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WELCOME FROM THE GOVERNMENT ACTUARY



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

It has been a busy few months for us and our clients, both at home and abroad.

The new UK Government is likely to bring changes for many of our UK clients including challenges in the areas of pensions, government finance and institutional investment. We have prepared a short [pamphlet](#) which sets out the challenges facing the new administration where actuarial analysis can make a difference in informing decisions.

Our insurance team continues to be busy helping our overseas clients prepare for the implementation of Solvency II, the new European Directive on the regulation of insurance business.

We very much value your feedback, 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.

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

TREVOR LLANWARNE GOVERNMENT ACTUARY

NEWS FROM GAD

Scotland office grows

We have strengthened our team in Glasgow with the secondment of Daniel Selby, an experienced actuary who has been working in our London office for 10 years. Daniel will support our existing Glasgow team of Alison Murray and Anne Kershaw.

Secondment

Ian Boonin has taken on a short secondment with the Board for Actuarial Standards. This close working will ensure the technical actuarial standards being developed will bear in mind the specific needs of our clients.

Climate change

GAD will be facilitating a discussion on how insurers price risk and uncertainty, in particular as related to climate change. This round table scheduled for 21 July will involve senior government officials and senior insurance industry representatives.

Longevity seminar

GAD hosted an informative Longevity Seminar on 2 June for key industry figures on future longevity improvements and the formulation of appropriate mortality assumptions.

Client Survey

Client service is our priority and feedback from our clients is key to our success. We will again be carrying out a client survey later this summer. This year it will be an online survey and we will email all clients with details when it goes live in August. We look forward to hearing your views on how we are doing.

GAD Annual Report

The GAD 2009/10 Annual Report will be available on our website in a few weeks. This sets out our aims, service commitments and values and provides details of our achievements during 2009/10 as well as our plans for 2010/11. We will inform all clients when this is published.

EMERGING ISSUES

Move to CPI indexation

The UK Government has announced that it will adopt the CPI for the indexation of public service pensions from April 2011, rather than the RPI. This is expected to affect all public service schemes. We are working with our clients to identify and resolve the issues arising.

Independent Public Service Pensions Commission

The Independent Public Service Pensions Commission "will undertake a fundamental structural review of UK public service pension provision" and will make recommendations about the long-term sustainability and affordability of public service pensions. We will liaise with clients when the Commission produces its interim report, expected in September 2010, and its final report, expected by Budget 2011.

Review of pensions tax relief for high earners

The proposed changes to pensions tax relief for high earners are to be reviewed by the new UK Government and may be replaced by a reduction in the annual allowance. An announcement is expected in the autumn, with implementation in April 2011. We will continue to keep clients informed of developments.

Solvency II—Internal models

Under Solvency II, insurance companies will require supervisory approval to use internal models to determine their regulatory capital requirements. Therefore EU insurance supervisors will need to have the capability to assess insurers' internal models. We are developing a complete review service for all internal model applications for our supervisory clients.

Queries on any of the emerging issues can be discussed with your usual GAD contact or our Technical Director, Eddy Battersby.

REVIEWING THE NATIONAL INSURANCE FUND

If you work in the United Kingdom, it's likely you see a regular deduction in your pay slip relating to National Insurance Contributions.

In Great Britain* National Insurance Contributions are paid into the National Insurance Fund - the fund that pays State pensions and certain other social security benefits, such as incapacity benefits and bereavement benefits. Every five years, the Government Actuary is required to report to Parliament on the long-term financial position of the National Insurance Fund, known as the Quinquennial Review. The latest report was published and laid before Parliament at the end of March this year.

