

Annual Pensions Convention 2006

Cash Commutation An Employer's Actuary View

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5th June 2006

Risk Warning

The views expressed in this session are those of Julian Davies and do not necessarily represent the views of Mercer Human Resource Consulting, the Actuarial Profession, Employers,.....

.....or indeed anyone else.

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Before we start, we have a few questions for you . . .



Who has changed factors in response to A Day?

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Questions . . .



Who has changed factors by more than 25%?

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The Accountant's Bookkeeper
TAKING THE ACCOUNTANTS TO THE MARKET

Questions . . .

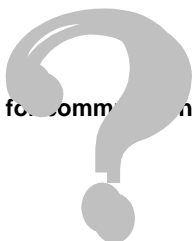


Who allows for Commission in Funding?

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The Accountant's Bookkeeper
TAKING THE ACCOUNTANTS TO THE MARKET

Questions . . .



Who allows for Commission in FRS17?

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The Accountant's Bookkeeper
TAKING THE ACCOUNTANTS TO THE MARKET

What are Employers saying about Trustees?

"I didn't just write a cheque for £40m to improve security so those ***** could **** £30m of it away in benefit improvements"



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What are Employers saying about Trustees?

"How can they pay away money they don't have, based on an investment strategy they don't follow, using tables that don't apply....."



.....supposedly because the law has changed, when it was supposed to prevent an increase in liabilities"

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What are Employers saying about Actuaries?

"How am I supposed to have confidence in someone who advises a 50% factor improvement overnight....."



.....and what do I say to those who retired last year
.....after I fired them"

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What are Employers saying about Actuaries?

"You mean you've just increased all the benefits for non-pensioners by over 5%, when they could have gone down by over 5% after A Day?"



.....Begorrah!

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Topics

- What an Employer might want
- What were actuaries doing?
- What are actuaries doing?
- Observations, issues and anomalies
- Is Regulation or Guidance required?
- A Suggestion
- What should(n't) actuaries be doing?

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A-Day Changes : Employer Perspective

- Welcome HMRC decision to continue to allow tax free cash to be taken
- Welcome HMRC intervention not to increase liabilities when IR limits scrapped via Transitional Regulations
- Why wasn't commutation included for protection?
- Congratulations to actuaries for scuppering that Transitional Regulation Objective!

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A-Day Changes : Employer Perspective

- 25% in cash is a good idea if scheme benefit surrendered
- Taking 25% AVCs in cash is not unreasonable
- Taking 100% AVCs as cash is not reasonable
- Who proposed and agreed to that?

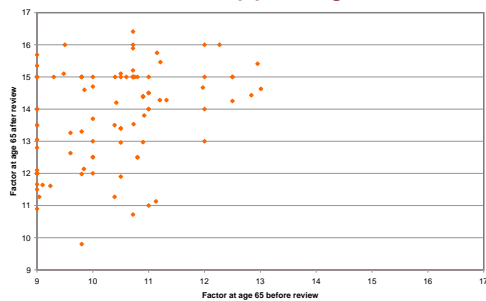
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A-Day Changes : Employer Perspective

- Factors set as low as reasonably possible
- Keep commutation take up as high as possible
- Commute Post 97 benefit first
- Pension plus cash for future service

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What has been happening?



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Technical Considerations

Q. Discount Inflation Rate

- Solvency?
- FRS 17?
- Funding?
- Current or expected?

A. Choose high – tax free compensates (28% - 67%)

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Technical Considerations

Q. Indexed/Non-indexed?

- Exclude indexation if not guaranteed or pre 97?
- Priority Orders, PPF and members interests

A. Choose non-indexed – security improved

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Technical Considerations

Q. Commutation v Transfer Values

- Subject to asset coverage?
- Subject to Priority Orders?
- Reduce for under-funding?

A. Choose low – protect remaining beneficiaries

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Other Considerations – A,B,C,

Anomalies

Benchmarking

Backdating

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Other Considerations

- Consultation
- Conflicts of Interest
- Caution
- Consistency
- Credibility

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Guidance from the Pensions Board

"On 23 July 2004, the *Financial Times* published an article by Debbie Harrison headed *Hidden dangers in tax-free cash option*'. Its central theme was that tax-free cash commutation factors appear less than generous when compared to today's level of annuity rates. Consequently, the Pensions Board would like to draw the attention of pensions actuaries to a very interesting graph on the williamburrows.com website (currently located at <http://www.williamburrows.com/ar/fallingrates.asp>) which shows how dramatically annuity rates have fallen in recent years. It appears that in many defined benefit schemes there may be a good debate to be had with trustees about the degree to which it is necessary and appropriate to move tax-free cash commutation factors in sympathy with the annuity or gilts markets. "

Pensions Board news, September 2004

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Regulation – Overseas Examples

- United States : PBGC, IRA Roll-over
- Belgium : Insurance Chamber, Tax Favourable
- Switzerland : BVG, Guaranteed Annuity Rates
- Holland :No Commutation

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A-Day : Missed Opportunity

- Enshrine Maximum Factors
- Make Commutation Compulsory
- Align Public/Private Sectors
- Reduce Cost Pressure
- Reduced Actuarial Churn
- Level Playing Field

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Risks

- Investment Risk (mismatching)
- Longevity Risk (living longer)
- Employer Risk (insolvency)

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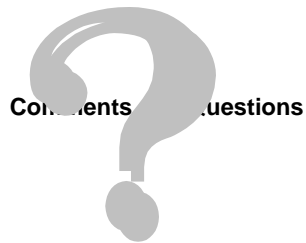
Risks

- Regulatory Risk (wrong goalposts)
- Regulator Risk (fix yesterdays problems)
- Actuarial Risk (reckless approximation)
- Actuarial Risk (hysterical overreaction)

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The Actuarial Revolution
Tackling the Risks of the Future

What Should Actuaries Be Doing?



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The Actuarial Revolution
Tackling the Risks of the Future
