



DB Funding in 2020

Adam Walker FIA
2 November 2010

Warning

- Any resemblance between the future speculation in this presentation and what happens in reality is entirely coincidental.
- This is just one version of what might happen...



Agenda

A review of the last ten years

- Inflation
- Taxation and government debt
- Scheme funding
- PPF & TPR
- Mortality
- Other issues

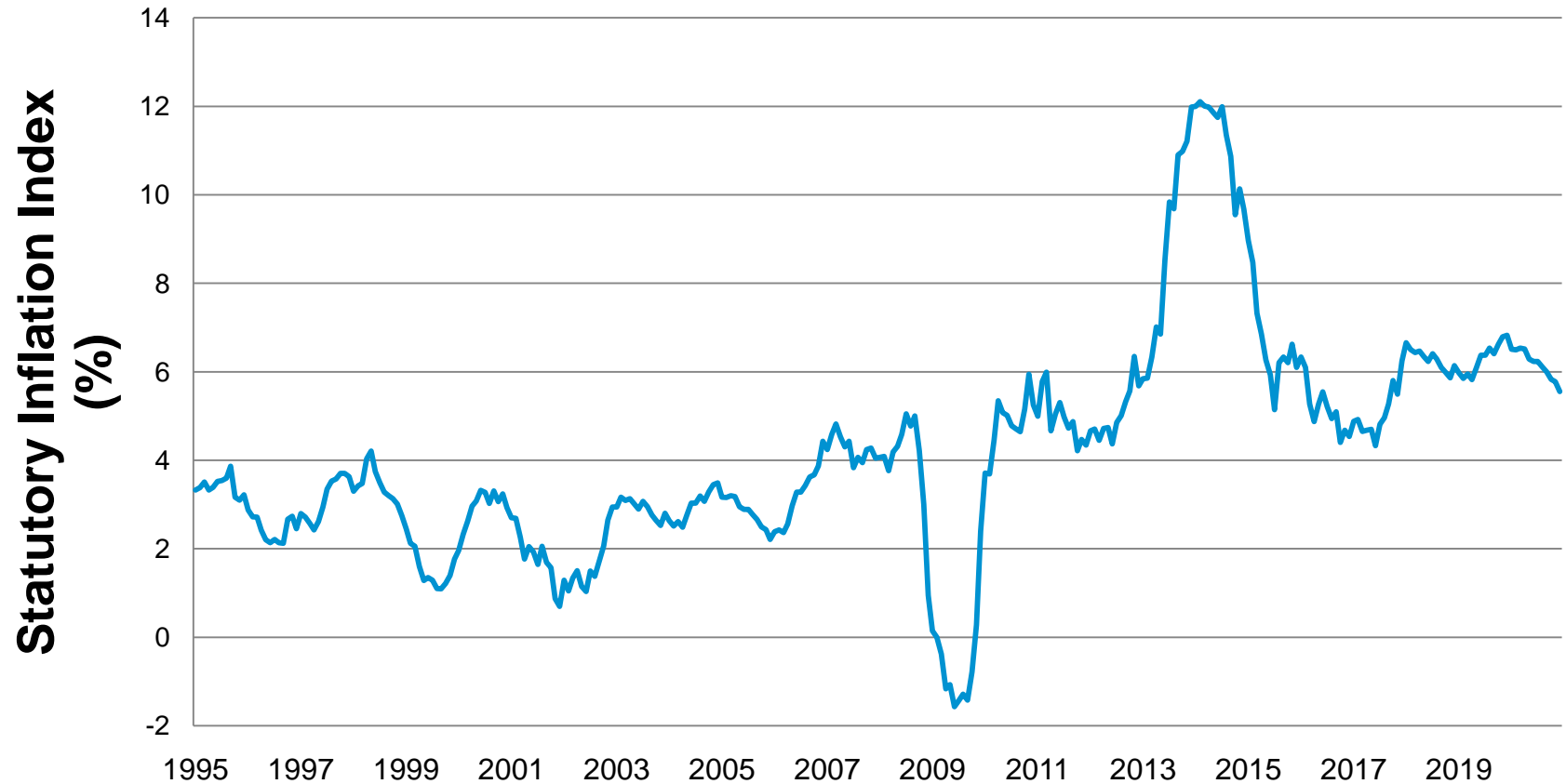


Inflation 1

- 10 years ago – policy all about keeping inflation low and engineering stability
- Still the goal – but we have seen what has happened now! Makes funding hard work!
- Pension liabilities reduced in real terms by high inflation years (caps apply), but assets also hit
- Uncertainty partly caused by ultra-hot capital flows under the New Protectionism

Inflation 2

Source: ONS Retail Prices Index; and some speculative twaddle



Inflation 3

- Demographic problem of moving wealth from one generation to the next while retaining some kind of stability
 - Taxation?
 - Inflation?
 - Inheritance?
 - Other forms of redistribution
- Gradualism still the favoured mode. (2006, 2009, 2012, 2014 reductions in statutory inflation protection.)



