First Actuarial briefing for trade unions
October 2012

Introduction
Welcome to the tenth edition of our briefing for trade unions. Topics covered in this bulletin include:

i. The beginning of auto-enrolment
ii. Miliband’s call for a cap on scheme charges
iii. EIOPA’s plans to review pension funding requirements
iv. The Pensions Regulator’s analysis of scheme funding
v. ONS opens consultation on options for “improving” RPI
vi. Ongoing consultations

As always, comments are very welcome and anyone not already on our mailing list who wishes to be should contact us using the contact details at the end of this briefing.

Auto-enrolment begins

After years of planning, delays and rethinks, auto-enrolment finally began for the largest UK employers on 1 October 2012. The move was welcomed by many bodies in the pensions industry as over the coming years millions will begin saving into a work-based pension scheme for the first time. Joanne Segars, Chief Executive of the National Association of Pension Funds (NAPF), said “this is a game changer that will get millions of people saving for their retirement. The UK is drifting towards an iceberg when it comes to paying for its old age, and we need radical reform like this.”

It is hoped that these reforms will halt the decline in the number of workers saving for retirement over the past several decades.

A detailed description of the auto-enrolment requirements can be found on the First Actuarial website.

Miliband calls for cap on scheme charges

The launch of auto-enrolment coincided with Labour leader Ed Miliband’s calls for a 1% cap on pension fund charges. The call followed claims over the summer that some savers were paying as much as 5% pa of their fund in charges. The cumulative cost over a saver’s lifetime can be hugely significant.

The Labour leader pledged to cap fund charges at 1% if re-elected - “If we win the next election, we will make sure that no pension company can take too much out of your pension; a strict cap on pension fees.”

As well as expressing pension charges as an annual single figure in percentage and cash terms, they would also include a projection of how charges will impact on the final fund value over the years to retirement.

EIOPA to look again at pension funding requirements

The European Insurance and Occupational Pensions Authority (EIOPA) has said it will review plans to introduce new funding requirements for pension schemes. The current plans are to introduce a European wide standard known as the “holistic
balance sheet” approach. However, many pensions professionals and politicians have raised significant concerns over the proposals and the impact they would have on the schemes and the companies that support them. Respondents to the EIOPA’s consultation in June said that the approach would “jeopardise occupational pension provision and will have further economic, financial and social repercussions”. The approach would lead to a considerable increase in the administrative burden on, and funding requirements of, occupational pension schemes. Respondents called for further impact studies before legislation was proposed.

Following this, the EIOPA has released its draft technical specifications which included plans to undertake a quantitative impact study (QIS) on the holistic balance sheet approach. This is expected to continue until December. Jonathan Camfield, partner at LCP, criticised the methodology put forward in the draft technical specifications stating “it’s very complex and attempts to put a value on a company’s financial strength in a mechanistic way. This will result in meaningless figures for many companies who support pension schemes…. We can only hope that Europe realises that trying to shoehorn pension schemes into a one size fits all regime like this will create widespread anomalies and be unnecessarily destructive for pension schemes and their sponsoring employers.”

The results of the QIS are to be submitted by the end of 2012.

Pensions Regulator analysis of scheme funding

The Pensions Regulator (TPR) has published evidence on how some of the flexibilities in the funding regime have been used by pension schemes and employers. Key results of the analysis include:

i. contributions as a percent of liabilities vary significantly from scheme to scheme;

ii. there are wide variations in discount rates with assumptions for investment performance relative to gilts varying from below 0% to over 2%; and

iii. Schemes in the current round of valuations have seen an increase in the length of recovery plans by just over 4 years.

Starting from the premise that sponsors wish to maintain the level of contributions already committed to in recovery plans, the Regulator has concluded that:

i. about 25% of schemes would not need to amend their current recovery plans,

ii. about 30% of schemes would remain on track to meet their long term liabilities with a 3 year extension to their existing recovery plan and a 10% increase in contributions,
iii. about 20% would remain on track with a 3 year extension to their recovery plan, 10% increase in contributions plus use of greater investment outperformance in their recovery plan, and

iv. about 25% of schemes would need to make maximum use of the flexibilities available in the funding framework because of the affordability challenges for their sponsoring employers.

TPR does not dwell on the fact that in many schemes, members have had to stump up a good proportion of the costs of deficits by having their benefits cut from being RPI linked to CPI linked.

The analysis also showed that for over 50% of the FTSE350 companies sampled, deficit contributions were less than 20% of the money distributed by way of dividends. At the other end of the scale, for 15 of the FTSE350 companies sampled, deficit contributions were higher than 50% of dividend payments.

Earlier this month, TPR’s chair, Michael O’Higgins, said that TPR would relax its stance on the length of scheme recovery plans, stating “there is no upper limit to recovery plan lengths and what is appropriate will depend upon the individual circumstances of the scheme.” Previously, TPR had used an automatic trigger to scrutinise those schemes submitting a recovery plan greater than ten years in length.

TPR’s analysis can be found here: http://www.thepensionsregulator.gov.uk/docs/the-defined-benefit-regime-evidence-and-analysis.pdf

ONS opens consultation on options for “improving” RPI

The Office for National Statistics (ONS) has opened a consultation to gather views on options for amending the way that the Retail Price Index ("RPI") is calculated. The changes up for consultation could result in gradual changes in the RPI, narrowing the difference between the RPI and the Consumer Prices Index ("CPI").

