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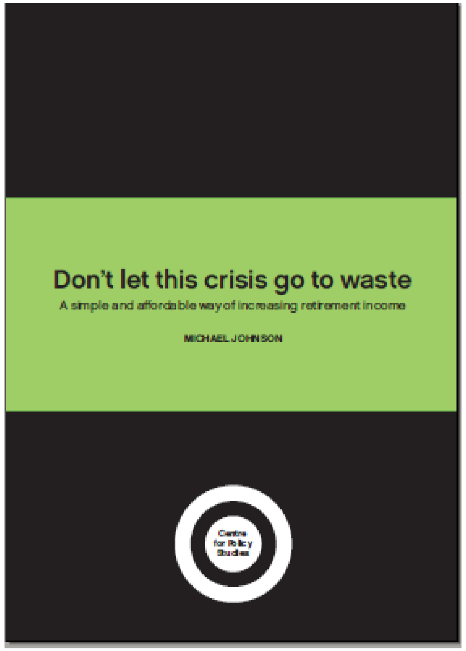
CONSULTING ACTUARIES

ACA Sessional Meeting

14 April 2011



Public sector pensions

Michael Johnson

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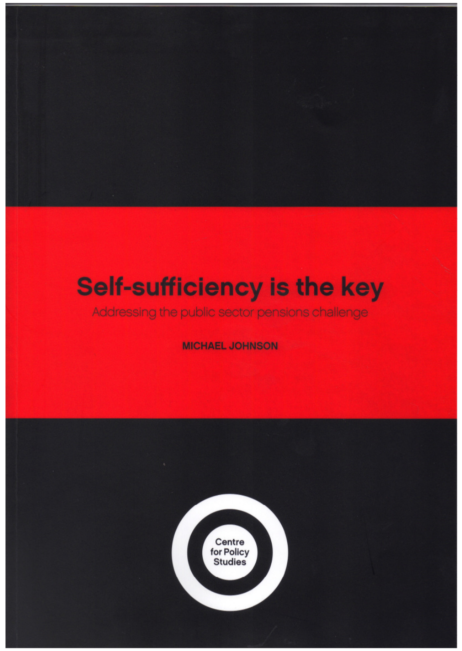


Lord Hutton; a *framework*

- DB - CARE
  - Pensions indexation: CPI*
  - Active: average earnings (but CPI if deferred?)

Retention vs. mobility

- NPA linked to SPA for *future* accruals
  - Periodic NPA review

- Accrual rates, indexation methods, employee contribution……?

- Risk sharing: fixed cost ceiling
  - If negotiations fail…..automatic default……to what?

* Pre-Hutton, along with 3% contributions rise (scheme average)

Lord Hutton; assessment

- **Adequacy**
  - Ref. Turner's replacement rates — Unclear
- **Affordability**
  - CARE — Slow
  - NRA from 60 to SPA (for future accruals) — Slow
  - Risk sharing; fixed cost ceiling? — Vague
- **Fairness**
  - Internal: redistributive — Yes?
  - External: a new 80:20 rule? — No

Lord Hutton; assessment, cont.

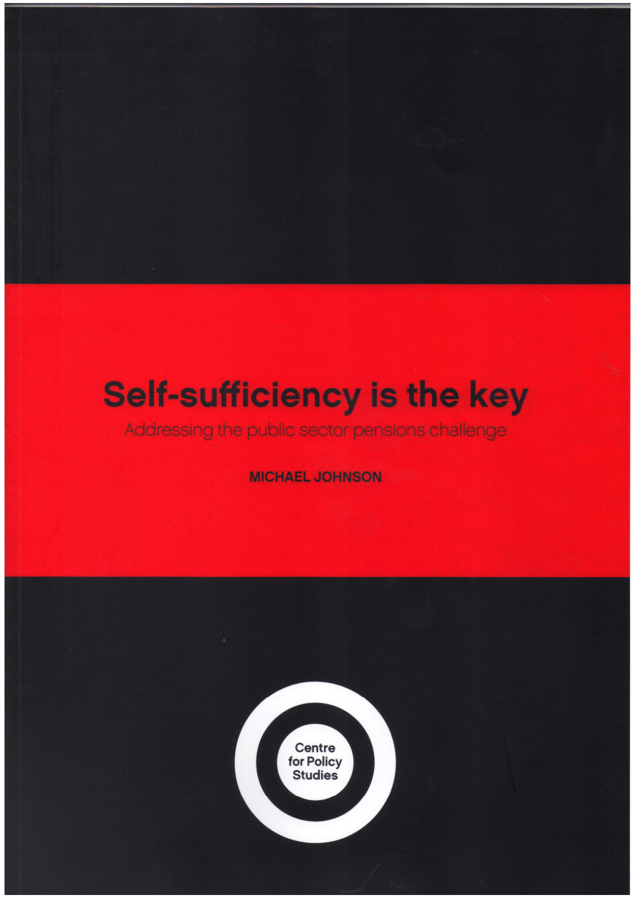
- **Simplicity** Yes
- **Supporting productivity** Unclear
  - No private sector access
  - Fair Deal consultation
- **Transparency / clarity** Some
  - Pension Boards, benefit statements, indep. oversight of governance, OBR reports ref, fiscal impact, more published data

