

The Actuarial Profession
making financial sense of the future

Lessons from Politics

Stephen Yeo

Lessons from politics

- Communication means keeping it simple
- How to fool people with numbers
- Problems that will not be solved

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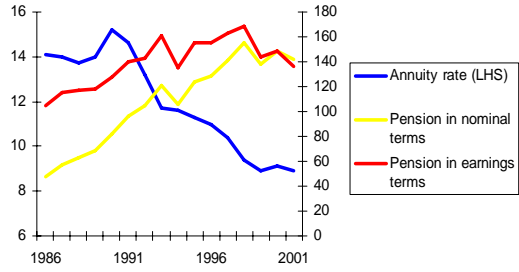
Communication means keeping it simple



A Fair Deal for everyone on Pensions
Written by David Willetts & Stephen Yeo

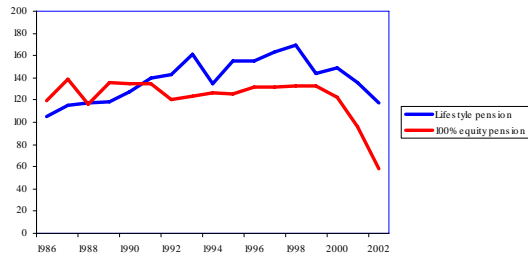
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Government version : Pensions are doing OK



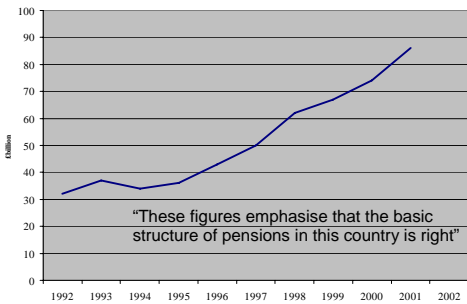
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Opposition version : Pensions cut



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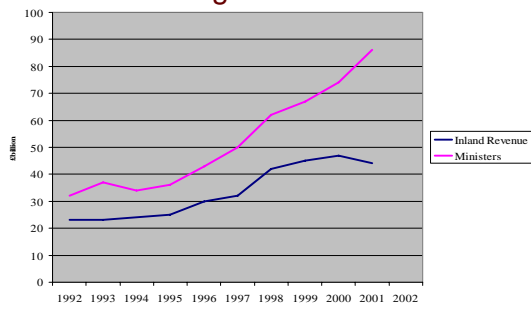
Contributions to funded pensions



"These figures emphasise that the basic structure of pensions in this country is right"

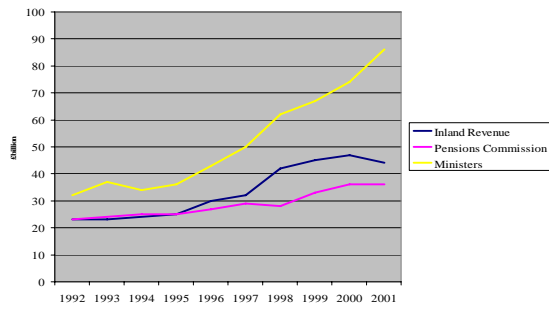
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But were the figures correct?



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The truth was even worse!



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Correct and misleading estimates of life expectancy post-SPA

Correct calculation for the average man

Best estimate of life expectancy of man aged 65 in 2005: 19.4 years ← Cohort life expectancy allowing for anticipated continuation of mortality rate declines.

Misleading (but frequently used) calculation

Period life expectancy of man at birth in 2005: 76.9 years ← Period life expectancy at birth underestimates true cohort measure as it fails to allow for future continuation of mortality rate declines.

Minus State Pension Age: 65 years

=

Calculated (but wrong) estimate of life expectancy post-SPA: 11.9 years ← Subtracting State Pension Age from life expectancy at birth is wrong since it fails to allow for the fact that life expectancy at birth is reduced by deaths that occur before SPA.

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The Prime Minister: 19 June 2002

“Yes, the stock market has fallen, but it is still massively up on where it was five years ago.”

“the stock market rose £520 million before the recent fall, but the fall ... still leaves the stock market in a net balance up of £250 billion.”

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“Yes, the stock market has fallen, but it is still massively up on where it was five years ago.”



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Pensions Bill: Regulatory Impact Assessment

Savings	£ million
LPI	370
Scheme Specific Funding	100
Other Simplification Savings	<u>80</u>
Total Saving	550
Costs	
Pension Protection Fund	300
Other	64
Net admin Costs	<u>28</u>
Total Costs	392
Overall Saving	158

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Full fund on wind up – Regulatory Impact Assessment

“Full buy-out costs would only fall to those solvent employers who opted to wind up their schemes. We cannot calculate the exact costs of full buy-out due to data limitations. But we can estimate that the costs are likely to be in the range £50 million–£100 million. Under the new rules, we have assumed that schemes with more than £500 million in assets will not wind up, due to the limited annuities market. Also, the increased cost of voluntary wind-up will tend to discourage such wind-ups.”

