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IPT 7: Risk Management and Risk Sharing
Current developments in UK pensions

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Main changes in workplace provision over last decade or so

- Massive closure of final salary schemes
  - to new entrants
  - to future accrual
- Major growth in DC arrangements

Main reasons for swing away from final salary schemes

- Longevity risk
- Investment risk
- Company accounting standards
- Increased legislation
  - benefits eg mandatory indexation
  - administration
- Employer debt on winding up
- Pension Protection Fund levy
- Mobility of labour

Replacement schemes

- For new entrants
  - primarily DC
- For future accrual
  - reduced DB
  - DC
  - combination of DB and DC

Making DB more affordable

- Reduce future service accrual
- Change to career average
- Increase member contributions
- Increase NRA
- Worsen early retirement terms

Problems with DC for modest earners

- Choosing risk/reward trade-off
- Variability of results between members
- Investment strategy depends on retirement date being known

Risk sharing – current position in UK

- Combining DB and DC
- Deregulatory Review – report published late July 2007
- Too much legal uncertainty
- Radical extension of risk sharing required

UK Government's pension reforms

- Changes to State pension scheme
- Introduction of Personal Accounts

Why conditional indexation?

- A natural step
- Career average schemes with targeted increases – backed by “prudent” reserves – conditional indexation
- Avoids leakage of any funding surplus
  - no abatement of employer future service contributions
  - “passed” increases reinstated out of future surplus
- Change NRA, with protections, if life expectancy increases
- Requires modest changes to the law – amendment to current Pensions Bill

Conditional indexation
From employer's perspective

- Gives control of contributions
- Winding-up debt excludes targeted increases
- Pension Protection Fund (PPF)
  - lower levies: as better funded than DB
  - separate from DB: to avoid cost of legacy
- Less volatile numbers in company financial statements
- Could have level % employer contributions with age-related member contributions

Conditional indexation
From member's perspective

- More stability of provision than under DC
  - sharing of risks with employer
  - pooling with other members

  Important for modest to mid earners
- Employer takes first 'hit' when experience is adverse
- Age-related member contributions align with modern lifestyles
- PPF compensation is 100%, but excluding targeted future increases: avoids "cliff edge"

Conditional indexation - positioning

- Needs modest change in legislation – NOW – ACA has worked with UK Association of Pension Lawyers
- Similar to The Netherlands
- Addresses public sector vs private sector polarisation on pensions in UK
- Leave more radical risk sharing to a future Pensions Bill

Where will conditionally indexed schemes come from?

- Medium to large employers
- Future service benefits
- Initially – final salary schemes about to be closed to future accrual
- Subsequently – upgrading of existing DC schemes
- Evidence of interest from employers

The campaign – so far

- ACA membership
- UK national pension bodies
- Employer and trade union representative bodies
- Media
- Politicians – Government, Opposition, members of both Houses of Parliament

What's been achieved – so far

- Has increased the profile of risk sharing pensions in the public arena
- Pensions Bill currently before Parliament
- Government has reacted with detailed consultation on risk sharing – but aimed at legislation in next session
- ACA's role compared to Actuarial Profession

Cometh the hour!

This is a once in a lifetime opportunity for

revitalising workplace pensions in the UK