Lord Hutton: summary

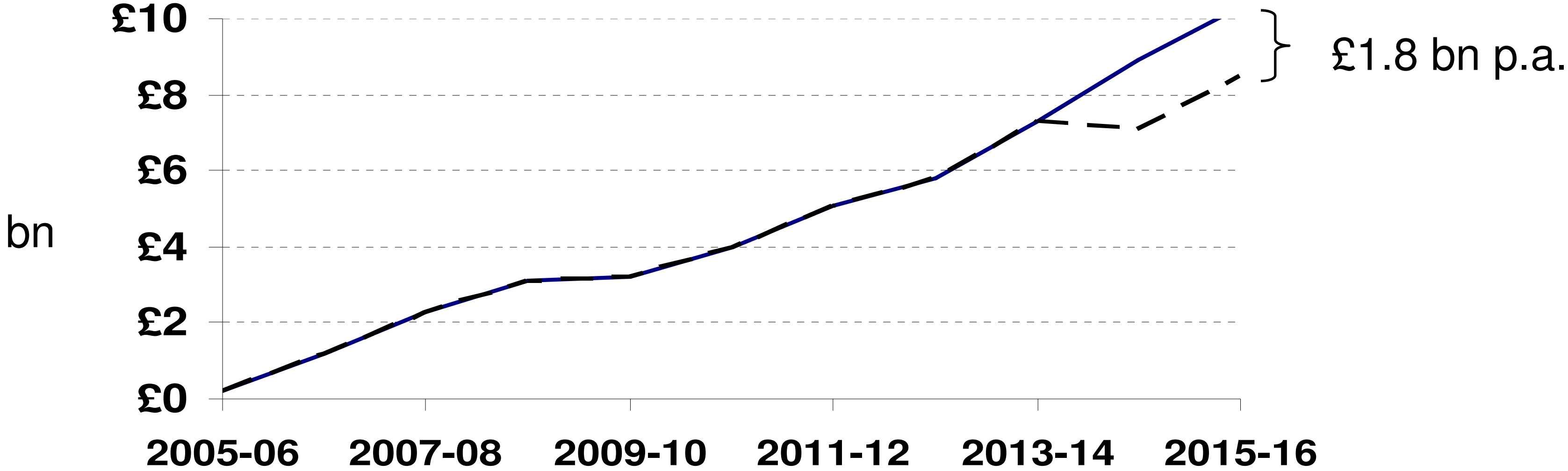
- Lacks specificity; more Q’s than A’s
  - Egg-shell politics; pragmatism to the fore?
    - But what else could he have done?
- Parameterisation; a negotiations nightmare?
- Ducked fairness issue; internal focus only
- Private sector provision: second class from hereon… societal schism
- Revisit in 5 years?

An alternative view

- Backed by Conservative and Labour peers
- At no cost to the taxpayer!



Focus on cashflow; mind the gap*



Contributions	2008-09		2015-16 (post-Hutton)	
Employees	£4.9	23%	£7.2	22%
Employer	£13.8	65%	£17.5	53%
Gap (Treasury)	£2.5	12%	£8.0	24%
Pensions	£21.2bn		£33.0bn	

77% from taxpayers

Fair?

