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A very warm welcome to the latest edition of **e-News from GAD**.

GAD has been a very busy and active department over the last few months. A lot of this relates to public service pensions 'reform' planning but we have still had time to progress new areas on developing issues, such as strategic risk, long-term care and modelling to name a few.

So it is with great pleasure we issue this latest edition of e-News covering a number of both the busy and developing areas.

We very much value your feedback on eNews, either to your usual GAD contact or to our central email address enquiries@gad.gov.uk. As always, previous issues of e-News are available on our website www.gad.gov.uk.

Wishing all our readers a very happy Christmas and New Year holiday.

A handwritten signature in black ink that reads "Trevor Llanwarne".

TREVOR LLANWARNE GOVERNMENT ACTUARY

NEWS FROM GAD

Scotland office

From 4 January 2012 our Scotland office, under the leadership of Ken Kneller, will move to a new permanent location at Room T18, 44 Drumsheugh Gardens, EH3 7SW.

Promotions

Norman Niemi has recently been promoted to Deputy Chief Actuary, leading on General Insurance within our Insurance Team. Paul Nixon has recently been promoted to Deputy Chief Actuary in our Staff Transfers Team, taking over from Sarah Brough who has transferred to Deputy Chief Actuary of the NHS and Funded Schemes Team. Congratulations to all of them and we wish them success in their roles.

EMERGING ISSUES

Deputy Pensions Ombudsman ruling on deadlines

A [recent Deputy Pensions Ombudsman case](#) demonstrated that to avoid findings of maladministration it may not be sufficient to merely comply with statutory deadlines. The case in question concerned delays in issuing a transfer cheque, which meant that payment was not made prior to the member's death resulting in lower death benefits being payable. In particular, the Deputy Pension Ombudsman commented that 'it should not take more than five working days to raise and issue a transfer value cheque'.

Pensions—Definition of money purchase benefits

The Supreme Court dismissed the DWP's [appeal in *Houldsworth v Bridge Trustees & Secretary of State for Work and Pensions*](#) and upheld an earlier decision of the Court of Appeal about the definition of money purchase benefits. The case decided two fundamental issues: that a guarantee in the accrual phase does not prevent the rights from being considered to be money purchase benefits and 'internal annuities' remain money purchase benefits. In response, the DWP has included legislation in the [Pensions Act 2011](#), to ensure that only benefits that cannot develop a funding deficit are defined as money purchase. We will consider any implications resulting from this legislation on a scheme by scheme basis.

Kay Review — UK equity investment

The Kay Review of UK Equity Markets and Long-Term Decision Making, set up to examine investment in UK equity markets and its impact on the long-term performance and governance of UK quoted companies, launched a [call for evidence](#) in September. The consultation closed on 18 November 2011. The review is expected to publish an interim report in February 2012 and a final report in July 2012.

Investment and Risk team grows

We are delighted to have strengthened our Investment & Risk team with the appointment of Matt Gurden, an experienced pensions and investment actuary. Matt is one of the first actuaries to obtain the new Chartered Enterprise Risk Actuary qualification.

Client survey

We are very pleased that responses to this year's client survey are broadly in line with, and in some respects significantly better than, those in the 2010 survey. Our strategy for the three years to 2014 is to continue to focus on further improving our flexibility and responsiveness. [Detailed results](#) of the survey are available on our website.

Insurance—Solvency II and Omnibus II

Draft Presidency Compromise text of the proposed Omnibus II Directive (which will amend the Solvency II Framework Directive and the Prospectus Directive to reflect EU regulatory reform) was published in July, with a [further draft](#) published in September. The FSA, the UK Insurance Regulator, has revised its [implementation assumptions](#) in light of the discussions. The FSA is working to a date of 1 January 2013 to put the legal framework into place for supervisors and EIOPA and 1 January 2014 for firms to comply with the new rules, although further delays are possible.

EIOPA: Draft response to call for advice on review of IORP Directive for Pensions

The European Commission issued a [Call for Advice](#) for the European Insurance and Occupational Pensions Authority (EIOPA) to provide advice on changes to the [IORP Directive](#) (2003/41/EC) which affects pension schemes. EIOPA has issued two consultations on its response. The [first consultation](#) closed in August and the [second consultation](#) will close on 3 January. This has no immediate implications for pension schemes but may become important area if solvency II principles are extended to pension schemes.

Dilnot Commission—long-term care

The Dilnot Commission on Funding of Care and Support in England published its [report](#) on 4 July. The main recommendations included a cap on individuals' lifetime contributions towards their social care costs with full state support thereafter and an increase in the means-test threshold above which people are liable for their residential care costs to £100,000.

