

WELCOME FROM THE GOVERNMENT ACTUARY



Welcome to the first edition of GAD's electronic newsletter, **e-News from GAD**.

Through this periodic electronic newsletter, we hope to keep our clients and contacts updated on topical issues affecting our clients in the UK public sector and overseas and on news of what is happening at GAD.

We plan to publish e-News from GAD three or four times a year and will archive back issues on our website www.gad.gov.uk. I hope you will find the articles of interest. Do feel free to let me have your feedback by contacting me at:

Telephone +44 (0) 20 7211 2620, trevor.llanwarne@gad.gov.uk

TREVOR LLANWARNE GOVERNMENT ACTUARY

IN THIS ISSUE

GAD ADDS INVESTMENT AND RISK EXPERTISE

GAD has added another service, Investment and Risk.

Colin Wilson has joined to lead the development and delivery of the service.

- > Why has GAD introduced the new service?
- > Why is it different from more traditional forms of actuarial advice?
- > What is Colin's background and experience which make him ideally suited to the new role?

TRANSFERS OUT OF AND INTO THE PUBLIC SECTOR

- > Regulations govern how pensions must be transferred into, out of, and within the public sector.
- > Several stakeholders watch the process to make sure that government policy is followed.
- > How GAD works with you to make sure you comply.

NEWS ABOUT THE NATIONAL INSURANCE FUND

An insight into an annual event in the GAD calendar, publication of a report to the UK Parliament on the National Insurance Fund.

- > Why is it prepared?
- > What are the findings?
- > How is the fund likely to progress in the future?

GAD CONTACTS



COLIN WILSON

INVESTMENT AND RISK

TAKING UP THE NEW POST OF HEAD OF INVESTMENT AND RISK



Why has the Government Actuary's Department set up the new post of Head of Investment and Risk?



"Because of the growing interest within Government on asset related matters and our clients have been asking us for help in this area", confirmed Government Actuary, Trevor Llanwarne. So what is different about Colin Wilson's expertise, compared to traditional actuarial techniques?

TRADITIONAL TECHNIQUES

GAD has for many years been able to produce cash flow projections, and the discounted value of liabilities, as the orthodox methods of actuarial analysis.

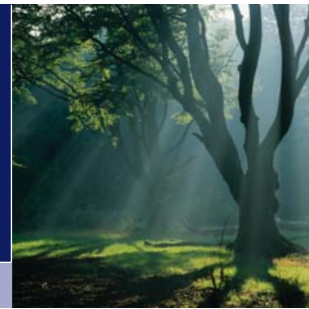
For the actuarial purist, the methods are described as deterministic. Assumptions are made about the future course of economic and demographic factors which are applied to produce a single projection of cash flows (which is a series of numbers) or a single number for a discounted value. In essence, the methodology produces a single expected outcome (either as a cash flow or as a discounted value) reflecting what will happen if the assumptions are actually borne out in practice.

So far so good, the arithmetic might be intricate, but the concept is simple: make assumptions, produce a single answer. The downside is that the single answer depends totally on the assumptions. If the assumptions are changed, then the answer changes and, crucially, the assumptions are only assumptions, not predictions, as making precise predictions is impossible.

NOW ADD IN THE UNCERTAINTY

Modern computing power now enables deeper and more sophisticated thinking, and consequently a more intricate and intellectually challenging analysis. Let's take the analysis to the next level, asking two supplementary questions:

- > What if what actually happens in practice is slightly different to what has been assumed, and
- > What is a sensible measure of the risk of that difference arising?



Now that is starting to be materially tricky. Applying the principle to a pension fund, a typical question might be:

- > “What is the chance that equity yields will fall below gilt yields over the next three years, and – if that were to happen;
- > What would be the financial impact to the security of pensions?
- > How might the investment portfolio be re-structured now to give some protection against any detrimental impact of that happening?
- > What other contingency plans should be in place as protection?

This is a question about the risk of something (usually bad) happening, the impact of it happening, and consideration of how to put some protection in place.

RISK AND UNCERTAINTY NOW A PART OF LIFE

“Now more than ever, investment and risk are recognised as being of central importance to economic activity and government planning,” Colin explained.

Government Actuary, Trevor Llanwarne, adds, “We expect a high demand for Colin’s expertise as it applies specifically to the identification and control of financial and investment risks inherent in the structuring of financial institutions and economic levers, as well as to the provision of benefits and services by government”.

