ASSOCIATION OF
aca
CONSULTING ACTUARIES

St Clement's House, 27-28 Clement's Lane, London EC4N 7AE
Tel: +44 (0)20 3207 9380 Fax: +44 (0)20 3207 9134 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

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Pension Protection Fund
Knollys House
17 Addiscombe Road
CROYDON
CR0 6SR

Our Ref: EMB/MB

Dear Sirs

CONSULTATION ON SECTION 143 AND SECTION 179 ASSUMPTIONS

I am writing on behalf of the Association of Consulting Actuaries, in response to the above consultation.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is effectively the 'trade association' for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies.

General

In our response below we have dealt separately with Section 179 and Section 143. The purposes of the two sections are quite different, and it is not self-evident to us that changes to the assumptions for one section should automatically be reflected in changes to the assumptions for the other.

This distinction is reinforced by our reading of the legislation. Regulation 6(1)(a) states that for a Section 143 valuation the value should be "the estimated cost of securing scheme benefits …… by means of an annuity purchased at the market rate …". By contrast Regulation 6(1)(b), which governs Section 179 valuations, refers to "the estimated cost of securing scheme benefits in accordance with any guidance issued by the Board …".

Our preference is that the section 179 assumptions should be changed as infrequently as possible. Keeping the section 143 assumptions up to date is more important in our view.

Section 179 assumptions

Given that the overall levy total is not affected by the assumptions, any change merely involves a redistribution between levy-paying schemes.

Whether such a change is worth making is open to question. The 'stability principle' suggests that any change would need to be material; in the absence of any published analysis of the impact on individual schemes (along the lines of that included in the November 2008 consultation, Chapter 6 and Annex A, section 3.2) we find it difficult to assess materiality.

Moreover, with the prospect of a major change in the whole levy calculation as from 2012/13, any changes in the interim will have a limited shelf-life. The costs of making a change – including updating of the PPF's systems, updating of advisers' calculation systems and communication of the changes to the trustees of 7,400 defined benefit schemes – should not be underestimated. These costs must be weighed against the short-term nature of the benefits of making a change.

Sections 6.2 and 7.3 of the consultation paper contain hints that there may be some slight impact on the levies for year 2010/11 ("*almost* no impact," "*barely* affect"). We should welcome clarification of the circumstances in which this could happen.

As you acknowledge in section 3.3 the Pensions Regulator uses a scheme's section 179 liabilities as part of one of his "funding triggers"; any reduction in those liabilities will therefore imply that fewer schemes will trigger. We have no objection to this but we do wonder whether this side-effect was deliberate on the Board's part.

Section 143 assumptions

In the context of section 143 we can see a much more convincing rationale for ensuring that assumptions are kept in line with market movements.

Our main reservation in this area relates to principle (h) in paragraph 3.1. We think we understand why the Board considers it necessary to understate liabilities, but that does not mean that it is seen as helpful (or fair) by the schemes that are consequently rejected. While the reconsideration process set out in paragraph 3.2 provides an element of respite, it is also time-consuming and expensive – especially for smaller schemes. And if the second application is successful these additional costs will in the end be borne by the PPF.

If an element of understatement is felt to be essential, our preference would be that it be kept as small as possible. A statement by the Board to that effect (and confirming the rationale behind the policy of understatement) would be reassuring.

Specific questions in Section 8 of the consultation

Q1. Do you consider that the proposed new section 143 and section 179 valuation assumptions in Appendix 1 are reasonable? If not, what would you propose as an alternative set of assumptions?

A1. The Board has arrived at these new assumptions by means of a confidential discussion process with a number of buy-out insurers. We have no reason to doubt that the result is a reasonable reflection of the buy-out market at the date of those discussions.

Q2. What evidence do you have, in summary, to support your response to Q1?

A2. Not applicable.

Q3. Is it appropriate to introduce the new section 143 and section 179 assumptions with effect from 31 October 2009?

A3. We are not clear why it is felt necessary to introduce new assumptions so rapidly. This consultation closes on 11 September and the Board has stated that it will publish its decision by the end of October. In the circumstances an effective date of 31 October seems premature, particularly in relation to section 179

Early introduction for section 143 is more acceptable – indeed, it could even be argued that the change ought to be backdated in that context. However we are unclear whether in practice the Board has any mechanism available to it for backdating.

Q4. Would you support the introduction of term-dependent yields (perhaps based on swaps) at the next review (for either or both of section 143 and section 179 valuations)?

A4. Many smaller schemes (and conceivably some advisers) would find it difficult in practice to adopt term-dependent yields. For section 179 purposes we have to question whether this is worthwhile.

It would also make roll-forward calculations extremely complex and prone to error.

We can see more justification for using term-dependent yields for section 143, though even here a case could be made for limiting this more sophisticated approach to larger schemes.

Q5. Would you think it appropriate, at the next review, to differentiate each member's mortality by postcode (for either or both of section 143 and section 179 valuations)?

A5. In many schemes little or no postcode information is available, so the strict answer to Q5 must be No.

The fuller discussion in paragraph 5.9 of the consultation paper points to a possible solution. If the Board were to introduce standardised loading factors to reflect industry, location and (possibly) pension size, these could readily be used by all schemes as a broad-brush approximation to a scheme-specific approach.

On balance, however, we are not convinced that the gain in accuracy from such a broad-brush approach would be sufficiently material. Our preference would therefore be:

- No change for section 179
- Postcodes to be used for section 143 wherever reasonably practicable.

Q6. Would you think it appropriate, at the next review, to introduce a cap on the allowance for winding up expenses?

A6. We do not see any clear justification for introducing a cap as such. Further research should be carried out on the actual level of wind-up expenses, but our gut feeling is that the current tiered expense loadings of 3/2/1% produce an answer that is often unrealistically high. Perhaps a fixed cost plus a lower tiered percentage would be more realistic.

Q7. If the cap mentioned in Q6 were to be introduced do you have any comments about what an appropriate cap might be?

A7. Not applicable.

Yours faithfully

Charles Young
Chairman, Pension Schemes Committee

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