We are working with our clients to identify and resolve the issues arising from these developments. Queries on any of the emerging issues can be discussed with your usual GAD contact or our Technical Director, Colin Wilson.

The ageing population is always in the headlines. The Office for National Statistics estimates that life expectancy in the UK has reached its highest level on record for both men and women. Most of us are living longer, and this means more of us are likely to need to be cared for when we get very old, even if we are in relatively good health now. This care might be provided in our own home, a residential home or a nursing home.

The cost of providing this long-term care (LTC) is a major concern both for individuals and the government. Care in residential or nursing home can be expensive, averaging £36,000 a year in the UK, and although the average stay in care is about two years, for some people the time can be much longer.

Recent research by the PSSRU* suggests that a quarter of people aged 65 today will need to spend very little on care over the rest of their lives. But half of people aged 65 can expect to spend over £20,000 on their own care needs in their lifetimes. A quarter can expect costs over £50,000. And one in ten can expect costs over £100,000. For a few, living longer means catastrophic costs of care over £250,000.

Long-term care funding in the UK

The social care system in the UK was established in 1948. In England, Wales and Northern Ireland local authorities charge fees to provide social care services to those aged over 65 in their own homes. These services might include assistance in performing everyday tasks, home adaptations, for example, installation of a stair lift, or financial help, for example, for insulating their homes for winter. Local authorities in Scotland provide free personal and nursing care and in Wales fees are capped at £55 a week.

Local authorities also provide funding assistance for care received in residential and nursing homes through a means-tested system. Very broadly, under this system, people in England and Northern Ireland with assets over £23,250 receive no financial state support. In Scotland and Wales the thresholds are lower at £22,750 and £22,000, respectively. Assets for the purpose of the means test include savings, investments and in some cases, property assets. Therefore some people are forced to sell their homes to pay residential and nursing home fees. Many see this as a disadvantage to those who own property, given thresholds are low compared to average house prices.

The National Health Service (NHS) also provides a weekly contribution of £108.70 (or £120.55 in Wales) for people in nursing homes. The NHS may also provide full funding for people who require specialist medical treatment in nursing homes under its *Continuing Healthcare* plan.

The Dilnot Commission

In July 2010 the UK Government established the Commission on Funding of Care and Support chaired by Andrew Dilnot to address several of the issues with the current system for care and support, for all adults in England, both in the home and other settings. The Commission submitted its [report](#) in July 2011 and recommended, among other matters, that:

- > the amount any individual should be required to contribute to the cost of their social care (apart from normal room and board costs) should be capped at between £25,000 and £50,000
- > the means-test threshold be increased to £100,000.

The Commission also recommended standardising assessments across England and improving public awareness of the system. The costs of all the proposals by the Commission have been estimated to be between £1.3 billion and £2.2 billion.

The Dilnot Commission's report also discussed the lack of private financial services products to help people deal with the risk of the high cost of long term care, commenting that 'Care is the one major area of our lives where, at the moment, there is no way for people to protect themselves against the risk of high costs.'

* The Personal Social Services Research Unit has three bases; in LSE, University of Kent and University of Manchester.



Laurence Kleerekoper

Insurance

'Half of people aged 65 can expect to spend over £20,000 on their own care needs in their lifetimes.'

Long-term care insurance

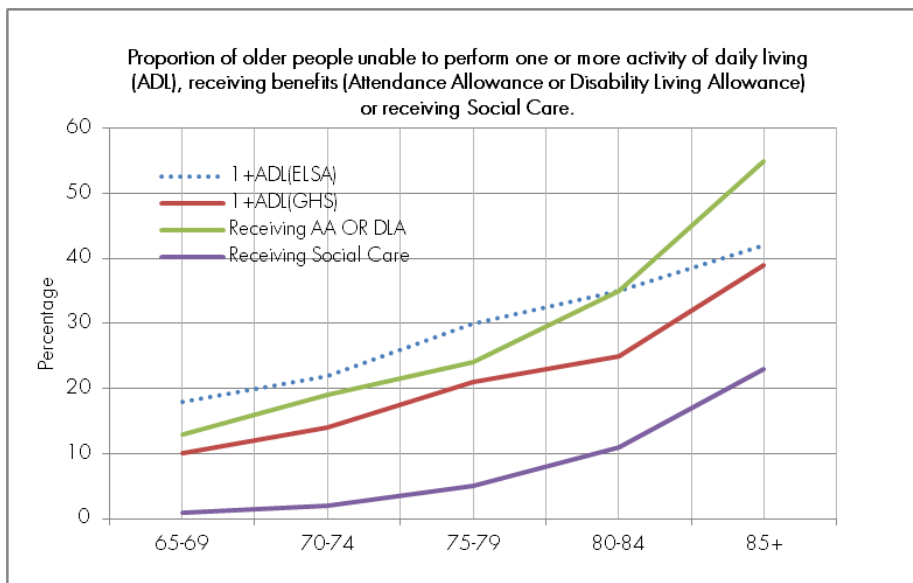
In other countries, such as the USA and France, insurance companies offer LTC insurance products where the payment depends on the inability to perform some of the basic ‘activities of daily living’ (ADLs), such as washing, dressing, eating, getting in and out of bed or a chair, moving around and using the bathroom. These products were sold for a time in the UK but not in significant volumes.

