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Current Issues in Funding

The Role of the Actuary

Nicola MacKay
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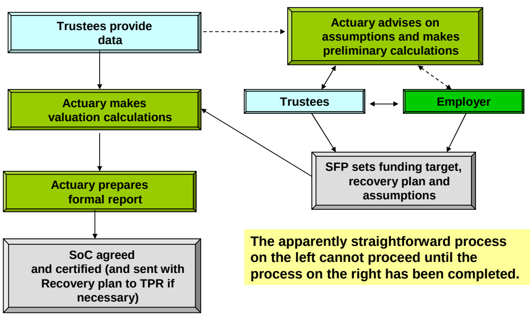
Agenda

Overview	Overview of the role of the actuary in the funding process
Technical Provisions	Advising on the setting of Technical Provisions
SFP	Helping the Trustees to draw up their Statement of Funding Principles
Solvency	Estimating solvency including the interaction with the PPF
Recovery Plan	Advising on the Recovery Plan
Schedule of contributions	Advising on Schedules of contributions
Actuarial reports	Preparing the funding update

Funding process

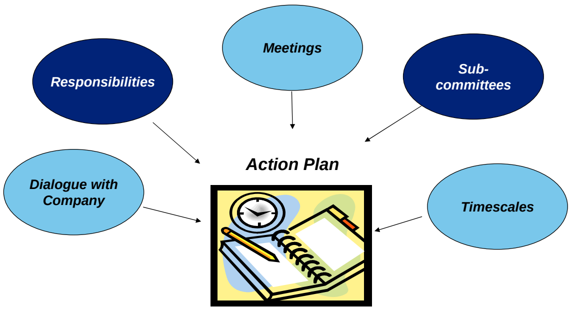
Overview



The apparently straightforward process on the left cannot proceed until the process on the right has been completed.

Overview

Practical Process



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Overview

Advising the Trustees

- Educator
  - Process
  - Practice
  - Requirements (statutory and recommended)
- Guide
- Facilitator
  - Discussions / negotiations with the employer
- Communicator
  - Correspondence etc with the employer
  - Liaison with the Pensions Regulator

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Overview

Interaction with the employer

- Approach of the employer to valuation process can vary:
  - Parallel running of process
  - Interactive involvement at key points
  - Review at end of process
  - Different levels of advice taken
- Approach of employer's adviser can vary
  - Guidance on assumptions
  - Challenging assumptions
  - Negotiation

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Technical Provisions

Company covenant

- Not strictly an actuarial point, but assessing the covenant is an important first step in the funding process
- Covenant and assumptions are clearly linked
- Affects level of risk that trustees can accept in the funding plan and investment strategy
- Contingent assets may affect covenant

Weaker covenant
•Very cautious assumptions?
•Cautious investment strategy?

Stronger covenant
•Less cautious assumptions?
•Some risk in investment strategy?

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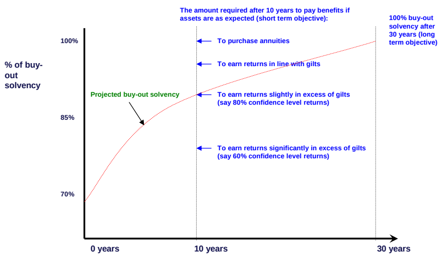
Technical Provisions

Drawing up a journey plan - relationship between short and long term objectives



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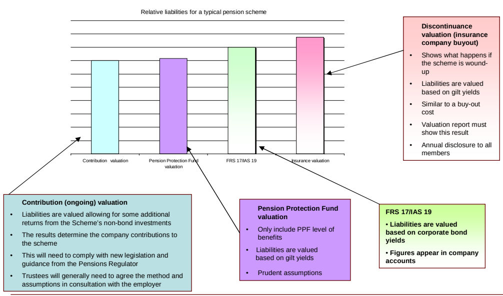
Technical Provisions

Setting a target - different ways that liabilities can be valued



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Setting the assumptions

Technical Provisions

- Determine best estimate
- Build in prudence
  - Which assumptions?
  - How much?
  - What is prudent?

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What risks need to be considered in order to establish the degree of prudence required?