Treasury Select Committee Report: *The 2006 Budget – Public Sector Pension liability*

The Government Actuary's Department estimated the total accrued liability of unfunded pension schemes for public sector employees at £530 billion as of 31 March 2005. However, this estimate is sensitive to the discount rate used. The measured pensions liability increases substantially if a lower discount rate is applied and likewise, the liability falls significantly if a higher discount rate is used. Professor Miles told the Committee that the choice of discount rate was not important: "Whatever number you use as a discount rate arguably one could use the same number to discount future receipts of revenues for the Government".

Treasury Select Committee Report: *The 2006 Budget – Recommendation 1*

Future public sector pensions can be paid from future tax revenues and therefore long-term forecasts of cash payments are directly relevant when considering fiscal sustainability. We recommend that the estimated present value of the Government's public sector pension liabilities today, which is useful for the purposes of comparing the pensions provision for public sector employees with that for employees in the private sector, be published regularly.

**Treasury Select Committee Report:
The 2006 Budget – Financial Assistance
Scheme**

The Pensions Commission has noted that there are a number of ways of presenting the future cost of pensions, but expressing them in cash terms is "the least useful because it exaggerates how expensive something will feel". Treasury appraisal guidance indicates that costs should be expressed in present value terms, using an appropriate discount rate.

Cost of FAS compensation

This is how the DWP say they have calculated the £15 billion cost of compensation.

125,000 people X average loss in pension £1,815 = £227m per year

227x30 years = £7bn. Although scheme would be expected to run for up to 50/60 years, costs in later years will decline significantly as people die.

Add on revaluation of rights (at 2.5% per year) for deferred members to scheme pension age increasing costs by 45% to £10bn

Add on indexation of pension once in payment (at 2.5% per year) increasing costs by 30% to £13bn.

**Treasury Select Committee Report:
The 2006 Budget – Recommendation 2**

A full understanding of the costs associated with policy options arising from the recent Report of the Parliamentary Ombudsman on final salary occupational pensions is essential to a proper public and parliamentary debate on that report in the context of the Comprehensive Spending Review. We recommend that the Government publish estimates of the cost of various options for compensating affected pensioners in net present value terms as part of the Department for Work and Pensions' further reply to the Report of the Parliamentary Ombudsman, including options for expanding the Financial Assistance Scheme.

**Treasury Select Committee Report:
The 2006 Budget – Cost of Public Sector
Pensions**

Another way in which the Government is seeking to release resources for front-line services is to secure savings from reforms of public sector pensions. In December last year the Chancellor of the Exchequer expressed confidence that these reforms would secure savings of around £13 billion. He also did not rule out the possibility of sector-by-sector negotiations leading to consideration of the age of retirement for serving public servants: "I think it is possible that all things will be looked at in the sector-by-sector negotiations" Treasury officials told us that they still expected to recoup the level of savings set out in the original proposal.

How much is £13 billion over 50 years?

- Less than 1% of outgo
- Present value at 3.5% discount is about £4 billion
- One year's salary strain in the NHS alone added £7 billion to accrued liabilities

Confusion over discount rates

In one report:

- FAS liability must be discounted, because cash liability overstates it
- Discount rate chosen for the accrued public sector liability doesn't matter
- Savings in future public sector pension costs presented as the cash cost over 50 years

Problems that will not be solved – MP's pensions



Letter from Chairman of Trustees to MPs

- There is no proposal to increase our pensions
- Members are not rewarding themselves at the expense of the taxpayer
- The whole cost will be met by member contributions
- Past contribution holidays would cover the cost
- MPs are setting a good example
- Average service is less than 10 years

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Increasing State Pension Age – taboo removed

- SPA - Polarising issue
- Not mentioned at 2005 General Election
- “Graduates to work to 70” story in May 2005
- Now everyone supports it!
- Lord Turner's major achievement

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Stripped of their pensions



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Parliamentary Ombudsman



What could members of underfunded schemes have done?

- pressured employers to raise contributions
- elected not to transfer benefits from other pension arrangements into the scheme;
- opted not to make additional voluntary contributions or otherwise spread their investments;
- retired from schemes sooner in order to secure their place higher up the winding-up priority order; or
- sought to take transfer values from schemes in financial distress (before reductions for under-funding were applied to transfer values).

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Lessons

- Communication means keeping it simple
- Governments have a huge resource advantage, but they need constant attention to detail to gain full advantage from it.
- Politicians would rather persuade you that black is white than admit that they are wrong
- Politicians, and their advisers, will take any opportunity to spin numbers to their advantage
- MPs have got their snouts in the trough

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