

Actuarial Assumptions for Assessment of Broad Comparability

Introduction

1. The government has a long-standing policy of protecting the pension rights of public employees whose functions are transferred to the private sector. At the time of transfer of employment the new employer must provide a pension arrangement which provides broadly comparable future service rights to those of the public service pension scheme from which the employees will be transferring. The principles on which broad comparability is assessed are contained in a Statement of Practice prepared by GAD, which forms an integral part of the Fair Deal policy (http://www.gad.gov.uk/pensions/staff_transfers). These include both tests of financial and qualitative value.
2. This note sets out the key actuarial assumptions used by GAD in making its assessments of financial value for broad comparability.

Methodology

3. GAD assess the value of a set of pension benefits by calculating the underlying employer cost, in excess of the contributions paid by employees, of providing scheme benefits which will accrue over the employees' remaining working lifetime. The employer's cost is expressed as a level percentage of pensionable pay which would be payable throughout that working life. The value is measured gross of any liability for tax. This approach to the assessment of cost is known as the 'Attained Age Method'. This method can be applied at any age and in respect of any member potentially involved in the transfer.
4. The results of the assessment depend on a number of assumptions made. These cover financial and demographic factors for the period until pension payments to the employee and to his or her dependents have ended.
5. Most of the assumptions are common to all our assessments. These include the financial assumptions and the set of mortality rates assumed to apply to pensions in payment. Other assumptions may depend on the pension scheme and the work group from which the employees are being transferred. Those other assumptions would generally be derived from the experience of the pension scheme against which broad comparability is to be measured, supplemented by information from other large schemes as necessary.

Financial assumptions

6. In all cases, long-term assumptions are made. These are assumed to remain unchanged from the date of assessment until benefit payments end. Although the public service pension schemes provide pension increases which follow directly changes in retail prices this is not the case for most scheme designs being considered for broad comparability. It is therefore necessary to have assumptions which cover alternative forms of pension increases. The most common are the two variations of limited price indexation with annual caps of 5% and 2.5%.
7. The main assumptions are:
 - 1 The gross annual rate of return achievable on investments is 6.5%.

- 2 The annual rate of investment return net of changes in general earnings growth is 2%.
- 3 The annual rate of return net of pensions increases fully linked to RPI is 3.5%.
- 4 The annual rate of return net of statutory limited price indexation with a cap of 5% a year is 0.75% more than that with uncapped RPI indexation.
- 5 The annual rate of return net of statutory limited price indexation with a cap of 2.5% a year is 1.75% more than that with uncapped RPI indexation.

These assumptions imply:

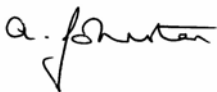
- 1 An annual average rate of pensions increase for schemes with uncapped RPI indexation of 2.90%.
- 2 An annual average rate of pension increases for schemes subject to LPI with a 5% cap of 2.15%.
- 3 An annual average increases in real earnings (before separate allowance for increment due to promotion and performance) of 1.47%.

Mortality of pensioners

8. The mortality of former scheme members during their retirement (other than for those who have left on ill-health grounds) is derived from standard actuarial table PMA92/PFA92 for calendar year 2045. Scheme-specific adjustments may be made to align with experience analysis. This basis also applies to the widows', widowers' or other dependents of a former member who has died. In each case, where the transferees are non-manual employees, the table is used as though the individual's age was one year younger than actual age.
9. Those who retire on ill-health grounds are assumed to have heavier mortality.

Review

10. GAD's technical committee keeps the assumptions used for the assessment of broad comparability under review to ensure objective outcomes. It remains GAD's intention, however, that changes in these assumptions should be infrequent to maintain consistency.
11. A background note has been issued to accompany this note which sets out more information on the choice of the assumptions for the differential between full retail price indexation and limited price indexation. Copies can be downloaded from GAD's website www.gad.gov.uk.



Andrew Johnston
Head of Pensions Directorate
Government Actuary's Department
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