A long-term commitment

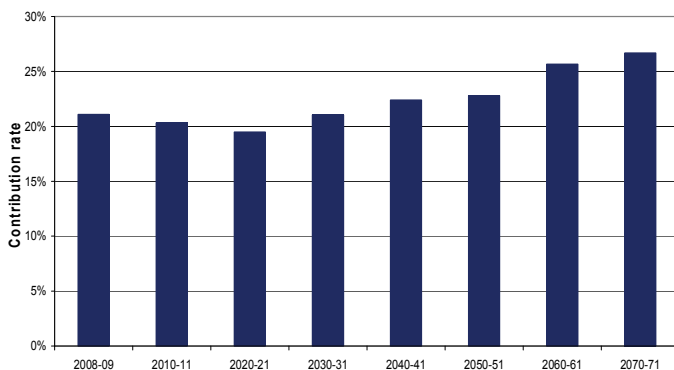
State pensions are very significant in the context of overall public expenditure. In 2008-09, the Fund received contributions of nearly £75 billion and paid benefits of about £70 billion, which is around 11% of total public expenditure. Furthermore, State pensions are a long-term commitment and decisions made now can have financial implications very many years into the future. So it is important that Government, Parliament and the public understand the financial commitment underlying the provision of State pensions.

The Quinquennial Review includes projections of the future cost of the National Insurance Fund over a long period, up to 2070-71 in the latest review. This requires a number of different assumptions to be made about the future, such as life expectancy, the size of the workforce and earnings growth.

What does the latest report show?

One of the key results from the Quinquennial Review is the contribution rate required to finance expenditure in each year. The chart below illustrates how this is expected to change over time. This chart is based on certain assumptions such as the basic State pension increasing in line with average earnings from April 2012 and allowing for the legislated future increases in State Pension Age. The contribution rate shown is the standard rate payable by employers and employees combined, but excluding the small part of National Insurance Contributions that is paid to the National Health Service (NHS).

Expected required contribution rate



* There is a separate National Insurance Fund for Northern Ireland



James Thompson

Social Security

"State pensions are very significant in the context of overall public expenditure."

This chart shows that the required contribution rate is expected to increase significantly, from just over 20% in 2010-11 to nearly 27% in 2070-71. The current rate of National Insurance Contributions payable by employers and employees combined is just under 20% (excluding the NHS share) and this is planned to increase to just under 22% from 2011-12.

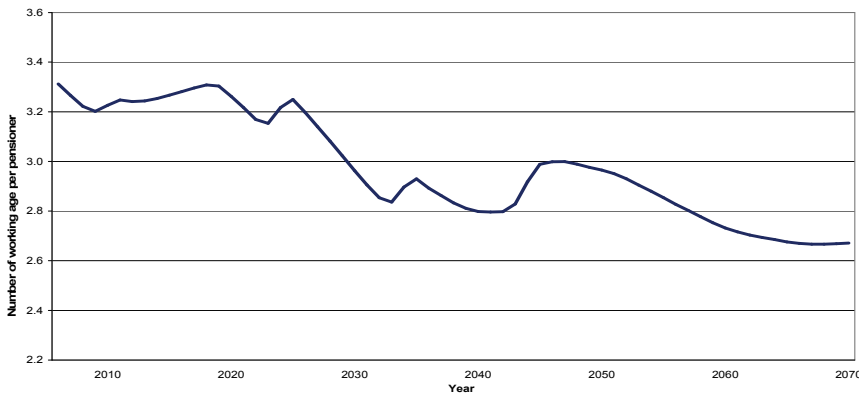
Why is the contribution rate increasing?

There are many influences on the cost of the Fund's benefits, but a key factor is the population structure.

In broad terms, each year's contributions received from those of working age are used to pay pensioners' benefits in that year, which means that no substantial fund is built up out of which to meet future benefit payments. Therefore, if there is a reduction in the number of people of working age relative to the number of pensioners, this will increase the contribution rate required to finance the benefits.

The following chart shows that the number of people of working age for each pensioner is expected to decline over the period to 2070-71. This happens because, although the working age population is projected to grow, it is not expected to keep pace with the growth in the pensioner population.

Number of people of working age for each pensioner



The decline illustrated in the chart is not smooth. This reflects the many factors that affect the population, for example the way the planned increases to State Pension Age between 2010 and 2046 change the balance between the number of people of working age and the number of pensioners.

