IACA 1994 CONFERENCE, HONG KONG

NATIONAL REPORT FOR THE UNITED KINGDOM

This report has been prepared by members of various Committees of the Association of Consulting Actuaries (ACA)

Life Assurance

The restructuring of the UK life assurance industry has gained momentum over the past two years. Several smaller insurers have been sold and subsumed into the operations of other companies, having ceased to be viable as separate entities. Many others are expected to follow. Meanwhile, banks and building societies have continued to increase their share of the market, and a number of building societies have recently announced their intention to establish their own life companies in the near future.

Most of the changes that are taking place can be attributed to the Financial Services Act, which came into force in 1988 but whose full impact has yet to be felt. The regulators have become increasingly vigourous in attacking bad selling practices and in expanding the amount of information available to buyers of life assurance and related products. Several household name insurers have been fined heavily over compliance problems, and the industry faces the possibility of a heavy compensation bill over mis-selling of personal pension contracts to those leaving occupational schemes. Increased disclosure of commission is in the pipeline, and this is expected to bring major changes in remuneration arrangements and product design, and to accelerate the rationalisation of the industry.

Consulting actuaries have been heavily involved in this process, advising on sales, mergers, portfolio transfers and demutualisations. At the same time they have been helping to set up new bancassurance ventures.

There have been significant developments in financial reporting for life assurance business. Faced with a requirement to report 'true and fair' profits to comply with the EC Insurance Accounts Directive, the industry developed a new approach, the Accruals Method, which has strong similarities to the methods used in Canada and Australia. This has failed to attract widespread support and is likely to be 'merged' with the more established embedded value approach. Moreover it now appears that profit reporting based on statutory surplus arising, modified to defer acquisition costs, will also be capable of attracting a 'true and fair' audit certificate.

Hence while the EC Directive will standardise the *format* of life assurance accounts in the UK and throughout the European Union, it is not expected to lead to a unified approach to profit reporting, at least in the short term.

The EC Third Life Directive will be implemented on 1 July, and will facilitate cross-border selling of life assurance within the European Union. This is not expected to revolutionise the UK life assurance market, but there is considerable interest in the possibilities for selling into the UK from continental European countries with more favourable corporate tax regimes. A major review of the UK life assurance tax system is under way, but the current expectation is that the status quo will be maintained for the time being, with only minor changes to eliminate some loopholes.

Pensions

Two major themes continued to dominate UK occupational pension scheme matters since the last IACA Conference in 1992. These were the security of occupational pension scheme rights and equal treatment between the sexes in occupational pension scheme matters.

On the first matter, in June 1992 Peter Lilley, the Secretary of State for Social Security, established Professor Goode's Committee to review occupational pension law. The Committee decided to operate by issuing a detailed consultation document containing many questions. The ACA responded in full to the Consultation Document and was also asked to appear before the Committee to give oral evidence. The Goode Committee finally reported on 30 September 1993. Their report consisted of two volumes and was substantial. In total they made 218 recommendations. These recommendations included:-

1. Compulsory funding for any pension promise below Inland Revenue limits.

2. Introduction of a minimum funding requirement based on cash equivalents.

3. Right for in service members to be represented on trustee boards, at their request, to the extent of at least one third of trustees for the final pay schemes and at least two thirds of money purchase schemes. This recommendation applies only to schemes with more than 50 members.

4. Protection under trust law for accrued rights and restrictions on amendment powers.

5. Definition in statute of powers of employer and trustees.

6. A new Pensions Regulator with costs met by the State.

7 An industry wide compensation scheme should be established for fraud, theft and misappropriation with the costs met by a levy on some schemes in arrears.

8 Approval of the Pensions Regulator and an adequate solvency margin required before any refund of surplus permitted to the employer.

9 There are to be tighter rules on scheme wind-ups including the involvement of the Pensions Regulator in each case.

10 Requirement for every scheme, including money purchase schemes, to have a scheme actuary,

11 Simplification of the disclosure requirements but annual benefit statements to become mandatory.

12 Tightening of self investment rules and current 5% limit, no loans to the employer and existing property investment to be sold if necessary to meet the limit.

13 Tighter rules on payment of contributions to schemes especially money purchase schemes.

14 Greater penalties for non-compliance with pensions law including criminal offences.

15 The Goode Committee recommended retention of trust law and that no changes should be made to the law with regard to the correction of surplus or deficit in a final salary pension scheme.

