# National Report for the United Kingdom

## 1. Association of Consulting Actuaries

Since the last report the membership of the Association has increased to 240, of which 160 are Full Members. This increase reflects the growth of actuarial firms over the period in response to ever more legislation affecting pension schemes in particular and increasing interest of corporate management in the financial state of pension funds. The increase has happened notwithstanding the departure *en bloc* of members from one of the consulting firms on being taken over by an American concern.

Members of the Association meet regularly to discuss topical matters and, through its sub-committees, review developments affecting the work of consulting actuaries and make submissions to government and other bodies as appropriate. The Association is a founder member of the Occupational Pensions Joint Working Group which includes members of other bodies involved in pensions and is a further point of influence on government.

Apart from actuaries in private professional practice who are members of the ACA, actuaries in certain other organisations can now become members of IACA.

## 2. Economic Background

Since the last report, inflation in the UK has been reduced to the lowest level seen for about 20 years. Two years ago inflation was running at about 5% p.a.; the rate of inflation over the past year has been about 2½%. Despite this reduction in price inflation earnings have continued to increase nationally at a higher rate than most commentators regard as justified. Real rates of pay growth of 3% to 4% p.a. have been seen in the past 2 years, notwithstanding unemployment of 12% of the working population. Investment returns have been exceptionally favourable. Measured by market value, returns have averaged about 20% over the past three years. Improvement in the level of corporate profitability has led to increases in dividends on UK equities of 30% over the last two years alone.

Against this background schemes have tended to move into surplus and in many cases this has been further enhanced by the effect of large scale reductions in the workforce. Many mature schemes in the UK at the present time are having contribution holidays for the employer, which has attracted a good deal of press comment, and in many cases substantial benefit improvements have been granted out of surplus. Amongst larger schemes the practice of giving discretionary increases to retired members and their dependants has developed further, and many schemes have been giving annual increases virtually in line with price inflation.

## 3. 1986 Finance Act

In the last report mention was made of concern that the tax status of occupational pension schemes might be changed adversely. Lobbying of the Government has successfully prevented, or at least postponed, this possibility but the 1986 Finance Act has introduced a limitation on the level of assets which can be built up tax free in an approved pension fund.

As from 1st April 1987 actuaries will need to review the financial position of schemes on a basis laid down by the Inland Revenue on the advice of the Government Actuary. The basis itself is intended to represent a fairly cautious set of assumptions, i.e. at the more conservative end of the range of bases currently in use, and includes allowance for future pay and pension increases. If the assets are more than 105% of what is needed to cover the past service liabilities on this basis action will need to be taken if tax approval is not to be restricted to the 105% level. The action to be taken can include improvements in benefits, reductions in employees' and/or employer's contributions, or a refund of excess assets to the employer subject however to a 40% tax charge. Where the action taken includes a reduction in contributions, the reduction must be such as to rectify the position within a 5-year period. A refund cannot exceed the amount needed to reduce the solvency level to 105% on the Government Actuary's basis.

Representations about the new rules have centred on the instability which the short period of 5 years could create and also on the fineness of the 5% solvency margin.

## 4. Health and Social Security Act 1984

This Act introduced the "anti-franking" legislation, whereby revaluation increases on the Guaranteed Minimum Pension (GMP), which contracted-out pension schemes provide in replacement of the State earnings-related pension, have to be paid from State pension age **in addition to** the scheme pension as calculated at the date of leaving service. Formerly such increases could be covered out of the excess of scheme pension over GMP which normally applied at the date of leaving service. The effect is to increase the pensions payable to members who leave service (referred to as "early leavers" in the UK).

## 5. The Social Security Act 1985

This Act was enacted in July 1985 and implemented further long awaited changes to improve the treatment of early leavers from pension schemes. The changes introduced were as follows.

(a) Benefits to be preserved after 5 years service in all cases; formerly benefits did not have to be preserved where age was less than 26.

(b) Compulsory revaluation of the part of pension in excess of GMP which has accrued since 1st January 1985, in line with price inflation but subject to a ceiling of 5% p.a..

(c) The right for members to have a cash equivalent transfer payment made either to another pension scheme or to an insurance policy (commonly known as Section 32 buy-out policies).

(d) Disclosure requirements on trustees.

The change in qualifying service period is of minor effect whilst the revaluation requirements apply only to future accruing rights. However the interaction of the revaluation requirements with the anti-franking requirements is complicated, especially where normal retirement age is earlier than State pension age. Furthermore, the method of revaluation does not correspond to any of the three methods of GMP revaluation which schemes can choose. Whilst the principle behind the legislation has been generally accepted by schemes, the administrative implications are formidable.

