

- Better outcomes for members
- More stable outcomes for members
- No extra cost to employers
- => **Surely we should think about it more?!!**



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Summary – key conclusions

- Value liabilities using better assumptions
- Smoothing works
- Solve the insolvency problem
- LDI works (but solves the wrong problem)
- DC not as bad as I thought
- Lifestyling works
- CDC is so much better!



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One final thought

Pensions? Where we're going, we don't need pensions.



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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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



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