From the actuary's point of view the controversial recommendation is the introduction of the minimum solvency requirements. Some actuaries are concerned about the implications for the investment policy of schemes. The Goode Committee recommended quite penal correction by cash injection should solvency fall below 90% of the proposed basis. Otherwise the correction period for any solvency shortfall was to be over three years. With UK schemes being substantially equity invested the debate concerns the extent cash equivalents should reflect the underlying accrued rights of members which may be related either to more traditional fixed interest securities or the investment portfolio actually held by schemes. Any mismatching between the investment portfolio and the liabilities and the solvency standard would require additional reserves if the solvency standard is not to be breached.

The Government issued Consultation Documents in response to the Goode Committee's Report in December 1993. The period of consultation was short and comments were required back by mid-January 1994. Again the ACA responded to

the consultation exercise. The response of the Government is expected in a White Paper in June or July 1994 with legislation possibly starting through Parliament that Autumn. The consultation exercise, as with the White Paper, will possibly deal with other matters than the strict issue of occupational pension scheme security as reported by Professor Goode. Other matters to be resolved include the equalisation of guaranteed minimum pensions and the future structure of contracting-out; the future of the limited price indexation legislation enacted by the Social Security Act 1990 but never implemented; and an issue on which the Goode Committee was split, the level of pre-retirement revaluation of early leavers accrued pension rights.

For future contracting-out of the State Earnings Related Pension Scheme the Consultation Document issued by the Government favoured one of two approaches:

(a) a return to a requisite benefit test which had originally been present in the original structure for contracting-out in 1978 but with the abolition of guaranteed minimum pensions or

(b) an approach to contracting-out based on the actuary certifying that the scheme benefits are at least of equivalent value to either a level of contribution or alternative benefits available from the State.

In July 1992, the employer debt legislation contained in the Social Security Act 1990 was implemented with the debt being based on scheme's liabilities calculated as the cash equivalents, the alternative minimum statutory transfer values available to members and on the value of immediate annuities for pensions and other benefits in payment. Pensions lawyers were not happy with this approach as scheme deeds typically provide the benefits to be provided on the wind-up should be non-profit annuities. The debt could therefore be collected fully and the scheme could still be technically insolvent. However, the current non-profit annuity market in the United Kingdom is very narrow and a substantial number of schemes would be too large for benefits to be provided by that manner. The Goode Committee's proposed minimum funding standard is consistent with the debt provisions.

On equal treatment at the time of writing we are still awaiting full clarification of the Barber judgement via the Coloroll case. Some clarification has occurred. The Moroni case confirmed that the Barber judgement only applied to pensions accrued from 17 May 1990, and the Neath case had judged that discrimination in actuarial factors was still permitted on grounds of sex where it was related to the funding of the scheme. Therefore as long as factors are based on the funding of the arrangement it was still permissible for sex based actuarial factors to be used for commutation lump sum options and for early retirement factors. However, at the time of writing, whether unisex annuities are required in money purchase schemes awaits the Coloroll judgement.

The other pensions issue currently hitting the headlines in the United Kingdom is the Securities and Investment Board review of pension transfers. A major accountancy firm prepared a report for the Regulator showing that the detailed

administration and record keeping requirements of the Regulator has been followed in very few cases by insurance brokers, insurance companies and advisers transacting pensions transfer business for early leavers from occupational pension schemes. The report also showed a similar position with regard to advice given to members opting out of occupational schemes for a personal pension. At the time of writing, the extent to which individuals have lost out by the advice given is not clear. However rumours as to the possible extent of compensation have affected some insurance company share prices.

Following the issue of the Consultative Document on the equalisation of State Pension Ages the Government announced in November 1993 that State Pension Age would be raised to 65 for men and women by 2020. Interim arrangements will be in force from 2010 to 2020 in which the State Pension Age for women is moved gradually from 60 to 65. Legislation is currency awaited on the exact details of the equalisation and on the long term viability of the State Earnings Related Pension Scheme.

Since the IACA Conference the Association has founded a Parliamentary Group with the aim of briefing MPs more thoroughly on pensions issues.

Taxation of Pensions

The two most significant changes to the tax treatment of pensions were introduced in the Spring 1993 Budget.

The first was a reduction in the amount of tax which can be reclaimed by exempt pension funds on their dividends from UK companies. Gross dividends from UK equities were reduced by 6¼%, resulting in a reduction of some 0.2% pa in the income of a typical exempt fund.