Most sizeable schemes already provided members with the right to a transfer payment, although not all were prepared to make transfers to insurance policies, usually on the grounds that this could be against the member's best interests. The legislation carries with it regulations governing the calculation of cash equivalent transfer payments: these have to be made by actuaries and have to be in accordance with a guidance note (GN11) issued by the Institute of Actuaries. Also transfer payments made out of schemes have to be calculated on a basis consistent with that used for transfers in. The main effect of the legislation so far has been to lead to closer attention being paid to market rates of interest and this seems to have resulted in a reduction in the size of transfer payments generally.

The disclosure requirements are not particularly onerous for schemes which already have a practice of communicating well with members. An annual report from the trustees including audited scheme accounts and an actuarial statement is required, whilst members and various other interested parties now have rights to see scheme documentation and actuarial reports. Schemes are obliged to provide new members with explanatory literature. The most significant change for many schemes is the requirement to provide benefit quotations at a frequency of at least once in every 12 months. Larger schemes will provide automatic annual benefit statements but smaller schemes may find these requirements a burden.

Actuarial firms have been busy assisting their clients in meeting these requirements.

## 6. Social Security Act 1986

The last report referred to Secretary of State for Social Services, Norman Fowler's Inquiry into Provision for Retirement. A Green Paper "The Reform of Social Security" was published in June 1985 which completely failed to tackle the major problem of different State pension ages for men and women but proposed that the State earnings-related pension scheme (SERPS) should be phased out over a 20 year period and replaced by a system of Personal Pensions whereby employees and employers would have to jointly pay contributions of 4% of earnings either to a Personal Pension or an occupational scheme.

In response to almost universal rejection by pension professionals and other bodies, the Government was moved to revise its proposals and the White Paper published in November 1985 was significantly different. The proposed changes, which have since been legislated for in the Social Security Act 1986, are as follows.

(a) SERPS is to be retained but at a reduced level for those retiring after the year 2000. The effect is to reduce the size of State earnings-related pensions ultimately to about 60% of their present level.

(b) Occupational schemes will still be allowed to contract-out but the GMP will be correspondingly reduced and schemes will be required to provide increases on it at 3% per annum (or the increase in cost of living if less) whereas formerly no increases had to be provided. Whilst the changes will be reflected in the calculation of the national insurance contribution abatement for employees in contracted-out schemes, the effect in many schemes will be to increase the size of pension increases which need to be provided and hence will increase costs.

(c) Employees will in future have the right to opt out of, or not to join, an occupational scheme and either rely on SERPS or have a contracted-out personal pension into which the equivalent of the national insurance contribution abatement would be paid. As an added incentive, 2% of earnings is to be made available for the first 5 years where the employee has not previously been in a contracted-out scheme.

(d) The qualifying period for preservation of benefits is to be further reduced from 5 years to 2 years.

These changes are to take effect from 6th April 1988 and most of the details are left to be dealt with in regulations which have yet to be seen. No clear statement has yet been made about the tax treatment of personal pensions although this is expected to be broadly comparable with self-employed retirement annuities. The interaction between the tax regime for money purchase personal pension benefits and the maximum benefit limits imposed on occupational schemes by the Inland Revenue will present a number of difficult problems.

Apart from this the terms for contracting-out are due to be reviewed from 6th April 1988, covering the calculation of the contribution abatement and the terms on which GMP liabilities can be bought back into the State scheme.

The new environment of Personal Pensions is prompting many employers to review the design of defined benefit schemes.

## 7. Equal Status for Men and Women

Although there is an EEC Directive on the equal treatment of men and women in occupational pension schemes, the requirements for equal retirement ages for men and women are effectively deferred until the UK state pension scheme adopts equal retirement ages. The government is deferring any action on this, apparently on cost grounds.

A related issue concerns employment conditions. A recent case has clarified that EEC

legislation prevents an employer from requiring women to retire earlier than men, at least in the Public Sector. UK legislation is being amended to bring it into line. Whilst this does not mean that pension conditions have to be equalised, it is a step in this direction. The government's plans for Personal Pensions envisage annuity rates which would be independent of sex and marital status. In practice the compulsory inclusion of dependants' benefits means that unisex annuity rates might not be unreasonable as long as the male retirement age remains at 65, but the principle is being strongly resisted.

Another related issue concerns the inclusion of part-time employees in occupational pension schemes. A recent German case reached the European Court and has increased the pressure on UK employers to provide proportional pension benefits for part-time employees.