*HM Treasury Budget 2010, Table C13, Total Managed Expenditure

Self-sufficiency is the key

- The vision; pensions equality across sectors
  - Pure DC
  - No Treasury backstop; scheme self-sufficiency
    - Discretion as to how to get there

- Two alternative implementation strategies; brave and cautious

- Prepare the ground; raise the State Pension

- Quick wins; politically painful; few choices
  - Raise contributions (opt-out risk?), RPI to CPI, end CO
  - Problem; if curtailing future accruals, saving are slow to emerge

PAYG; Madoff economics

More pensioners and / or shrinking workforce + Lack of financial discipline = Unsustainable framework

⇩

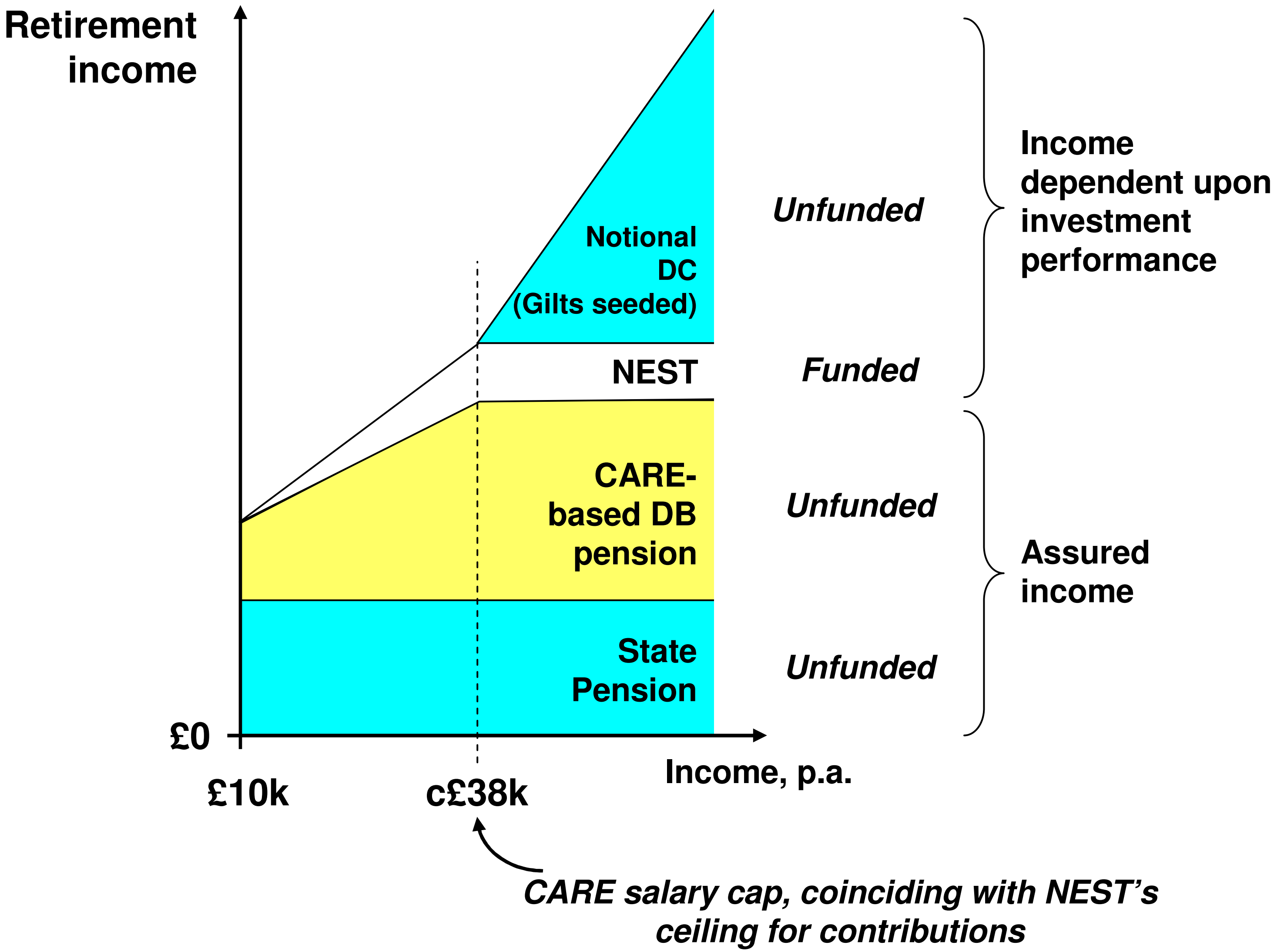
Generational injustice and fiscal calamity