These are complex subjects, but Colin thrives on hard questions about complex subjects.

HOW COLIN THINKS:

- > ***I CANNOT PREDICT THE FUTURE***
- > ***BUT WHAT IS THE CHANCE OF SOMETHING BAD HAPPENING?***
- > ***...AND WHAT PROTECTION IS NEEDED IF IT DOES?***

CAREER BACKGROUND

A relative latecomer to the actuarial profession, he started actuarial training 10 years after leaving Cambridge with a degree in mathematics, in the meantime having worked as an analyst programmer and consultant in a software company.

“What persuaded me to become an actuary was the opportunity to apply advanced mathematical techniques to the world of finance and business,” he explains. That is a common actuarial trait, but the Wilson CV is impressive, confirming his keenness to set about solving the most challenging problems in the largest arenas:

- > Three years developing new products at The Prudential, while training to be an actuary,
- > Nine years in the investment department of The Prudential, producing and interpreting asset-liability models to analyse cash flows and associated risks for an annuity fund of £25 billion and a with-profits life fund of £80 billion.
- > Three and a half years at consulting firm Barrie & Hibbert advising insurance companies on investment strategy and financial risk management.

There is a common theme; the experience in each role has been used to powerful effect as the foundation for the next role. He wants that trend to continue.

Looking back, Colin reflects that much of what he has done has actually required him to be an interpreter, fluent in three languages: Actuaryspeak, FundManagerspeak, and plain English. Ask him a question about whether to include a complex derivative, such as a credit default swap, in an investment strategy, and the technical analysis will be thorough yet proportionate, but the ultimate answer will be based on simple and penetrating criteria – Will it help us, and what could go wrong?

MAKING SENSE OF UNCERTAINTY

To most people, the uncertainty of risk is a cause for concern. The actuaries of the 21st century are comfortable with risk, because they are trained to look at the sources of risk, to examine the consequences, and to control the financial impact of any downside. Colin Wilson has joined GAD to build and lead the effort in helping clients to do exactly that.

***“... fluent in three languages: Actuaryspeak,
FundManagerspeak, and plain English”***



IAN BOONIN

LOCAL GOVERNMENT

TUPE TRANSFERS – MAKE SURE YOU COMPLY

Imagine the scenario. You are asked to transfer 100 employees from your own public sector department to a private sector organisation. Sounds easy? Transfers like this happen all the time. What could possibly go wrong? Quite a lot really!

Take pensions for a start. They rarely stir interest in anyone other than the professionals who look after them..... at least, not until someone thinks they might lose their pension. That's when they do the arithmetic and realise that their pension is – more than likely – their largest source of individual wealth, in capital terms often worth more than their house. So if something is going to happen to it (potentially good or bad), they are very interested.

So let's put your job in context 100 people are transferring from your department to a private sector organisation, and you are arranging the transfer of their largest source of wealth from a comfort zone to an unknown zone. It is starting to sound like you might be in the firing line.

UNDER SCRUTINY

Quite a few people will be watching you as you progress:

- > Those transferring – to seek reassurance that they are getting a fair deal.
- > Your own manager.
- > The new employer – to check that everything is proceeding efficiently.
- > Members' unions – a double check on behalf of those transferring.

Doing it right matters. That is why there are plenty of regulations with which to comply, not to mention specific government policy on staff transfers from the public sector known as *The Fair Deal*. There is one specialist area where GAD expertise can help you – pensions. For the specifics relating to pensions, see the link:

http://www.hm-treasury.gov.uk/d/pensions_bta_guidance_290604.pdf

HOW GAD CAN HELP

- > Explaining the process, discussing the issues and working with you to ensure you comply with government policy.
- > Analysing comparability between the current and proposed new pension schemes. This often means issuing a mandatory Certificate of Broad Comparability (a document that can stretch to over 30 pages)
- > Working with your lawyers on the contractual terms of the transfer that affect pensions.

HOW GAD CAN HELP *continued*

- > Helping to explain the detailed terms of transfer to the new employer.
- > Discussing the finance of the pension transfer with the new employer and then calculating and arranging the payment of money from the existing pension scheme to the new scheme. Sometimes routine, sometimes not. The pension transfer amount can greatly exceed the transferring payroll. If the transfer amount is less than the employer was expecting, then they may re-negotiate their bid as result of the pension transfer shortfall.
- > Communicating with transferring staff to explain what it means to them.