But the future is uncertain

Clearly it is not possible to predict with confidence what will happen over the next 60 years. There will always be considerable uncertainty about the future financial position of the Fund over such a long time period. The Quinquennial Review considers how the results would change for a range of different, but still plausible, assumptions, such as those for life expectancy and unemployment. These illustrate and help quantify the uncertainties.

The full report on the [Quinquennial Review](#) is available on GAD's website.

"There are many influences on the cost of the Fund's benefits, but a key factor is the population structure."

For more information, please contact

James Thompson
 +44(0)207 211 2723
 james.thompson@gad.gov.uk

PENSION SCHEMES AND EQUALITY – MINISTERIAL STATEMENT

In January this year, Angela Eagle, the then Department for Work and Pensions (DWP) Minister of State for Pensions and the Ageing Society, made a written [statement](#) on equality in occupational pension schemes, with particular reference to Guaranteed Minimum Pensions (GMPs).

In May 1990, the European Court of Justice passed judgment in the Barber case and ruled that, as occupational pensions are a form of deferred pay, scheme rules must treat men and women equally. Following this judgment, the UK Pensions Act 1995 included provisions for equal treatment where there is a 'comparator' of the opposite sex, that is, where more favourable treatment has been afforded to an individual of the opposite sex engaged in comparable work.

The [statement](#) announced DWP's intention to legislate to remove the requirement for a 'comparator' where any inequality in scheme rules after May 1990 results from the legislative provisions governing Guaranteed Minimum Pensions (GMPs). The statement said that European law requires any such inequality in scheme rules to be removed, whether or not a person can show that a comparator exists.

We understand* that this statement simply reflects the case law of the European Court of Justice, such as Allonby (2004), which widened the circumstances in which equalisation has to be addressed. Essentially, schemes must remove inequalities between men and women which result from the legislative provisions governing GMPs, whether or not a comparator exists.

Although GMP accrual ceased in April 1997, GMPs can considerably complicate the removal of inequalities. GMPs are payable for men at age 65 but at age 60 for women. Therefore, for example, difficulties may arise for schemes that, prior to 1997, had a normal pension age higher than age 60 and that were contracted out between May 1990 and April 1997. Similarly, there may be issues for schemes with a normal pension age higher than age 60 that permit members to transfer a GMP into the scheme.

These are only two examples of potential difficulties. There are many other ways GMPs may present complications.

The Government statement also expressed the opinion that trustees and others should act as if existing UK legislation has already been amended to remove the requirement for a comparator where inequality results from GMP legislation. As a result, many schemes have been advised to take and/or review their legal advice regarding the Barber judgment and GMPs. We would be happy to discuss the outcome of any such review.

* Please note that nothing in this article should be interpreted as a legal opinion.



James Pepler

Pension Policy

"GMPs can considerably complicate the removal of inequalities."

For more information,
please contact

James Pepler

+44(0)207 211 2683

james.pepler@gad.gov.uk

COMMITMENT TO QUALITY— PROFESSIONAL STANDARDS

GAD's advice is backed by rigorous professional standards so our clients can rely on the advice they receive.

In April this year, the first of a new set of principles-based actuarial professional standards came into force. The overriding objective of these new standards is to give users of actuarial advice confidence that advice is comprehensive, reliable and clear.

The framework set by these standards enables individual actuaries to develop their own approaches and tailor their work to their client's circumstances. Actuaries are professionals, and their judgment is a valued attribute.

Professional standards for the Actuarial Profession

The UK actuarial profession has been setting professional standards for over 35 years. Its first 'Guidance Note' on long-term insurance came into force in 1975.

In 2005, an independent review of the actuarial profession recommended that the Financial Reporting Council (FRC), the UK's independent regulator for corporate governance and reporting, take on responsibility for technical actuarial standards. To do this, the FRC established a new operating body, the Board for Actuarial Standards (BAS). The actuarial profession has retained responsibility for ethical standards.

Initially, BAS adopted the actuarial profession's existing technical standards. More recently, it has started reviewing the objectives and structure of these technical standards, with the aim of gradually replacing all the adopted guidance with its own technical standards, known as Technical Actuarial Standards (TASs).

