

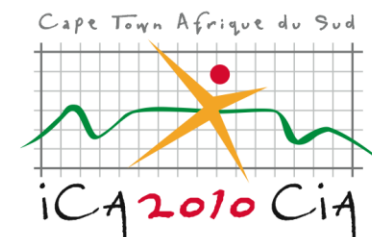


Re-invigorating company pensions through risk sharing between employer and scheme members

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Theme of the presentation



**Lessons from the experience of the
ACA engaging with Government and
those who influence national policy in
the United Kingdom**

History of change



Brief history of, and reasons for, the replacement of final salary pension plans in the UK private sector by defined contribution arrangements

- New legislation made the employer sponsoring a defined benefit (DB) plan liable for full accrued pensions if the plan was wound up i.e. a change from an employer's "best endeavours" to a "guarantee"
- Increasing longevity, and related uncertainty, coupled with a reduction in long-term interest rates
- New standard for accounting for pensions in company financial statements

History of change continued...



Brief history of, and reasons for, the replacement of final salary pension plans in the UK private sector by defined contribution arrangements

- First wave of DB closures to new entrants
- Second wave of DB closures to future accrual of benefits
- Switching has been almost entirely so far to DC; very few risk sharing arrangements
- There has been a growing number of new career average (revalued) DB plans
- UK law makes it difficult to establish pension arrangements which share risks between employer and scheme members in meaningful and cost-effective ways

Political difficulties



The political difficulties of removing the requirement for indexation of defined benefit pensions, both in payment and deferment, in the UK

- **UK unique in the world for requiring mandatory indexation in payment and in deferment for final salary plans in the private sector**
- **Memories of how price inflation had materially devalued the purchasing power of pensions before mandatory indexation**
- **Affected attitudes of trade unions, senior civil servants and politicians**
- **Aversion to removing the protection fought for in the past**

What presently possible?



What risk sharing between the employer and plan members can be achieved under current UK legislation?

- **DB: Changing rate of future accrual of benefit**
- **DB: Changing normal pension age for future service benefits**
- **DB: Varying the rate of member contributions**
- **Cash balance plans**
- **Combining DB with DC**

Pressure for change



The pressure for change in legislation to extend significantly the scope for risk sharing

- **Why should ALL the terms and conditions relating to a year's accrual of DB have to be "guaranteed" for a period of up to 45 years or so until payment of pension commences?**
- **The significant inefficiency of DC compared to DB due to the pooling of risks and investments, as manifested by the difference in the expected cost of each £1 per annum of pension**

Technical development



The technical actuarial development of conditional indexation for defined benefit plans, whereby indexation is pre-funded but granted only if the plan funding is not in deficit, and of changing normal pension age to reflect longevity experience

- **Technical development by ACA**
- **Legal changes identified by the Association of Pension Lawyers in the UK**
- **Consultation carried out with the Pensions Regulator and the Pension Protection Fund**
- **Legislative changes needed to introduce conditional indexation into UK legislation were tabled in a formal amendment to the 2007 Pensions Bill (supported by both major Opposition parties) and were debated in the House of Commons and in the Committee stages of the Bill**

Technical development



Main features of the ACA developed conditional indexation include

- **Sharing risks equitably amongst actives, deferreds and pensioners**
- **Funding deficits are removed automatically over relatively short periods by adjusting future pension increases**
- **Accrued benefits are fully protected on wind up**
- **A stable rate of employer contributions can be expected because of the cushion of funding reserves held in respect of future pension increases**
- **Normal pension age can be increased for accrued benefits in respect of members who have 10 or more years to reach normal pension age, provided the increase can be justified actuarially, by reference to actual increases in longevity**

Reactions to idea



The reactions thereto of Government, political parties, parliamentarians, employer bodies, national pension organisations and the media

- **Generally positive**
- **The one major exception was the trade unions (representing mainly public sector workers) who argued against any changes to DB indexation requirements. Public sector schemes are generally DB with index-linked pensions**
- **The national newspapers and the pension trade press were very supportive – also featured on BBC radio programmes**

Reactions to idea continued...



The reactions thereto of Government, political parties, parliamentarians, employer bodies, national pension organisations and the media

- **Government established a Deregulatory Review of Private Pensions**
- **An independent report by Chris Lewin FIA and Ed Sweeney (a senior trade union leader) on the Deregulatory Review was commissioned by the Department of Work and Pensions**
- **Report gave divided views on major issues including conditional indexation**

Other advantages



The possible impact on the polarisation between UK private sector and public sector pensions

- **Conditional indexation would go some way towards closing the gap between private sector provision and public sector provision which is 100% DB**
- **There would then be an arguable case that public sector provision could remain DB – but at lower quantum of benefit than currently, including a cap on pensionable earnings**

Government consultation



The formal consultation carried out by Government on changing the law to facilitate new ways of risk sharing

- Risk sharing consultation document was issued on 5 June 2008 in response to the pressure from the amendment to the 2007 Pensions Bill promoted by the ACA
- Consultation closed on 28 August 2008
- Subjects covered were
 - What risk sharing can be implemented under current legislation
 - Conditional indexation
 - Collective defined contribution approaches

Outcome of consultation



Why the UK Government decided not to make any changes to the law at the current time to allow conditional indexation

- They said significant additional regulation required – but not according to UK's Association of Pension Lawyers
- Complexity would hamper member understanding – surely could be managed and no more difficult than DB or DC
- Not sufficient demand from employers – results of very small Government survey of just over 30 firms highly questionable and not borne out by much larger surveys carried out by ACA

Outcome of consultation continued...