- PAYG accommodates behavioural risk
  - Deferral of today's labour costs
  - Lack of cashflow discipline
- The liability; tabloid distraction

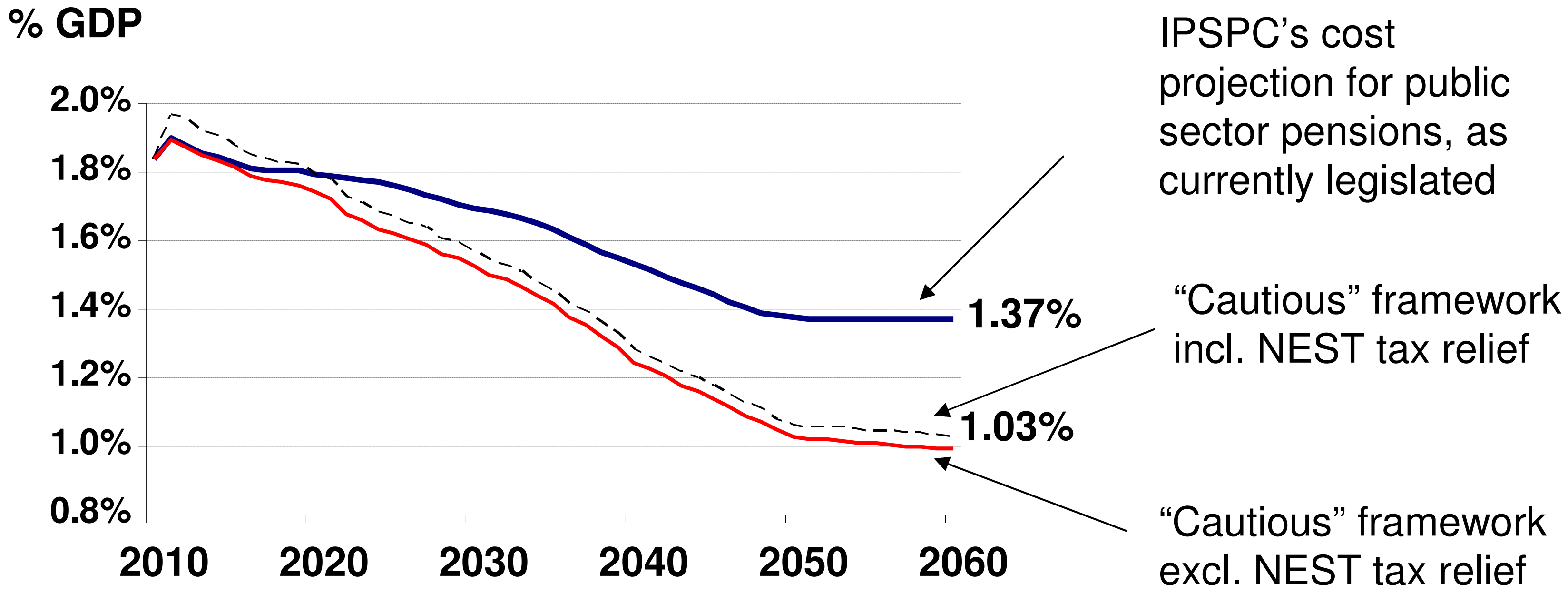
The benefits of funding

- Enhanced transparency
  - Easier to hold management to account
  - Public and private sector schemes directly comparable
- Harder to perpetrate generational inequality
- Cashflow discipline / threat of recovery plan
- Lower cost of pension provision (ref. Audit Commission)
- Stimulate a savings culture, boosting investment
- Political resonance; responsibility revolution

