CAPITA HARTSHEAD
ACTUARIAL AND CONSULTANCY SERVICES

Neutral Funding Estimates

Peter Barnard

June 2011

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Disclaimer

- Going to briefly share some of my thoughts and experiences
- View expressed may not represent the views of my Employer
- I am not part of BAS nor a research actuary, just an ordinary practising Scheme Actuary

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TAS M Definition of Neutral

"A neutral measure, assumption or judgement is one that is not deliberately either optimistic or pessimistic and does not incorporate adjustments to reflect the desired outcome. A neutral estimate is one that is derived using neutral measures, assumptions and adjustments. There be a range of neutral estimates, reflecting inherent uncertainty".

TAS M Significant Considerations

- No consensus on what "best estimate means"
- Possibilities include: median, weighted average and practitioner's honest belief
- A neutral estimate need not be a best estimate
- But all best estimates are neutral estimates
- Might be many neutral estimates

Whose estimate is it?

- Prudent valuation basis set by Trustees/Employer
- Neutral estimate is (I think) the Actuaries neutral estimate
- Difference is not therefore the Trustees' quantification of prudence in the valuation

Reactions from Trustees

- Do I have to give this to the Employer?
- Surprise at difference between neutral estimate and prudent estimate
- I am expecting some Trustees to want a different neutral estimate

Reactions from Employers

- It demonstrates that the prudent funding basis is too prudent
- I am expecting some Employers to want a different neutral estimate
- I am expecting some Employers and their Actuaries to use this as an argument to weaken the prudent bases
- Expecting Employer Actuaries to challenge neutral estimates

Constructing a neutral estimate

- Do you take account of investment strategy?
- Do you assume Employer still exists so any existing equity focus can be retained?
- Does one ignore Employer covenant?
- Might CETV basis be the neutral estimate (commutation aside)?
- Estimates at times of market peaks and troughs

Assumptions

- For a scheme 100% in bonds and buying annuities out at retirement neutral and prudent may be similar
- For a scheme in equities there may be significant differences
- Issue may reduce to altering your equity return and tweaking mortality and a few other assumptions
- Risk of anchoring to prudent bases

Sample figures

	Prudent	Neutral
Assets	£61m	£61m
Liabilities	£69m	£53m
(Deficit)/Surplus	(£8m)	£8m

- This was for a scheme with 80% equities
- Trustees surprised by results
- But only equivalent to about 1% p.a. on investment return for 30 years

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