You really should get on top of pensions issues early in the transfer process, preferably at the bidding stage and certainly before contract award. All too often there is no room to negotiate a fair and value-for-money pensions deal for staff because pensions are an afterthought. This can mean very unhappy employees.

NEITHER STANDARD NOR PREDICTABLE

To those involved regularly, these transactions are routine. GAD advises on TUPE transfers frequently, with transactions from any area of the public sector. Some departments see them regularly, but others hardly ever.

GAD has a well-established track record of helping clients navigate their way through the labyrinth of compliance requirements, using our accumulated knowledge and direct practical experience.

GAD can advise what will work and what will not. Even those who see these transactions regularly, and who come to us for a Certificate of Broad Comparability, check with us on the handling of – yet another – new angle to a transaction not seen before. Additionally, we have helped those regularly involved to streamline their procedures.

THE OBJECTIVE

Government policy is to ensure that the pensions of employees who transfer out of or into the public sector (or even within the public sector) are transferred on a fair basis. GAD's objective is to confirm for you and others that your particular transaction is in line with government policy, and that pensions will not be too costly a burden.

Implementing these transactions, while easy in principle, is usually technically detailed, and always subject to scrutiny. GAD will help you through the process to a successful outcome.

WHAT YOU NEED TO DO:

- > ***PLAN WELL AHEAD (CRITICAL)***
- > ***PERSUADE THE KEY PEOPLE TO TALK TO ONE ANOTHER AND TO THEIR ADVISERS***
- > ***DON'T LEAVE ANYTHING TO DO WITH PENSIONS UNTIL THE LAST MINUTE***
- > ***THINK OF THIS AS A PROCESS BUT WITH A LOT TO GET THROUGH. THE SOONER YOU START, THE BETTER FOR EVERYONE***



IRENE LANE

SOCIAL SECURITY

APRIL 2009

THE NATIONAL INSURANCE FUND

Every year, GAD prepares a report on the National Insurance Fund (NI Fund). Publication of this report is an annual event in the GAD calendar. The 2009 report was laid before Parliament on January 2009, alongside the orders which increase National Insurance (NI) benefits and National Insurance contributions.

Why is the report prepared?

The NI Fund was set up in 1948. It receives NI contributions, and pays out NI benefits. NI benefits are financed on a pay-as-you-go basis. Any excess of the contributions received over and above the benefits paid is retained by the NI Fund. For the last 15 years, the Government Actuary has recommended that this balance is maintained at a level of at least one-sixth of the annual benefit expenditure, to ensure that there is always a reasonable working balance in the fund.

One of the requirements of the report is to confirm that the balance will be above the recommended minimum. If not, Parliament needs to vote a Treasury grant to the NI Fund.

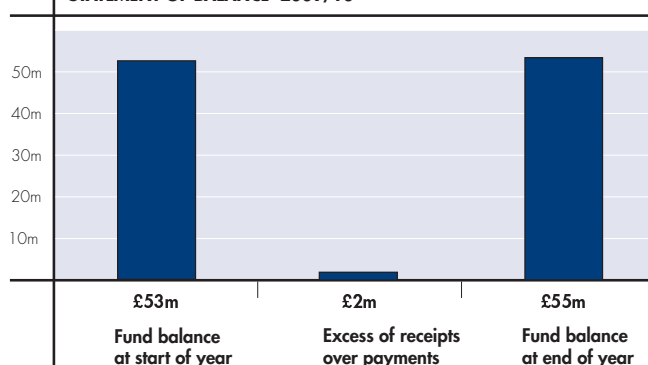
What are the findings of this year's report?

GAD's latest report takes account of the increases in benefits and contributions (the "up-rating") effective in April 2009. It shows that, even with the less favourable economic conditions expected in 2009-10, the income of the NI Fund is expected to exceed the expenditure by about £2 billion pounds. This is projected to increase the size of the NI Fund to almost £55 billion pounds by the end of 2009-10 (as shown in the table opposite).

MAIN BENEFITS RATES 2008/09

BENEFITS	WEEKLY RATE
Retirement Pension – person claiming on their own or their deceased spouse's NI contributions – standard rate	£90.70
Retirement Pension – person claiming on their spouse's NI contributions – standard rate	£54.35
Contribution-based jobseeker's allowance single person over 25	£60.50
Incapacity benefit long-term main rate	£84.50
Employment and support allowance, personal allowance age 25 or over, plus work-related activity component	£84.50

STATEMENT OF BALANCE 2009/10



What are the fundamentals?