Inflation 4

- Issue for most developed economies
 - Countries with demographic issues have turned to immigration to curb the problem
 - Wealth shift from old “developed world” to developing economies – impact on exchange rates and inflation
 - Facilitating savings and security for younger generation and for international workers – important economic incentive that doesn’t require cash up front

Taxation 1

- “Hard yard” budget of 2012
- Tax-free PCLS revoked by coalitions
 - But only a small drop-off in people taking cash, despite fewer paying off mortgages
- 2014-16: tax incentives increased in relation to all long-term savings (pensions and medical policies), including increased tax allowance in relation to pension income after SPA below a threshold; liberalisation of State pension; and a partial tax break on PCLSs.



Taxation 2

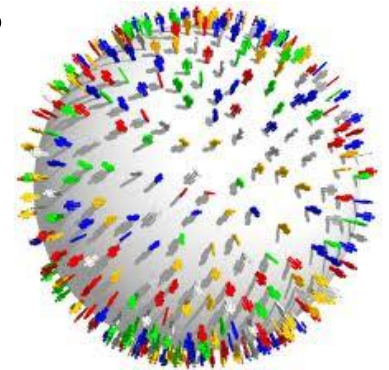
- After 2011: incremental increases in income tax to widen social security safety net (including State pension)
- 2012: CGT, corporation tax (less so), but especially inheritance tax and VAT increase
- Tax increases and higher tax allowances serve to make pensions saving more attractive
- New sponsor-friendly tax approach to dealing with the possibility of refunds of surplus

Government debt 1

- Inflation has occurred in all developed economies
- ...flight to real assets
- Increase in government spending
- Less structural demand for UK government debt due to new supply of debt (including more index-linked, but capped!)
- ...despite good credit rating
- Fall (in real terms) of expected value of past promises
- Mismatched and short-invested investors do well...

Government debt 2

- European state benefit system costs in particular have necessitated extra borrowing by governments
- Follow the UK lead of ultra-long debt!
- US gets cuddlier
- Fragile creditworthiness now stabilising (for “Northerners” at least)
- 2014 “open door” EU policy on immigration alleviates some concerns about demographics and improves credit ratings



Government debt 3

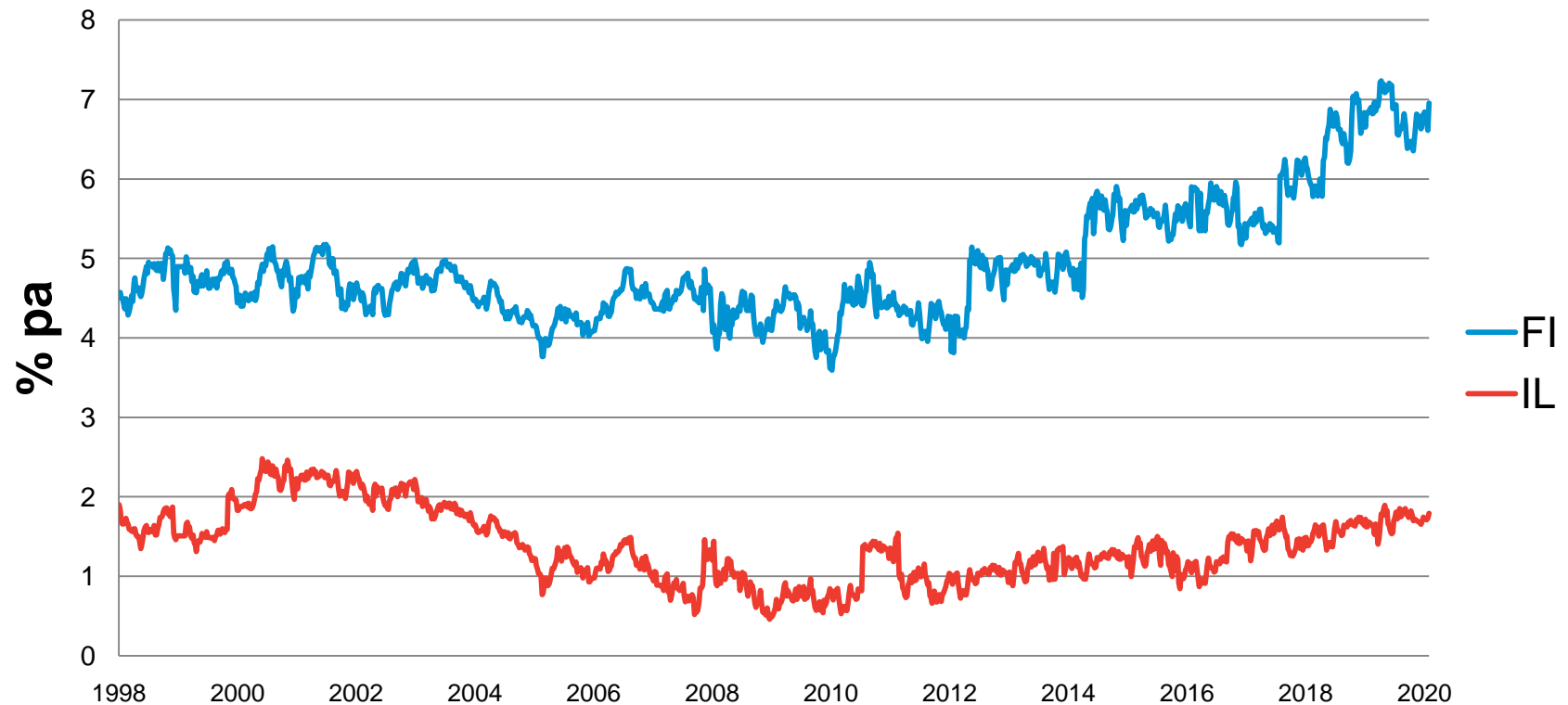
- Corporate bond markets have grown at the expense of equity markets (but equities are coming back)
- Increasing maturity of schemes offset by flight to real assets
- New supranational / international issuers
- 2013: First coalition breaks down... and a succession of coalitions begins with first three-way coalition in 2016.
- Short-termism of previous governments counteracted.