Why the UK Government decided not to make any changes to the law at the current time to allow conditional indexation

- Experience in The Netherlands (where conditional indexation is the norm with a small proportion of private sector schemes being collective DC) rooted in the Dutch industrial relations model – but UK version based on UK work and pensions environment
- No workable consensus apparent – there is no need for consensus for legal changes which open up new design options for those employers who want to use them

A closed door?



The possibilities for change in the near future, given a General Election is due in the UK no later than 3 June 2010, and the views of the Opposition political parties

- **The amendment to the 2007 Pensions Bill was tabled by HM Opposition to facilitate conditional indexation after extensive briefings**
- **The amendment survived well into the parliamentary process but, in the end, was withdrawn with the Government arguing for a wider risk sharing consultation**
- **The amendment was supported by both main Opposition parties – Conservatives and Liberal Democrats**

A closed door? continued...



The possibilities for change in the near future, given a General Election is due in the UK no later than 3 June 2010, and the views of the Opposition political parties

- **Public opinion polls have, for some time, pointed to the likelihood of the Conservatives winning the next General Election, although the lead has recently been narrowing**
- **The Conservative party is still very interested in conditional indexation – both the Shadow Secretary of State for Work and Pensions and the Shadow Pensions Minister have spoken in favour**

A closed door? continued...



The possibilities for change in the near future...

- **The new legislation required to facilitate conditional indexation should be straightforward and could be implemented quickly – acting as a stepping stone to further legislation in due course to allow a wider range of new risk sharing opportunities**
- **Press coverage daily highlights DB scheme closures and the inadequacy of pension provision for the generations after the baby boomers**
- **Although pensions is unlikely to be a key theme in the General Election campaign, the public are well aware of the collapse of a once admired system for providing good quality pensions in the private sector and politicians would be unwise to ignore the high level of public concern**

OECD support



The support for conditional indexation as having more potential than other risk sharing mechanisms was given in a technical paper, dated March 2009, by the Organisation for Economic Co-operation and Development

- **OECD is a highly regarded independent body**
- **The report came “out of the blue”**
- **A range of different risk sharing methodologies was examined**
- **Conditional indexation was determined to be the most efficient**

What's to be done?



What should be done for the future, or will defined contribution arrangements be the only type of pension plan for other than a small minority of the population in the private sector in the UK?

- **Remove the indexation requirement for pensions in payment for DB plans in the private sector**
- **If politically unacceptable, change the law to allow conditional indexation (ACA version)**
- **Legislative changes might also 'free up' other pension design possibilities from present regulatory restrictions, such as collective DC and cash balance plans – employers should have better choice available to suit their business needs (and those of employees)**

What's to be done? continued...



What should be done for the future...

- **Retain DB including mandatory indexation for the public sector, but with lower quantum of benefit, pensionable earnings capped and pension ages changing to reflect increasing longevity**
- **Make proper allowance in public sector remuneration for a DB pension with mandatory indexation which will be reflected in levels of wages and salaries relative to those in the private sector**
- **Timing is important – UK is introducing auto-enrolment from 2012. Employers need new choices in legislation ahead of this, otherwise switch to DC to mitigate costs may accelerate still further**

The lessons



Lessons to be learnt on how to bring actuarial influence to bear in the public arena in a non-party political way

- Tackle Government and each main Opposition party separately but in parallel
- Work alongside major employer bodies and main trade unions
- Keep media fully informed
- Consult with other national pension bodies, recognising their different agendas, and collaborate where possible for strength in numbers
- Continually hone the positioning of your argument but not the substance

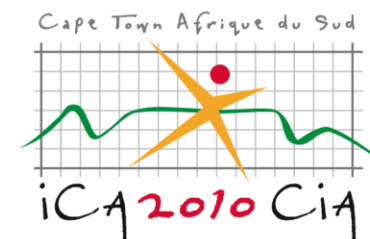
The lessons continued...



Lessons to be learnt on how to bring actuarial influence to bear in the public arena in a non-party political way

- Re-check the substance of your argument from time to time
- Keep battling on when events and opinions turn against you
- If you are confident your argument still stands up, do not give up
- Keep calm and confident at all times
- Believe that, at some point, the tide will turn in your favour
- The discipline and rigour of actuarial thinking will see you through

Contact Details



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