Overview; cautious framework

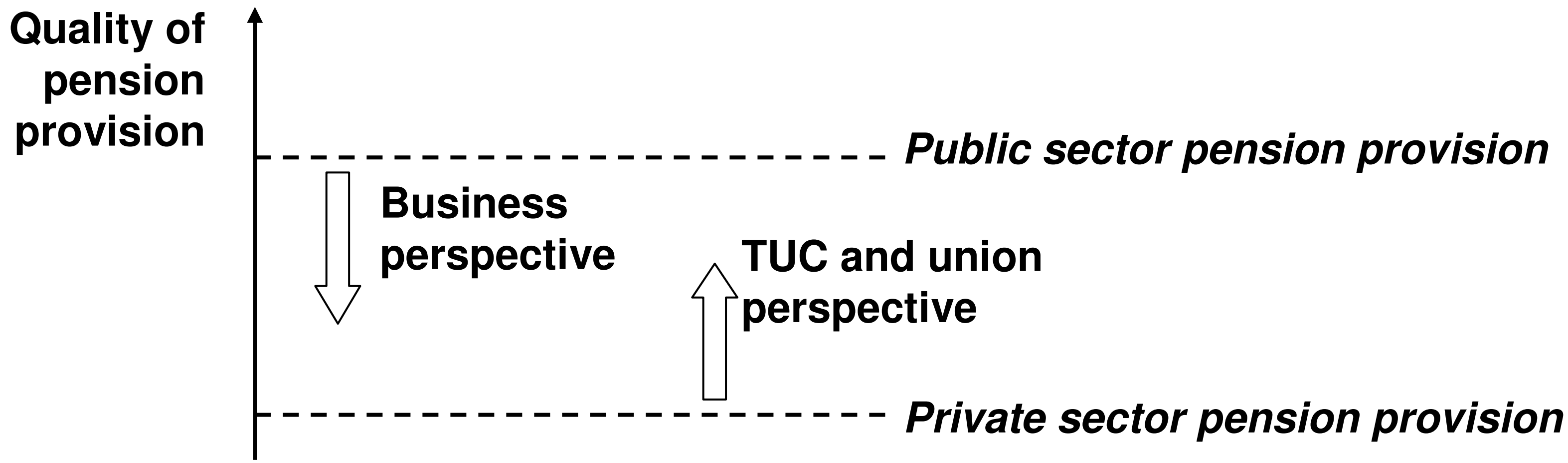


Cost projection



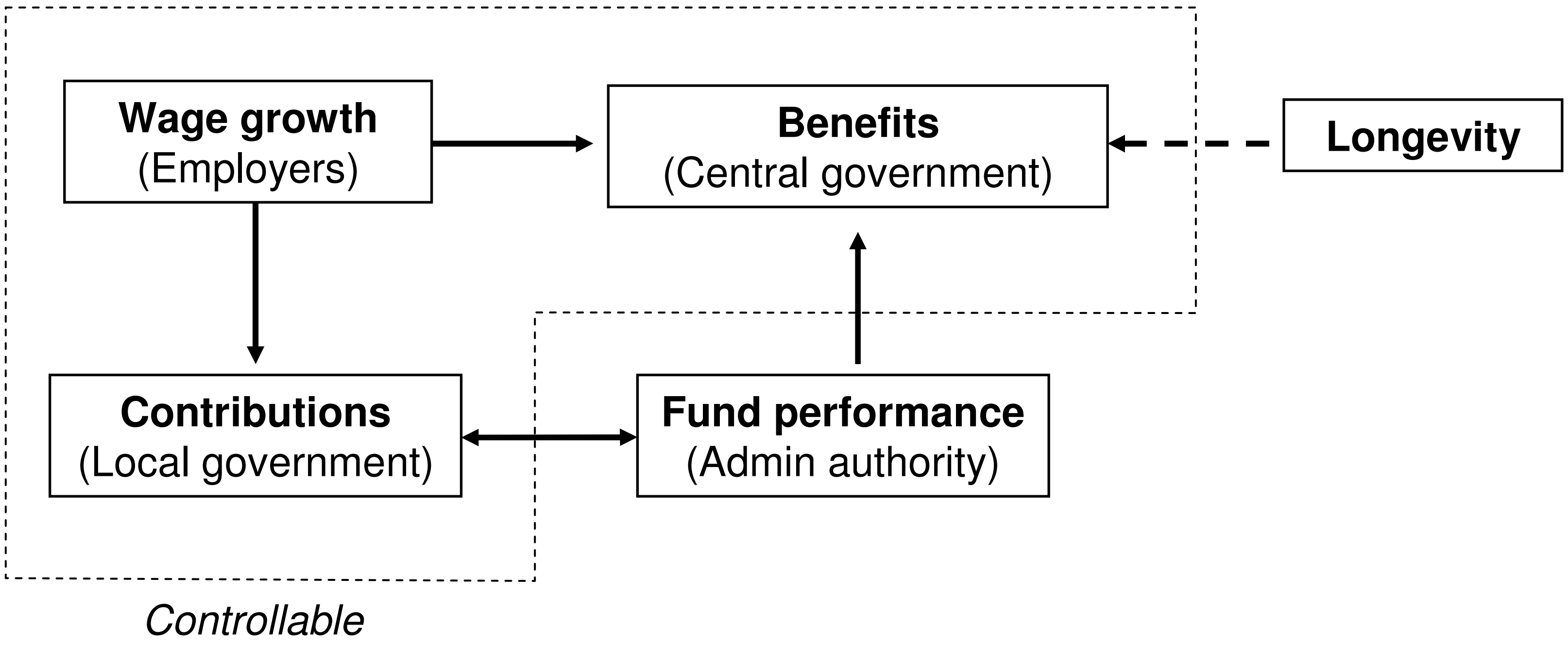
Communications challenge

- Different perspectives



- Great scope for obfuscation and bamboozlement
  - The word “average”
  - Funded vs. unfunded

Governance; a tripartite tragedy?



- Single trust-based Board required for each scheme, incl. employers, government (local / central) and admin authority

Conclusion

- Generational and sectoral inequality too high a price to pay