## 8. Financial Services Bill

This Bill will affect actuaries who give investment advice as they will need to register with an appropriate statutory body. The general structure proposed is for a Securities and Investments Board (SIB) to oversee a number of Self Regulatory Organisations (SROs), which latter are in the process of now being formed. It is not yet clear which will be the most appropriate SRO or SROs for consulting actuaries nor whether the actuarial profession as a whole will choose to be regarded as a Recognised Professional Body (RPB) (which would confer certain exemptions from the full requirements in respect of certain limited activities).

This legislation will have a more direct effect on insurance companies. In particular there are expected to be rules regarding bonus projections for with-profit contracts, a requirement to quote indicative surrender values when a policy is taken out, and insurance intermediaries will have to identify themselves as either tied representatives of single insurance companies or as fully independent. Independent intermediaries will be subject to a number of controls possibly including commission levels.

## 9. Insurance Companies

During the past two years Life Office valuations have become increasingly orientated towards meeting statutory requirements. The need to demonstrate cover for EEC solvency margin requirements came into effect in 1984. Since then working practices have been developing in consultation between the Government Actuary, insurance company actuaries and consulting actuaries regarding the items within the valuation basis that may be counted towards the solvency margin requirement. The implications of the minimum valuation standards for "mathematical reserves" introduced in 1982 have also been growing clearer, the most significant development being a requirement for mismatching reserves to be stated explicitly on bases acceptable to the Government Actuary's Department. In a similar connection the Institute of Actuaries has initiated further investigations into reserving for maturity guarantees.

A major industry event with implications for actuaries arose earlier this year when a substantial UK mutual office found it necessary to cease transacting new business due to diminishing asset backing for future bonuses in comparison with other offices. There was no question of insolvency but the event has to some extent shifted market attention from present and recent bonus records to attempts to measure the relative financial strengths of competing offices.

The not insubstantial Friendly Society movement still awaits the legislation required by the EEC Life directive which will impose new valuation and solvency margin requirements on the larger societies. It is not clear yet how the structural problems for, for example branch societies, will be resolved.

The introduction of Personal Pensions under the Social Security Act 1986 has created a potential new market for insurance companies although they will be in competition with banks, building societies and unit trust groups. A major difficulty is how to keep expenses low on what will be small units of business.

Consulting actuaries are becoming increasingly involved in non-life references.

## 10. Accounting Standards

A report on the codification of funding standards produced by the Institute of Actuaries has been generally helpful in this area. The most recent developments are the issue of an exposure draft (ED39) by the Accounting Standards Committee relating to the treatment of pension costs in company accounts and the issue of a statement of recommended practice (SORP1) relating to the accounting information provided in pension scheme accounts.

ED39 leaves the actuary free to choose appropriate actuarial methods and assumptions as long as these reflect future salary increases and any established practice of discretionary pension increases. Normally surpluses and deficiencies are to be written off over the average future working lifetime of the existing employees. Divergences between contributions paid and pension cost are to be reflected in a company's accounts although in many cases it is anticipated that the two measures will coincide. ED39 also proposes disclosure of the level of solvency relative to both discontinuance and ongoing past service liabilities.

FAS87 issued by the US Accounting Standards Board will have an impact on some UK schemes, mainly subsidiaries of US multinationals.

## 11. Investment Matters

The most noteworthy feature of the period under review for actuaries has been increased activity in the fields of performance measurement and investment manager selection. The growing size of pension schemes, particularly relative to the size of sponsoring companies in declining industries, the pressure from government for increased accountability and disclosure, and other factors have fuelled this. Changes in investment management organisations arising out of the City Big Bang (the introduction of dual capacity and removal of minimum commission scales in the Stock Exchange which takes place on 27th

October this year) create further pressure. There is also a tendency amongst larger funds to split the investment management between more than one organisation. The three largest firms merged their performance measurement services at the end of 1983 since when a number of other actuarial organisations have become associates.

The last two years have seen the proportion of UK pension funds invested outside the UK maintained at about 20%.

## 12. Legal Liability

In common with other professions and other countries it is becoming more difficult to obtain appropriate professional indemnity insurance cover and premium rates are rising sharply.

## 13. Professional Conduct

Reference was made in the last report to the revised Institute Code of Professional Conduct. The new code places less emphasis on independence of advice, leaving it to the actuary to make it clear to his client when advice is not fully independent. It requires actuaries to be identified to the recipients of their advice, so that actuaries employed by insurance companies and other organisations now have direct responsibility to the recipients of their advice as well as to their employer. Consulting actuaries feel that the code has been weakened and are concerned about the lack of recognition of the different constraints under which actuaries in other forms of organisation give advice. The rules on advertising and publicity have been liberalised and there has been some increase in promotional activity amongst consulting actuaries.