The graph below demonstrates the historic differences between the RPI and CPI over the past 24 years:
In 2011, the Government controversially changed the statutory index for uprating pensions in payment and revaluing benefits in deferment from the RPI to the CPI. Many bodies in the pension industry claimed this was not because (as the Government claimed) CPI more accurately reflected the cost of goods to pensioners, but was instead a simple way for them to cut costs.

Duncan Weldon, senior economist at the TUC, stated that the move will see pensioners lose thousands of pounds: “This is unjust. People who paid their hard-earned cash into schemes for decades shouldn’t be getting less money in retirement because the ONS decides to change an equation.”

The switch from RPI to CPI will have “huge implications”, says Darren Phillip of the NAPF. The move will not only affect how much pensioners see their annual income increased by each year, but he points out that “pension funds are major investors in government debt and changes to index-linked bonds could have far reaching impacts on those investments”.

The ONS is independent of the Government, and claims that it is consulting on the changes to see whether there is a need to make them.

Differences between the RPI and CPI estimates of inflation are due to a variety of factors:

i. they are calculated using different “baskets” of goods and services, with RPI including housing costs,

ii. CPI captures the spending of a wider group, with RPI excluding the spending of the wealthiest and those pensioner households dependant on state benefits (approximately 13% of the population in total),

iii. the way data is collected differs, and

iv. they use different mathematical formulae to calculate the increase in prices year on year.

The consultation considers ways of reducing or removing the formula effect and seeks views on the following options:
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<table>
<thead>
<tr>
<th>Option</th>
<th>Expected impact on formula effect</th>
<th>National Statistician view</th>
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<tbody>
<tr>
<td>No change</td>
<td>No change. Gap expected to remain around 1%</td>
<td>Difficult to defend current method based on international practice and weaknesses of the current approach. Clear message that the method needs to change.</td>
</tr>
<tr>
<td>Change method used to average changes in prices for clothing</td>
<td>Reduce formula effect, reducing gap to around 0.3%</td>
<td>2 different mathematical methods are considered, both producing similar results.</td>
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<tr>
<td>Change method used to average changes in prices for all items in the RPI</td>
<td>Reduce formula effect to a minimum.</td>
<td>2 different mathematical methods are considered, both producing similar results. Some difference between RPI and CPI formulation would remain.</td>
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<tr>
<td>Change RPI so that its formulae aligns fully with CPI</td>
<td>Remove formula effect.</td>
<td>There will still be differences in estimates of RPI and CPI as composition and weights of baskets would be different.</td>
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There are a number of critics of the use of CPI and many of their arguments apply equally in this consultation. One particularly helpful paper is that commissioned by the Association of British Airways Pensioners and written by Mark K M Courtney, D. Phil (Oxon), formerly Deputy Director and Head of Economics, Regulatory Impact Unit, Cabinet Office. This is available here:


The ONS has said that if any changes are made, they will be reflected in the RPI published in 2013. It has also confirmed that there is no proposal to amend retrospectively the formulae used to generate RPI or CPI estimates that have already been published.

The consultation period runs from 8 October 2012 to 30 November 2012, and the document can be found by visiting the ONS website: www.ONS.gov.uk

Ongoing consultations

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<th>End</th>
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<tr>
<td>08/10/2012</td>
<td>30/11/2012</td>
<td>ONS</td>
<td>Options for improving the Retail Prices Index*</td>
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<tr>
<td>04/10/2012</td>
<td>14/11/2012</td>
<td>DWP</td>
<td>The Occupational Pension Schemes (Miscellaneous Amendments No.2) Regulations 2013</td>
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<tr>
<td>25/09/2012</td>
<td>02/11/2012</td>
<td>PPF</td>
<td>The 2013 / 14 Pension Protection Levy Consultation</td>
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*see above section of our Briefing
The DWP consultation The Occupational Pension Schemes (Miscellaneous Amendments No.2) Regulations 2013 covers several minor amendments following the Government’s change in the preferred inflation measures. It is also covers some issues surrounding Bridging Pensions and the change in State Pension Age (“SPA”).

The PPF has issued a consultation on the proposed levy for 2013/14, which is estimated to be £630million. This is the same aggregate amount the PPF expects to collect in the 2012/13 year, which is £80million more than the original estimate. The levy is calculated using a risk based approach. The Chief Executive of the PPF, Alan Rubenstein, said “we know that many employers are still struggling in the continuing economic turmoil. That is why, exceptionally, we have set a levy estimate that means schemes will typically see levies at similar levels in 2013/14 as they will for this year.”

However, he went on to warn that future hikes in the levy were inevitable if the current economic climate persists, warning that the threat of PPF failure has far reaching consequences: “an inadequately resourced PPF would fail to offer the security that pension scheme members deserve, and would strengthen the hand of those who argue for more radical measures to deal with risk such as the imposition of insurance style insolvency requirements”.

Further information

If you require further information on any of the issues contained in the bulletin, please contact:

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We very much welcome feedback on any of the issues covered and suggestions for issues that should be covered. If any of your colleagues would like to receive future briefings but are not on our circulation list, please let us know and they will be added to the list.