Technical Provisions

- **Covenant** - the risk that the scheme sponsor may not be able to continue to pay contributions or make good any future deficits
- **Investment Return** - the risk that the future investment return on assets will be insufficient to meet the funding objective
- **Trustee view** – what do the Trustees define as prudent?
- **Mismatch** - the risk that falls in asset values will not be matched by similar falls in the values of liabilities thereby reducing the funding and/or solvency levels of the scheme
- **Options** - the risk associated with potential exercise of options against the scheme
- **Other demographic risk** - e.g. salary increases, withdrawal patterns
- **Mortality** - the risk that unanticipated changes in mortality will increase the cost of the benefits

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Mortality assumptions

Technical Provisions

- GN9: "This analysis must include the susceptibility of the results to variations in future mortality experience compared with that assumed".
- Code of Practice:
  - "Particular attention should be paid to assumptions about future mortality".
  - "Trustees should consider with their actuary the latest available relevant data on likely future mortality rates".
  - "it might be appropriate to adjust standard mortality tables to reflect scheme, employer or geographic factors where evidence exists to support this"
- The Pensions Regulator: "…indications are that some schemes are probably underestimating life expectancy".
- Institute of Actuaries
  - Library of mortality projections
  - Emphasis on need for actuaries to understand developing trends

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SFP

Statement of Funding Principles ("SFP")

- Summarises the agreed assumptions and methodology
- Agreed between trustees and Company
- Based on advice from Scheme Actuary
- Review and revise following each valuation
- Objectives:
  - Clarity
  - Flexibility

Solvency

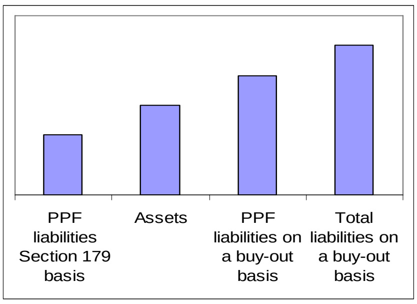
Estimating solvency - complications

- Self sufficiency or buy out?
- Insurance company costs
  - Scheme-specific
  - No rules of thumb
- New breed of buy-out
- Interaction with PPF valuation

Result must be communicated to members via the Members' Summary Funding Statement

Solvency

PPF



Recovery Plan

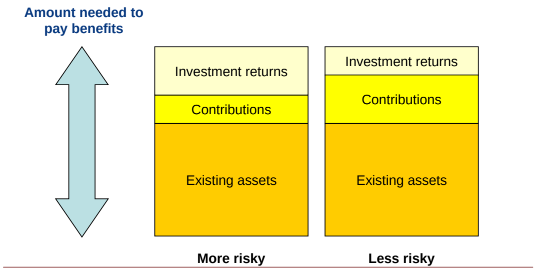
Recovery Plan

- Previously, usually some actuarial input on recovery period
- Now affordability is the key issue
- No statutory timescale for eliminating deficit
- Should aim to eliminate shortfall within a realistic and finite time
- Actuarial role is to advise on the impact of adopting different assumptions for assessing the recovery period

Recovery Plan

Recovery Plan strategies

Result must be communicated to members in Members' Summary Funding Statements



Schedule of contributions

Contributions for future service

- Assumptions
  - Same as for Technical Provisions?
  - Same as in Recovery Plan?
  - Something else?
- Methodology
  - Allowance for ageing
  - Allowance for expenses
  - PPF levies

Schedule of contributions

Special situations

- Actuary may have additional powers to determine contributions under the scheme rules
- Additional certification required by the Actuary
- Actuary must only certify the Schedule of Contributions if the rates are no lower than the actuary would have provided for if he or she had been responsible for preparing the funding documents.

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Schedule of contributions

Revisions to Recovery Plan

- Does the Schedule of Contributions need revising?
- Should an early valuation be carried out?
- Should post valuation experience be allowed for?
- What wording should be used if the shortfall has been eliminated?

Revised certificates should run for the longer of the balance of the Recovery Plan and five years from the date the revised Schedule is certified.

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Actuarial Reports

Actuarial Reports

- Qualitative or quantative?
- Approximate update or full annual valuation?
- New funding advice or consistent with SFP?
  - Actuary's document
  - Trustees/Company confirm consistent with SFP?
- Update of solvency position?
- Action required if position has worsened?

Result must be communicated to members in the Members' Summary Funding Statement

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Summary

- Role of Actuary is key in the valuation process
- Part of the role is to help Trustees (and employers) understand the issues relating to the funding decisions
- Statutory responsibilities outlined in
  - Code of Practice
  - Legislation
- Need to work in accordance with GN9, GN48 and GN49
  - Bring to the attention of Trustees specific matters set out in the code (75,79,102)
  - Peer review of work

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