- Cautious approach merely an interim step to pure DC
  - Confine state's exposure to longevity risk to State Pension
  - Cross-party support is key
- Key risks; communication and implementation
- Pensions reform; a side-show. Inefficiency is the issue
- Private sector "pensions" may disappear….incentivised saving

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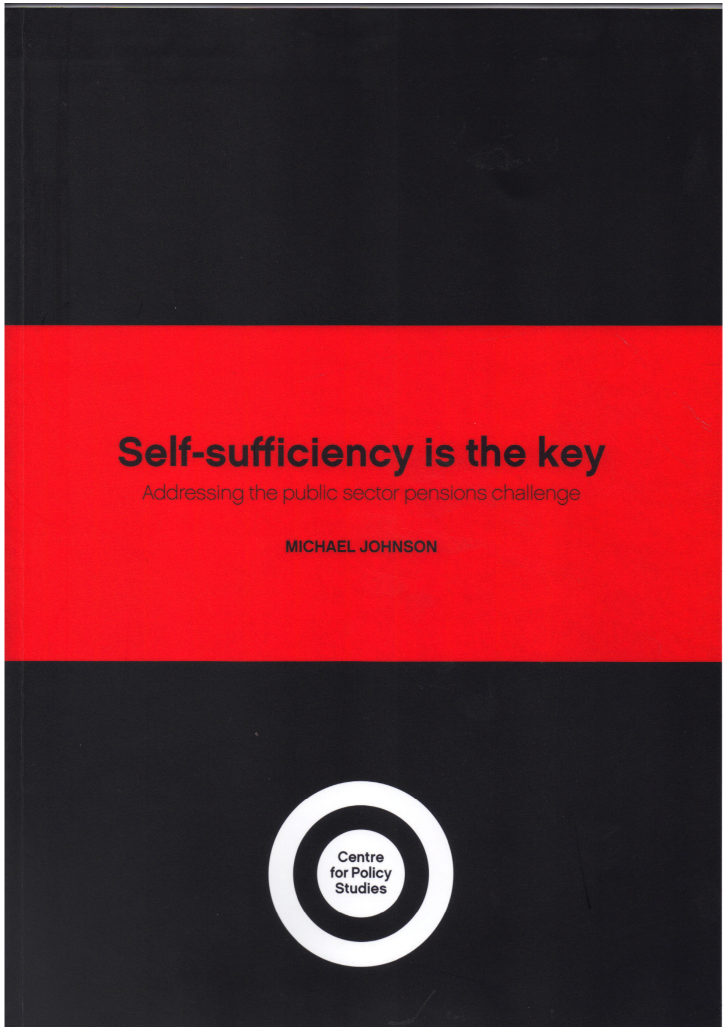

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