UK long gilt yields

Source: UK Debt Management Office and some spurious nonsense

Graph of long fixed interest vs index-linked gilt yields



Funding methodology

- 2010-12: Mark-to-market methods still the norm
- 2013-16: Bond market volatility upsets the applecart; inflation hits equity markets temporarily
- 2017: Adoption of new “smoothed” methods, which look remarkably like old smoothed methods
- Continuation of trend to reflect employer covenant, but less important as liability values fall relative to balance sheet values



Funding 2

- 2010: concerns that Solvency II would affect pensions
- 2011: the U-turn
 - “Section 67 killer” techniques develop
 - EU realises that UK pension schemes are not insurers (and that UK pensions are not gold-plated)
- 2020: concerns about Solvency IV



TPR 1

- 2005 - 2010: high profile, pulling up funding levels, “self-sufficiency” as objective
- 2010 - 2015: “phase two” – markets improve funding positions; volatility of market indicators make it harder to regulate; manpower at TPR still an issue
- 2015 - 2020: political will to protect companies/economy restrains TPR



TPR 2

- 2010 - 2014 – continuation of “rescue deals” where existing owners of capital lose out, but otherwise profitable businesses are helped to continue
- 2015 onwards – improvement in funding positions, and most difficult cases dealt with



PPF

- Since 2005 – tail-off in ability to collect levies as sponsor numbers fall
- 2014 – worries about funding level; debate about funding out of tax revenue
- 2015 – the PPF reduces the level of benefits payable by switching to higher level of discretion
- 2015 – 2020 – funding level improves
- New generation of “non-PPF” DB schemes

Mortality issues

- Steady improvements have continued at around 1% per annum since 2010, but tailing off recently
- Impact of longer working life still to feed in properly, but anecdotal evidence suggests no major shift.
- Cost of healthcare per unit of improvement increasing?
- 2013: first *Dignitas* case and DTVs
- Continued moral / ethical debate
- Mortality analysis now commonplace



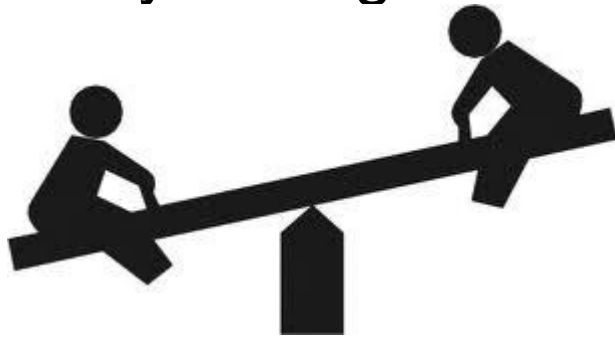
State benefit provision

- State Pension Age now 67, soon to be 70
- NEST in position – not changing lives?
- Auto-enrolment (once controversial) is now accepted
- BSP now a flatter formula, but not increased much in real terms in last 10 years (earnings have not exceeded price inflation in aggregate over the last decade)



Risk-sharing schemes

- Reaction against pure DC
- New schemes, not eligible for the PPF and not subject to the levy, with low levels of guarantee
- Capping / controls on salary-linking and inflation-proofing; much lower accrual rate
- Salary-linking to disappear altogether by 2025



DC provision generally

- Annuity rates hit a historic low in 2011; more attractive now
- ETVs were once discouraged due to historic high level of guarantees given to DB – no longer...
- Resurrection of “DC guarantees” and the DC Insurance Fund
- Superportability / superflexing



Equalisation

- Was a big issue back in 2010!
- Equalisation requirements (especially age discrimination issues around salary) cause levelling down in provision for members who do not sign a waiver
- Opting out of various provisions of EU legislation now a commonplace – expect some protections to wither



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