The second was the freezing of the Earnings Cap which limits the amount of benefit that can be provided from exempt occupational schemes and the contributions that can be paid to personal pension schemes. The Earnings Cap is meant to increase each year in line with the Retail Prices Index and was due to rise from £75,000 to £77,400 in April 1993. However, it was frozen at £75,000. Following representations from many bodies, including the ACA, indexation resumed in April 1994, although the missing year's indexation has not been made good.

Accounting Standards for Pensions

There has not been a great deal of activity over this period since the accounting profession has made only slow progress on its review of SSAP24, the UK's accounting standard on pension costs in company accounts. The actuarial profession has informally provided comments to the accountants on proposed changes to the standard and the ACA, through the Accounting Standards Sub-Committee, provided input to that process.

We anticipate that the Accounting Standards Board will put forward specific proposals for change later this year and the ACA will then respond formally to these proposals. It seems likely that improved disclosure of pensions information will be required and it is possible that some flexibility of accounting treatment will be removed.

In 1992, the Chartered Accountants Joint Ethics Committee (CAJEC) issued a draft ethical guidance note on the subject of accounting firms providing specialist valuations for their audit clients' accounts. This was of interest to the actuarial profession since one of the main types of specialist valuation covered is actuarial valuations. The note stated that specialist valuations should not be carried out by the auditing firms but appeared to exclude actuarial valuations if the judgemental decisions behind them were taken by the company's directors.

The ACA submitted evidence to CAJEC which included their view that for reasons of independence actuarial valuations carried out for SSAP24 purposes should not be carried out by actuaries in the company's audit firm. This view received much support from the accountancy profession generally but was strongly resisted by those large accountancy firms who have in-house actuaries. Whilst the outcome is not entirely clear it seems that the "big boys" have probably won the day.

The recent inclusion in ACA membership of actuaries in accountancy firms should give us an added perspective and enable us to have the best possible dialogue in this sometimes difficult area.

The ACA's recent reorganisation of sub-committees means that, in future, the Accounting Standards Sub-Committee will consider accounting issues on all aspects of employee benefits and on a worldwide basis. This will considerably widen its scale of activities and we hope to have a fuller report in two years' time.

Healthcare

General

Healthcare in the UK continues to be dominated by the National Health Service reforms. The Government hopes to achieve greater cost control and efficiency by creating an "internal market". This is being achieved by separating the purchasers of health services for the general public in the form of Health Authorities and fund-holding GPs from the suppliers in the form of semi-independent "trust status" hospitals.

Amongst other things, these reforms were intended to create a level playing field position to facilitate competition between the National Health Service providers and the private sector. Thus, in theory, health authorities are able to contract with NHS or private health facilities to supply service to the general public and the same concept applies to GP fund-holders. However, the private sector has had difficulties

in competing and maintaining adequate profit margins and there is little evidence, as yet, that the private sector has made significant in-roads. There are signs that the major purchasers of private health care, ie the insurance companies, are seeking to bring rising costs under control by introducing more active management of claims.

Private Medical Insurance

The number of lives covered by private medical insurance in the UK has remained static for several years at about 12% of the population.

The normal accounting requirements for pension schemes (SSAP24) in the UK have been extended to post retirement medical benefits. Such benefits are invariably funded on a pay as you go basis, whether insured or not. Thus the new accounting standard will give rise to "book reserve" entries in balance sheets and an "expense" item for profit and loss accounts representing the accrual of benefit for the year, interest charge and amortisation, where applicable.

The new accounting method applies to accounting periods ending after 23 December 1994 and will require regular actuarial valuations. A Guidance Note for the actuarial profession is in course of preparation by a Joint Working Party of the Institute of Actuaries and the Faculty of Actuaries. Approximately 10% of all medical insurance plans are believed to include post retirement cover although the impact of the new accounting requirements is expected to reduce this number.

Long Term Care (LTC)

The number of UK citizens above age 65 is expected to increase by 50% in the next 40 years with little or no change to the numbers below this age. One of the important impacts under investigation is the increased demand for LTC (Long Term Nursing and Care Services) from a static funding base. Recent actuarial research indicates that the cost may increase in real terms from £40 billion per annum to, perhaps £100 billion per annum with a greater share falling upon the private sector.

A number of insurance companies offer pre-funding, long term care policies for individuals and groups of lives. Whilst of interest, there are no signs as yet that employers intend to include this form of insurance in their range of employee benefits.