We project the cash flow into and out of the NI Fund for the next year, using estimates for employment and unemployment levels and the rate of increases in earnings. The report gives details of the:

- > **BASIC FACTS:**
 - the new benefit and contribution rates and earnings limits, which are known at the time of preparing the report.
- > **FINANCIAL PROJECTIONS:**
 - showing how the new rates are expected to change the income and expenditure of the NI Fund.
- > **FINDINGS FOR 2009/10:**
 - the new benefit rates are expected to increase expenditure by about £3.75 billion. Most of this increase will be paid to retirement pensioners, who are the main beneficiaries of the NI Fund.
 - the changes to the contribution rates and the earnings limits are expected to reduce the income of the NI Fund by about £0.11 billion.

It may well come as a surprise that increasing the earnings limits reduces the amount of contributions received. This is because:

- > only a small percentage of people pay more contributions when the upper earnings limit goes up, and
- > everybody pays less when the lower threshold is increased.

Particular issues with this year's report – assumed unemployment

For this year's report, the current economic conditions have merited special attention. The baseline assumptions for economic factors are linked to those underlying the pre-Budget report by Her Majesty's Treasury on 24 November 2008. However, we also examine the sensitivity of the projected income and expenditure to alternative employment scenarios. Here is a summary of the impact:

EFFECTS OF VARIATIONS IN ASSUMPTIONS	Effects on receipts in 2009-10 (£81,649m)	Effects on payments in 2009-10 (£79,537m)
£m		
GB number of employees in employment lower by 200,000 in 2009-10	-500	
GB number of employees in employment higher by 200,000 in 2009-10	+500	
Earnings increases 1% lower over the year to 2008-09 and 2% lower over the year to 2009-10	-2,480	
GB unemployed and claiming benefits higher by 200,000 in 2009-10		+120
GB unemployed and claiming benefits lower by 200,000 in 2009-10		-120

For a more complete set of results please see the full report at www.gad.gov.uk

The report also shows the results for a scenario of even higher unemployment and lower earnings inflation. If:

- > the number of unemployed and claiming benefits were 500,000 higher, and the number employed were 500,000 lower than assumed; and
- > the increases in earnings were 1% lower in 2008-09, and 2% lower in 2009-10, then;
- > projected net receipts would be about £4 billion lower.

Under this scenario, the amount in the NI Fund would be almost £51 billion at the end of 2009/10. However, this is still more than the recommended reasonable working balance of one-sixth of annual expenditure.

The future of the NI Fund

As well as looking just one year ahead, the report also looks at the projected position of the NI Fund over the next five years. Estimates indicate that the NI Fund could exceed £100 billion in 2013/14, well above the recommended minimum level. However, a Quinquennial Review will be carried out in 2009 and that will give a much better idea of the long term outlook.

The report by the Government Actuary on the drafts of the Social Security Benefits Up-Rating Order 2009 and the Social Security (Contributions) (Re-rating) Order 2009 was published on 28 January with reference Cm 7312. It is available from the GAD website www.gad.gov.uk and that of The Stationery Office as well as from The Stationery Office as a hard copy price £14.35.



GOVERNMENT ACTUARY

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

PENSIONS POLICY

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

ADVICE TO GOVERNMENT

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

DEMOGRAPHY

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

TEACHERS AND POLICE

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

LOCAL GOVERNMENT AND RAILWAYS

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

NHS AND FUNDED SCHEMES

David Hughes +44 (0)20 7211 2645
Email david.hughes@gad.gov.uk

COAL PENSIONS AND FUNDED SCHEMES

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

INVESTMENT AND RISK

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

INSURANCE

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

SOCIAL SECURITY AND OVERSEAS PENSIONS

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

RESEARCH

Barbara Sinkinson +44 (0)20 7211 2685
Email barbara.sinkinson@gad.gov.uk



GOVERNMENT ACTUARY'S DEPARTMENT

Finlaison House 15-17 Furnival Street London EC4A 1AB

Fax: +44 (0)20 7211 2630/2660

Switchboard: +44 (0)20 7211 2601

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

Email enquiries: enquiries@gad.gov.uk

Email: firstname.secondname@gad.gov.uk

Web: www.gad.gov.uk