The new technical standards will comprise generic standards, which will apply to all types of actuarial work such as data, modelling, and communicating advice, and specific standards, which will apply to specific practice areas such as pensions or insurance.

A general criticism often levied at regulation is that ensuring compliance leads to additional time and costs but the new TASs take a different, principles-based, approach. Indeed BAS has explicitly stated that it wishes to avoid a 'tick-box' approach – compliance depends critically on applying the spirit of, and reasoning for, the standard.

The first new generic standard on reporting actuarial information, known as TAS R, came into force in April.



Eddy Battersby

Technical Director

"Professional standards are key parts of our commitment to quality."

Reporting actuarial information

TAS R concerns the Reporting of Actuarial Information. The objective of TAS R is to ensure that actuarial information is clear and complete, and that users can understand the implications and relevance of the information they receive, along with any material risks or uncertainty. In many respects it simply formalises current best practice while encouraging further improvements in communication.

Most of the requirements of TAS R will already be familiar to our clients. For example, TAS R requires actuaries to explain relevant risks and highlight material uncertainties such as sensitivities to key assumptions, as well as describing the data and assumptions underlying the advice.

TAS R recognises that actuarial reports should reflect the materiality of the work undertaken. It explicitly does not require any additional work to be carried out that is not proportionate to the relevant assignment or any decision that might be based on the work.

Compliance with TAS R is only compulsory for specific pieces of work. In broad terms, this is work that must be carried out by a member of the UK actuarial profession in order to comply with legislation or some other legal obligation, including, for example, some accounting standards. It does not include work that must be carried out by the holder of a unique post, such as the Government Actuary.

Nevertheless, actuaries are encouraged to comply with TAS R where it is not compulsory. GAD recognises the importance of professional standards and, where compliance is not required, we will consider each case on its own merits. In particular, work that must be carried out by the Government Actuary will follow the standard to the extent that it is sensible and practical.

Commitment to quality

Professional standards are key parts of our commitment to quality. On 1 July, a technical standard on data (TAS D) came into force and others will follow over the coming months. At GAD, we are continuing to develop our work practices, both technically and professionally, in order to provide the best quality service to meet our clients' needs.

Further information

The Board for Actuarial Standards

<http://www.frc.org.uk/bas/>

If you would like to discuss our standards or processes please contact Eddy at eddy.battersby@gad.gov.uk or on 020 7211 2636.

"The overriding objective is to give confidence that advice is comprehensive, reliable and clear."

For more information,
please contact

Eddy Battersby
+44(0)207 211 2636
eddy.battersby@gad.gov.uk

PENSIONS: SHARING THE RISK

Many employers are concerned about the costs and risks involved in sponsoring defined benefit pension schemes. In these schemes, the key financial risks fall mainly on the employer. Most commonly, employers have replaced defined benefit schemes with defined contribution schemes, where the financial risks fall mainly on scheme members.

However, some employers are finding a middle way. They're changing their schemes so that risks are more evenly shared between employers and members. 'Cap and share' is one such risk sharing option and it is the approach being adopted by several large UK public sector pension schemes.

Risk sharing

There is a wide range of risk sharing options. The Department for Work and Pensions has published a [note](#) providing information on various options for sharing risk between employers and members including practical case studies from five employers.

Cap and share

Cap and share involves **sharing** changes in the cost of pension provision, such as those due to changing life expectancy, between employers and members. However, there is a **cap** on the level of employer contributions and all increases in cost above this cap will be met by members. Up to the level of the cap, changes in cost will generally be shared equally between employers and members.

The Teachers', NHS, Civil Service and Local Government Pension Schemes together cover around 90% of public service employment. Under current regulations all these schemes are due to implement cap and share following their latest actuarial valuations, which have effective dates between 2008 and 2010.

Independent Public Service Pensions Commission

The Independent Public Service Pensions Commission "will undertake a fundamental structural review of UK public service pension provision" and will make recommendations about the long-term sustainability and affordability of public service pensions.