LTC Insurance products fall into two main types:

- > ‘pre-funded’, where premiums are paid many years in advance of expected claims;
- > ‘immediate needs’ when claims are imminent and only the length of time for which payments must be made is uncertain.

Insurers prefer to make payments dependent on ADLs, but these may not be the same as the ‘needs assessment’ scales that are used by local authorities. Similarly, insurers prefer policies to pay a known amount of benefit, rather than ones which indemnify a person against all future care costs.

The graph below shows how the proportion of older people unable to perform one or more ADL increases with age. The chart shows care needs based on a number of different measures, including two different data sources assessing ADLs.



Source: Dilnot Commission Report

For pre-funded products, the challenge facing insurers includes the uncertainty of the risks over the very long time before claims start to arise. As shown in the graph above, the likelihood of needing care and support increases with age.

Insurers also face uncertainty where the state provision of care costs is not known with sufficient clarity. The Dilnot Commission considered that ‘by capping the overall risk that people face, new financial products could develop to support people in making their contribution.’

GAD role

GAD supported and is continuing to support Government on a number of aspects relating to long-term care over the last 18 months. For information, please contact Laurence Kleerekoper.

‘Insurers also face uncertainty where the state provision of care costs is not known.’

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Bill Rayner looks at financial modelling - a central part of much actuarial and econometric analysis - including examples of where the techniques have been applied in government.

'What a wash-out summer! Rain, rain and more rain! Cost me a fortune in umbrellas. Two got destroyed in downpours. I left three on the train. At least I still have one! With hindsight, I would have been better off buying a raincoat.'

Thereby hang some questions. Would it be more cost-effective to buy a raincoat next summer? Or could the remaining umbrella see me through? This year's summer is no guide to next year's. How could we go about making the right decision?

The scenario essentially describes a financial decision that involves inherent uncertainty. Most people will take a decision on the basis of cash-flow or fashion. But for those who want a financially 'best-estimate' answer, you need look no further than financial models.

Most financial decisions involve inherent uncertainty. The situations we come across at GAD are generally more complex than the scenario described above. Nearly all of the situations we come across involve using financial models. In some cases we develop the financial models that are required. In other cases, the financial models are developed by others and we review them, often providing certification by reference to testing outputs.

A fundamental part of any model is the underlying assumptions and the sensitivity of the output to alternative sets of assumptions.

Application in government

Some of the situations (UK and overseas) where we at GAD have been involved in using financial models - either developing models or reviewing others' models - are:

Public service pensions	Asset Protection Agency	Risk analysis
Long-term financial planning of public expenditure	Pension Protection Fund	Financial Assistance Scheme
National Insurance Fund (NIF)	Overseas social security	Drawdown
Contracting out rebate	Long-term care	Insurance analysis

Governed by professional standards

At GAD, we are required to work in accordance with the Actuaries Code, and to standards laid down by the Board for Actuarial Standards (BAS), a division of the Financial Reporting Council. BAS has published a Technical Actuarial Standard on modelling, known as '[TAS-M](#)' which sets out principles to be adopted when carrying out modelling work.

GAD booklet for better decisions

GAD has produced a [Decision Makers Guide](#) to Long Term Financial Modelling, a short booklet with checklists, hints, tips and points to watch, which is available on our website. Do read and let us know what you think.



Bill Rayner

Client Relations

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2012 sees the introduction of major pension changes which are likely to affect all employers in the United Kingdom. The reforms are designed to maximise participation in workplace pension arrangements via 'automatic enrolment'.

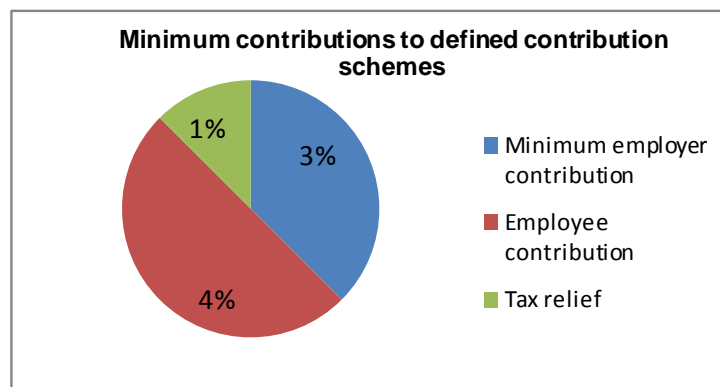
Can you summarise the changes?

All employers will be required to automatically enrol their staff into a qualifying workplace pension scheme. A qualifying scheme will typically be one of Defined Benefit, Defined Contribution or Group Personal Pension (GPP) schemes. It is for employers to decide which scheme best meets the needs of their workforce.

They can choose to:

- > enrol them into their existing pension scheme which meets or exceeds the qualifying requirements
- > amend their existing scheme to meet the qualifying requirements
- > use a scheme which meets the qualifying requirements
- > set up a new qualifying scheme; or
- > enrol them into the new National Employment Savings Trust (NEST).

If an employer chooses a defined-contribution pension scheme to meet their automatic enrolment duty they must make a minimum three per cent contribution on qualifying earnings which broadly refers to gross earnings (including, for example, any statutory sick pay or statutory maternity pay) in excess of £5,035 and less than £33,540. (These figures are expected to be reviewed in early 2012.) The employer contribution will be supplemented by the worker's own contribution and around one per cent in the form of tax relief. Overall contributions must total at least eight per cent.



There are different rules for defined benefit schemes, including final salary schemes, with schemes required to meet certain quality requirements. These rules are available on the Pensions Regulator website.

Why are these changes occurring?

- > It is estimated that seven million workers in the UK are not saving for their old age, relying only on the basic State pension
- > Only 50% of UK employees are members of an employer-sponsored pension scheme, and this proportion has fallen over recent years, in part due to closures of defined benefit pension schemes
- > An ageing population combined with millions of people under-saving is one of the biggest long-term challenges the UK faces. Without action this could place unsustainable pressure on the State system or lead to poorer pensioners.



Andrew Hancock

Funded schemes & Pensions policy

'All employers will be required to auto-enrol their staff into a qualifying... pension scheme.'

When are these changes occurring?

The automatic enrolment requirements are being phased in over time, with larger employers required to comply from, or shortly after 1 October 2012 and smaller employers later in the process. The date by which each employer is required to comply with automatic enrolment is known as its 'staging date'.

The staging dates for employers with 3000 or more individuals on their PAYE Scheme fall between 1 October 2012 and 1 July 2013 and can be found on the Pensions Regulator website.

The Pensions Minister is expected to issue a statement about staging dates for all other employers early in 2012.

What is automatic enrolment?

Automatic enrolment requires an employer to automatically enrol all eligible workers into a qualifying workplace pension scheme. Eligible employees are those employed in the UK, aged between 22 and state pension age, and earning more than £7,475 in 2011-12. Employees will be able to choose to opt out after being automatically enrolled, with contributions being refunded where appropriate. However, employees who opt out must be automatically re-enrolled every three years.

Automatic enrolment does not require people to make an active investment choice. To ensure that default options are sound and suitable for members, the Government has published guidance for offering default options for defined contribution automatic enrolment pension schemes. This includes guidance for suitable charging structures.

What is NEST?

The National Employment Savings Trust (NEST) has been introduced to support automatic enrolment and will offer low cost pension provision to any employer who wishes to use it. NEST is one of many qualifying schemes an employer can choose to use.

Do employers have to use NEST?

Employers will be able to choose the pension scheme(s) they want to use to fulfil their new duties provided the scheme(s) meet certain qualifying requirements.

Qualifying schemes

Qualifying schemes may include defined-benefit, defined-contribution, hybrid, stakeholder or group personal pension schemes. Employers with existing good quality pension schemes will be able to continue to use them to meet their new duty, if they meet the qualifying requirements. Employers can easily self-certify that their scheme qualifies but they may wish to seek actuarial advice.

For more information visit The Pension Regulator website at:

<http://www.thepensionsregulator.gov.uk/>

and the NEST website at:

<https://www.nestpensions.org.uk>

'Defined benefit schemes [are] required to meet certain quality requirements.'

For more information,
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