According to its terms of reference, in reaching its recommendations the Commission is to have regard to how risk should be shared between the taxpayer and employee. It is possible that this could include a review of cap and share.

The Commission has requested interested parties to provide views and evidence by the end of July. We will liaise with clients when the Commission produces its interim report (expected in September 2010) and its final report (expected by Budget 2011).



Sandra Bell

Teachers & Police

"Risks are more evenly shared between employers and members."

For more information, please contact

Sandra Bell
+44(0)207 211 2659
sandra.bell@gad.gov.uk

GOVERNMENT ACTUARY

Trevor Llanwarne +44 (0) 20 7211 2620
Email trevor.llanwarne@gad.gov.uk

DEPUTY GOVERNMENT ACTUARY

George Russell +44 (0) 20 7211 2666
Email george.russell@gad.gov.uk

TECHNICAL DIRECTOR

Eddy Battersby +44 (0) 20 7211 2636
Email eddy.battersby@gad.gov.uk

ADVICE TO GOVERNMENT

Stephen Humphrey +44 (0) 20 7211 2646
Email stephen.humphrey@gad.gov.uk

COAL PENSIONS AND FUNDED SCHEMES

Ken Kneller +44 (0) 20 7211 2673
Email ken.kneller@gad.gov.uk

DEMOGRAPHY

Martin Lunnon +44 (0) 20 7211 2656
Email martin.lunnon@gad.gov.uk

INSURANCE

Harvey Duckers +44 (0) 20 7211 2794
Email harvey.duckers@gad.gov.uk

INVESTMENT AND RISK

Colin Wilson +44 (0) 20 7211 2672
Email colin.wilson@gad.gov.uk

LOCAL GOVERNMENT AND RAILWAYS

Ian Boonin +44 (0) 20 7211 2973
Email ian.boonin@gad.gov.uk

NHS AND FUNDED SCHEMES

Sue Vivian +44 (0) 20 7211 2667
Email sue.vivian@gad.gov.uk

PENSIONS POLICY

George Russell +44 (0) 20 7211 2666
Email george.russell@gad.gov.uk

SOCIAL SECURITY AND OVERSEAS PENSIONS

Martin Lunnon +44 (0) 20 7211 2656
Email martin.lunnon@gad.gov.uk

STAFF TRANSFERS

Adrian Hale +44 (0) 20 7211 2795
Email adrian.hale@gad.gov.uk

TEACHERS AND POLICE

Sandra Bell +44 (0) 20 7211 2659
Email sandra.bell@gad.gov.uk

RESEARCH

Barbara Sinkinson +44 (0) 20 7211 2658
Email barbara.sinkinson@gad.gov.uk

CLIENT RELATIONS AND DEVELOPMENT DIRECTOR

Bill Rayner +44 (0) 20 7211 2975
Email bill.rayner@gad.gov.uk

FINANCE DIRECTOR

Kevin Down +44 (0) 20 7211 2709
Email kevin.down@gad.gov.uk

GLASGOW OFFICE

Alison Murray +44 (0) 141 249 6555
Email alison.murray@gad.gov.uk

GOVERNMENT ACTUARY'S DEPARTMENT, LONDON

Finlaison House 15-17 Furnival Street London EC4A 1AB

Fax: +44 (0)20 7211 2660

Switchboard: + 44 (0)20 7211 2601

Direct: +44 (0)20 7211 plus extension number

Email enquiries: enquiries@gad.gov.uk

Email: firstname.lastname@gad.gov.uk

Web: www.gad.gov.uk

GOVERNMENT ACTUARY'S DEPARTMENT, GLASGOW

Abbey Business Centre The Beacon 176 Vincent Street

Glasgow G2 5SG

Fax: +44 (0)141 249 6700

Switchboard: + 44 (0)141 249 6555

Direct: +44 (0)20 7211 plus extension number

Email enquiries: enquiries@gad.gov.uk

Email: firstname.lastname@gad.gov.uk

Web: www.gad.gov.uk